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Illustration by Lars Leetaru

Close to Everyone

In his classic short story collection *Cosmicomics*, Italo Calvino imagines being alive at the Big Bang, with everything in the universe packed into a single point. Sometimes, the global entertainment and media landscape feels that way. Even as events such as the Brexit vote divide the world politically, people on every continent are more interconnected than ever. Moreover, every aspect of this industry has been struck by major technological change. Thus, if you're a senior media or entertainment industry executive, and you learned your trade in the broadcast or early Internet era, you are constantly engaged in rearguard actions against your own past assumptions.

Hence the array of articles on the entertainment and media industry in this issue. They were developed by the *strategy+business* team (led by executive editor Daniel Gross) and PwC's Global Entertainment and Media Outlook (overseen by U.S. entertainment, media, and communications advisory leader Deborah Bothun). For 17 years, the Outlook has produced a robust compendium of data and perspectives on consumer and advertising spending in these extraordinarily vibrant sectors.

In "A World of Differences" (page 122), PwC specialists Chris Lederer and Megan Brownlow summarize the Outlook's latest findings and forecasts, and describe the compelling opportunities that exist around the world. "You're a Media Company. Now What?" by Deborah Bothun and PwC head of global thought leadership John Sviokla (page 106), lays out four strategic orientations that media companies can adopt in order to succeed.

In the emerging market of India, journalist Suvarchala Narayanan reports (page 140), there are three rapidly growing media audiences: rural newspaper readers, smartphone-oriented sophisticates, and enterprising youth who use inexpensive "feature phones" to connect with the world at large. On page 8, journalist Sarah Ellison compiles her fantasy-league media conglomerate. On page 160, University of Southern California researcher Erin Reilly explains why consumers behave like fans.

In a first for *strategy+business,* we've included in-depth interviews with three of the entertainment and media industry's most influential leaders. Vineet Jain, publisher of the *Times of India* (the world's largest-circulation English-language newspaper) and many other media properties in that country, is interviewed on page 154. Sir Martin Sorrell, founder and chief executive of the advertising network WPP, describes his vision of the future (page 172), and Carolyn Everson, vice president, global marketing solutions at Facebook, explains what "connecting at scale" means (page 184).

Elsewhere, innovation specialist Alexander Kandybin deconstructs dislocation, the real competitive forces that threaten incumbent companies (page 86). Journalist Juliette Powell describes the "chrysalis effect": the midlife crisis that strikes every startup when it tries to scale up (page 48). And Julien Courbe and Peter Raymond suggest that the next big thing for private equity is infrastructure investment (page 73).

There's much else in this issue, but no room to describe it. When you converge on a single point, you're always running out of space.

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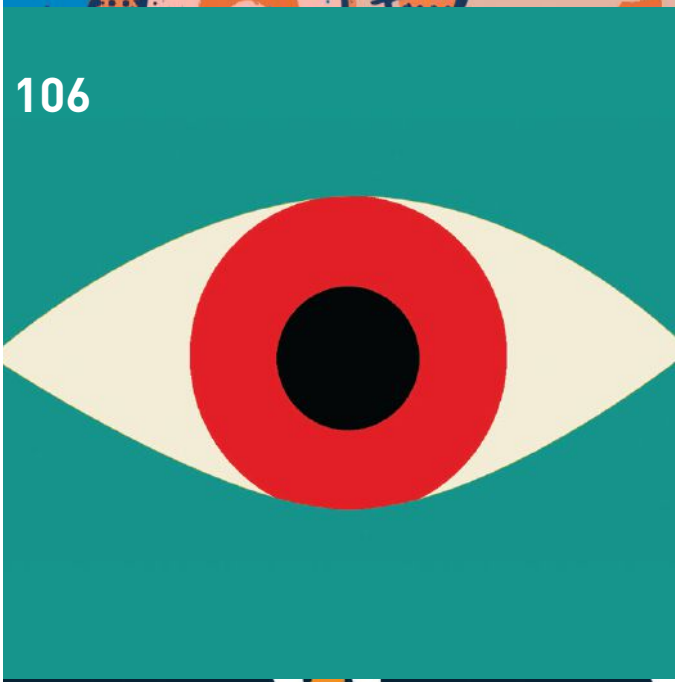
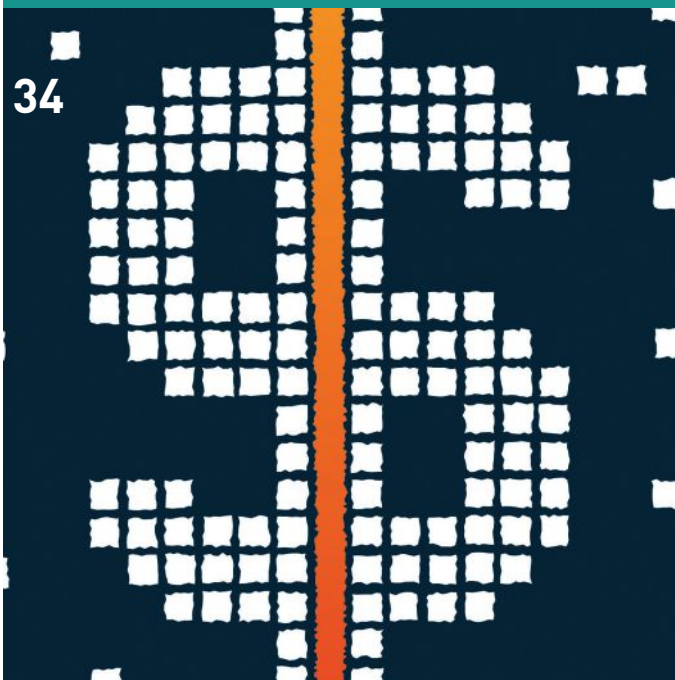
leading ideas





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Leading Ideas

Outlook 2016–20

Illustration by Benoît Tardif, colagene.com

Fantasy-League Media

If you could draft an all-star team of entertainment and media assets and capabilities, who would you pick?

by Sarah Ellison

The media conglomerates we have known and loved (and sometimes hated) in our lifetimes are, by definition, legacy institutions. The mix of businesses assembled to create today's multibillion-dollar empires are the result of decisions media moguls began making more than 50 years ago. Back then, newspapers were profitable, vertically integrated operations (many newspaper companies owned paper mills); televisions were black and white; and the @ symbol was a rarely used feature on manual typewriters. What made perfect sense to a young Rupert Murdoch sitting in Melbourne in 1952, when he took over the family newspaper business, may not make sense to the older mogul today. For that matter, what made sense to a (slightly) younger Ev Williams or Jack Dorsey just five years ago doesn't necessarily work anymore. One moment Twitter (the company they cofounded) is helping foment revolutions across the Middle East; the next, it's a faltering stock in need of a turnaround. Legacy isn't just for the old anymore.

Most media CEOs I talk to aren't even shy about admitting that they would like to own assets that make more sense for the current environment. In the aughts, media bosses resolved this pining by spinning off slower-growing businesses and holding on to those deemed more valuable. But now, there is simply too much change and unpredictability to make such simple bets. And even as audiences fragment, scale is more important than ever before. So a new age of media conglomeration is already upon us. Witness Time Inc.'s purchases of digital players Hello Giggles and Viant; telecom giant Verizon's purchase of AOL; and Comcast's investments in Vox Media and Buzzfeed. Some of the most unexpected new-look media conglomerates are emerging from technologically adept upstarts, such as Amazon and Netflix. But creating a thoroughly modern media empire isn't simply a matter of mashing up the mind-sets of media and technology, analog and digital, legacy and startup. From the 2000 AOL/Time Warner merger to

Facebook cofounder Chris Hughes's short-lived (and disastrous) ownership of the *New Republic*, it is clear that the two realms often speak different languages.

But what if you could start from scratch? What if you could take a cue from the legions of fantasy sports players (who have themselves become key participants in the emerging media world) and assemble your own all-star team? What if you could cruise around the world in your Gulfstream G650 and assemble the optimal collection of assets, capabilities, cultures, and executive skills that would allow you to succeed not just in 2016, but in 2020 and beyond?

For the purposes of this thought experiment, I decided that money is no object. (This is fantasy, after all. Hence the G650.) I'm similarly unbound by practical concerns of relocations and separation packages that might be required to woo individual executives, or the real-life rules that make it tricky to transplant corporate cultures. However, even in this fantasy world, my company — let's call it Ellison Global Media, or EGM — does have to abide by regulations and antitrust laws.

Let's assume that people want to watch long and short stories on video and listen to them on the radio, listen to music, read stories, and communicate with one another. They want to be informed about the world. Our fantasy conglomerate must have the kind of mobile platform and products on which people want to spend a lot of their time, the ability to create and market top-quality content, and a global presence. It will also need the ability to incorporate data and usage knowledge to build customer loyalty and great consumer experiences.

If the future of media is controlling slivers of human attention, I'd start with Electronic Arts, the gaming company that owns EA Sports titles FIFA, Madden NFL, NCAA Football, NBA Live, NHL, and SSX, not to mention Battlefield, Need for Speed, The Sims, Medal of Honor, and Command & Conquer. EA has shown it has the capacity to hold the attention of the legions of young people who inhabit alternate universes for several hours each day. And I'd plug EA's gaming properties into the portfolio of rival Tencent. Tencent is the largest Internet portal in the world's largest country (China) and the home of WeChat, a largely unheralded social app developed for mobile phones with voice and text messaging and time lines. WeChat, with its 700 million users, drives more interactions a day than anything Facebook has on offer.

Controlling screen time doesn't just mean controlling the intake of media content. It means holding the keys to interactions between humans, who increasingly interact only through the language of their social apps. And so I would make sure to include Facebook's main sharing platform. Aside from being the new town square where citizens argue about politics, parents brag about their children, and exes try to make each other jealous, Facebook has implemented the most successful zero-to-60 mobile strategy of any of the major tech players today. CEO Mark Zuckerberg understands that the future of interaction lies largely in gaming technologies and practices. He also understands the value of owning the platform on which others play. (Just ask the *New York Times, National Geographic,* and Buzzfeed, early partners in Facebook's Instant Articles experiment.)

The challenge for Facebook is acquiring its next billion users, in part because of the limitations to broadband connectivity, and in part because there's no guarantee the next generation of users will flock to it. Which is why I'd also want to include Snapchat in my fantasy media conglomerate. The mobile messaging application, which started as a way for college students to share impermanent photos and texts, has become one of the world's fastest-growing and most dynamic media properties. Although its user base (100 million daily users) is one-tenth the size of Facebook's (1 billion daily users), Snapchat's users spend a lot of time inside the app watching news and entertainment videos. With 21 publishing partners, Snapchat is blending communications and content on a global scale. And it's growing fast. Sixty-four percent of U.S. smartphone users between the ages of 18 and 24 used Snapchat in late 2015, up from 24 percent in early 2013, according to comScore. Penetration among 25- to 34-year-old users increased to 31 percent, up from 5 percent in 2013. What Snapchat is so good at, and what many in the media industry have missed, is that the app continually reengages its users, as they check back to see what their friends are sharing.

My fantasy conglomerate is going to have to be sophisticated about using its knowledge of what customers are looking at, and what they like to look at, to deliver to them informed and surprising offerings and recommendations. Which is why we'd need Netflix for long-form content. Netflix has shown its ability to create original content, with hits such as *House of Cards* and *Orange Is the New Black.* But it also has a global delivery system and data that other media companies can

only dream of as they scan their Nielsen numbers. While big media is still just guessing, Netflix knows exactly who Sarah Ellison is and how much she *really* lets her kids play on her iPad. (And she pays for that service.)

On the subject of engaging long-form content, I'd need a piece of the Walt Disney Company. And this time I wouldn't shy away from legacy businesses. Strip away the properties the company acquired in its 1995 merger with Capital Cities/ABC (the television and cable networks), and the premerger Disney had a fantastic film and television business, theme parks, and merchandising genius. Now add Disney's acquisitions of Pixar, Marvel, and Lucasfilm. Disney's dominance in the film business is astonishing. The Marvel characters and Lucasfilm's *Star Wars* franchise provide multiple universes from which to draw — for movies, yes, but also games, apps, and products. The omnipresence of *Star Wars* books, toys, costumes, and even waffle makers is evidence enough to give the Disney merchandising chief a sunny office on the top floor of my office building. Can you imagine what that kind of surround marketing could do for the products of Electronic Arts? Since this is fantasy media, EGM will also add a prestige film company, such as A24, which produced Oscar darlings *Ex Machina, Room,* and the documentary *Amy,* which recounts the short life of Amy Winehouse.

You have to capture the attention of investors and the public 24/7, you have to gain millions of followers, and you have to achieve ubiquity across a range of platforms.

For short-form content: YouTube, a US$10 billion business where people are spending a tremendous amount of time. (One might argue that Snapchat is the newer version of YouTube, but I would say that the platforms are complementary; the latter is primarily focused on content creation, and the former on sharing that content with friends.) In the long run, everyone wants to move up the chain from distributing others' content to producing their own. YouTube is financing $9 million movies, and walking up the content value chain. It reminds me of when AMC wanted to stop distributing other people's movies and bought *Breaking Bad.* These transitions can happen pretty fast.

My fantasy conglomerate won't just have fantastic video. For decades, conventional wisdom held that television would kill radio. It never happened. Today,

people still spend two hours of their day listening to podcasts, audiobooks, and music as they sit in traffic, walk to work, shop, and generally go about their quotidian tasks. Where are they going to listen to all these things? On Sweden's Spotify, which has a global and mobile presence.

I'll also need some pipes. Distribution isn't sexy. But it is very valuable, and I am trying to build a profitable company. Ultimately, we're moving toward a world in which broadband is a utility, and an increasingly regulated one at that. But when I think that I may not want to own pipes, I take a look at Warren Buffett, a one-man fantasy investing team. Last year, Buffett boosted his investment in Charter Communications as part of the Charter–Time Warner Cable merger. Why? He recognized that like Coca-Cola, one of his longtime holdings, broadband is going to be very much around for a long time and can deliver ample cash flow. (As a thought experiment, imagine how difficult it would have been for the iPhone to succeed without Apple's deals with AT&T or Verizon.) Avoiding cable, with its expensive infrastructure costs, and looking at the billions of people around the world who are just getting online, I'd choose India's Bharti Airtel. The world's fifth-largest mobile phone carrier, Bharti Airtel has at least 350 million subscribers in India and Africa.

I want all my company's products to be beautiful, which is why I'd want Jony Ive, Apple's chief design officer, to oversee the design of the offerings. And EGM would want to have a great advocate and a ruthless negotiator on board. Sharon Jackson of Hollywood powerhouse WME (William Morris Endeavor) would head up the talent division, bringing the power deal making of her boss, Ari Emanuel, without the attitude.

This team needs a head coach, and finding the right CEO will be a challenge. I don't want a pure Internet executive. All the movie people will quit once we start adding these other capabilities. Nor do we want a media executive who is hung up on the good old days of broadcast. I'd opt for a partnership of Reed Hastings, CEO of Netflix, and Evan Spiegel, cofounder and CEO of Snapchat: two people who are in no way tied to the previous ecosystem, who have encountered roadblocks and dealt with failure (recall Hastings's Qwikster fiasco?), and who have shown a willingness to change on a dime. (Netflix's pivot from DVD rental to streaming is already legendary.

But think of how quickly Snapchat has changed and updated its app.)

There's one last thing EGM is missing. Media is a business in which image, marketing, and sales matter a great deal. It's not enough simply to assemble a great set of assets. You have to capture the attention of investors and the public 24/7, you have to gain millions of followers, and you have to achieve ubiquity across a range of platforms. That means I'll need a public relations department that understands how to thrive in today's media miasma like nobody else. Since money is no object, I'll hire the Kardashians to run it. +

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Pharma's Identity Crisis

Four strategies for creating value in life sciences.

by Rick Edmunds, Jo Pisani, and Douglas Strang

High blood pressure now affects more than 20 percent of the adult population around the world. Complications from the condition account for 9.4 million deaths a year, according to the World Health Organization. The number of people with diabetes surged globally from 108 million in 1980 to 422 million in 2014. The rise in these and other chronic conditions is creating a need for healthcare on an epic scale. And it comes at a time when the overall demand for healthcare is growing, as a result of the Affordable Care Act in the U.S. and rising incomes in some emerging economies.

These circumstances have created growth markets for pharmaceutical and life-sciences companies. Yet new opportunities have also brought challenges. The competitive landscape for pharma companies around the world is changing rapidly, and those shifts are likely to accelerate. Drugs face greater pricing pressure; industry consolidation is creating unfamiliar dynamics among insurers, hospital systems, and doctors; and patients are far more involved in their own care. Rather than merely developing and selling medicine to treat clinical conditions, pharma companies need to shift to a value-based care mind-set based on improving patient health more broadly and creating better outcomes for insurers and healthcare providers.

To confront these forces, pharma companies need to be clear about how they create value and adopt a focused strategy that allows them to dominate in one specific aspect of the industry — along with developing a set of strong capabilities to support that strategy. Some capabilities apply across the entire pharma industry; for example, most companies conduct R&D at some level. But those that can identify and build the right capabilities for their particular strategy in ways that are demonstrably better than those of their competitors will set themselves up to win.

Competitive Shifts

The role of pharma companies in the healthcare ecosystem is changing. Insurers

are now asking them to interact more with patients and physicians, as part of a shift from fee-based care to value-based care. For example, some pharma companies are working to ensure that patients take their medicine as directed.

Such integrated care can ultimately be far more effective than past approaches. But it affects the way drugs are priced. Pharma companies that show superior results can potentially charge more for their products. But pharma companies don't have much experience in the delivery of care. In addition, generating positive results can be tricky for complex lifestyle diseases, for which outcomes require more than just drugs, and in fact often hinge on factors such as diet, exercise, and stress management.

At the same time, the customers that pharma companies sell to — physicians, hospitals, health systems, and pharmacy benefits managers — are all getting bigger and more powerful through consolidation. As they grow, those entities gain negotiating clout, leaving pharma companies with the difficult choice of accepting lower payments or losing big customers. Such consolidation also means that physicians at large hospitals and health systems tend to have less autonomy regarding what they prescribe.

Technology presents yet another challenge to pharma companies' traditional way of doing business. Patient care is becoming more high tech, through mobile apps, wearable devices, and other tools that change the way medicine gets into patients' bodies and how information gets to those responsible for their care. Rather than having to remember to take medicine in the correct dosage, a patient could soon wear a patch that delivers medicine through the skin, measures the patient's response to that medicine, adjusts the dosage as needed, and reports everything to the doctor and pharma company.

Know Thyself

For established pharma companies, the pace of change today can be dizzying. We have identified four strategic identities, each with specific capabilities, that pharma companies can adopt to help them succeed under these conditions.

1. Breakthrough science developers. Companies that follow this strategy create value by developing new medicines that lead to measurably better patient outcomes, allowing them to charge premium prices. Commercially, these compa-

nies have tools in place to help them identify and segment patient populations, and potentially tailor their medicines accordingly.

Breakthrough science developers have strong but focused R&D pipelines, with capabilities in understanding new technologies and assessing how they might apply to specific diseases. A critical aspect here is analytics. For the last four decades, both the quantity and the quality of medical information have grown exponentially, thanks to advances in electronic medical records, high-resolution medical imaging, and genomics. Yet integrating and analyzing that data simply hasn't been possible, because of technical limitations, high costs, and a traditional lab-based approach to discovering new drugs. Today, those constraints are disappearing, and leading players are employing advanced analytics to help them become more productive — in both developing new drugs and getting them to market.

Illustration by Serge Bloch

M&A capabilities are also critical for breakthrough science developers. Consider U.S.-based Celgene, which specializes in innovative treatments for cancer and autoimmune diseases. The company excels at buying or partnering with VC-backed companies that have products in preclinical testing. It has no strict deal template. Instead it works on a case-by-case basis to determine the right structures (such as strategic equity investments, option licensing deals, and structured acquisitions). Moreover, Celgene has developed a corporate culture that puts science and scientists first. It allows younger and more nimble biotechs wide leeway to control their own operations — making the company more attractive to potential future partners. Celgene closed 10 acquisitions or partnerships in 2014, and in March 2015, Bloomberg reported that it had 37 active alliances.

2. Disease outcome enablers. Companies that adopt this strategy have historically thrived by building up expertise and credibility within one or two therapeutic areas, along with a cohesive portfolio of products that capitalize on their expertise. This approach dovetails with the industry shift to value-based care. Some disease outcome enablers have gotten much better at engaging with patients and providers. For example, they have developed patient-education programs and other kinds of support that help patients manage their own treatment, leading to better outcomes at lower costs.

In the next couple of years, these companies will need to build on this progress, with capabilities in integrating drugs, devices, and technology to better track patient health, collect data, and adjust dosages over time. Other critical capabilities for disease outcome enablers include helping standardize the way patients receive care and coordinating directly with physicians, researchers, labs, and other entities involved in treating patients in the pharma company's target area.

Shire, based in Ireland, specializes not in one clinical area but in a category: rare diseases, for which patients usually need more personalized attention. In the U.S., Shire has developed the OnePath program, which designates a personal case manager for each patient. Case managers serve as a single contact who can coordinate care and access to therapy. They communicate with nurses, genetic counselors, pharmacists, and physicians, and they make sure that patients have the information and support they need, even regarding nonclinical issues such as finding a treatment center and demystifying insurance coverage.

3. Commercial value optimizers. Companies that adopt this strategy typically have a portfolio of low-risk, established products; a large global network; and a highly efficient infrastructure. They have strong capabilities in manufacturing different categories of drugs and selling them through various channels, and they are ruthless about wringing out costs.

These advantages are generating potential rewards for commercial value optimizers as several trends develop. Growing global demand for effective healthcare in multiple customer channels and segments will likely boost their business. Innovative technologies, such as advanced manufacturing tools that help lean manufacturers accurately plan for demand, have emerged to help fuel operational efficiencies as well. U.S.-based Mylan is a good example. The company has a wide-ranging portfolio of more than 1,400 generic and branded products, and it benefits from a large research and production system of more than 50 facilities around the world. Many pharmaceutical companies outsource a large portion of their manufacturing, but Mylan produces roughly 80 percent of its medicines internally.

In the current healthcare market, success requires that pharma companies do some soul searching. The complexities mean that a me-too strategy is no longer a viable option.

4. Disciplined portfolio managers. The fourth strategic approach — and the hardest — is to operate with a large, diversified portfolio of business units and product areas. This category includes many of the larger legacy pharma companies, which historically have been able to succeed through diversification. Pfizer and Novartis, for example, are legacy pharma companies with multiple business units and a wide portfolio of products, including generics, specialty drugs, and primary-care treatments. These companies require capabilities in managing brands, marketing, and assessing the ROI of new products in a range of categories and markets. And they need to strike the right balance between assigning accountability to each unit and having central oversight of all of them.

The optimist's stance is that in a highly volatile market, disciplined portfolio managers may be better able to respond to market shifts by reallocating resources among their various businesses. Because they have bets in many areas, they are

less vulnerable to major disruptions. Yet disciplined portfolio managers still face clear risks. Their approach complicates their ability to differentiate themselves from competitors, which limits the potential upside to the strategy. In addition, companies that have grown through acquisition may struggle to maintain deal volume as competition for assets gets tougher. Some of these companies may need to get better at selling off poorly performing drugs and business units.

Meeting the Bar

In the current healthcare market, success requires that pharma companies do some soul searching. They need to look at their current strategy and capabilities and determine whether that combination will allow them to outperform the competition. Some companies may have the right strategy, but discover that they need to build up key capabilities. Others may find that they need a new strategy, with corresponding changes to their organizational structure and portfolio of products and services.

That's strong medicine, but the complexities of healthcare today mean that a me-too strategy is no longer a viable option. New competitive dynamics and customer expectations have raised the bar, and the market will reward those that are truly able to deliver. +

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Some of the ideas in this article were first developed in "Beyond 2020: Building Strategic Coherence in the New Health Economy," *Pharmaceutical Executive*, March 2016.

The Financial Insecurity Bias

YOUNG PROFS

Tuck professor Eesha Sharma on how perceptions of personal wealth affect the decisions people make.

by Laura W. Geller

Why are people who feel poor less likely to use coupons than people who feel wealthy? Why do our opinions of how others should be punished for ethical transgressions vary by how well off we perceive ourselves to be?

Something happens when people take stock of their financial status and don't like what they see. If they haven't lived up to their own expectations or think their peers are better off, individuals facing money troubles — both real and perceived — form judgments based on these feelings. As Eesha Sharma, an assistant professor of business administration at the Tuck School of Business at Dartmouth, has found, feeling poor can affect the way people spend and save, among other habits. As she explained to *strategy+business* in an interview in March 2016, biases driven by financial pressure creep into a wide swath of people's choices and actions.

Sharma, a former investment banker, began her academic career examining how people think about and react to others facing poverty, which she wanted to study as a way of developing strategies to increase charitable giving. One method she has found particularly useful is to help potential donors feel effective, to believe they can make a difference. Her body of work speaks to the power of self-perception in influencing much of what we do.

S+B: How do people judge their financial well-being?

SHARMA: People use a range of psychological metrics to think about their financial position: how they felt about their position in the past, their ideal financial state, and how their financial state compares with that of their peers. These subjective perceptions tend to have a stronger influence on how people think about their financial standing than do more objective metrics, such as how much money they actually have. When comparisons highlight shortcomings or when people

feel they lack resources relative to others, they experience a sense of financial deprivation. Anyone can *feel* poor, regardless of his or her financial reality.

People typically first try to bounce back by taking direct actions to alleviate their state, such as limiting discretionary spending. But in the absence of such opportunities, they may compensate in other ways — by adopting a range of strategies that they think will improve their position.

S+B: How do people's spending habits change?

SHARMA: I've found that people who feel financially worse off than their peers tend to select and consume items that seem relatively scarce. Based on the existing literature, we know that items that seem scarce become more desirable, in part because people tend to take that scarcity as a cue for value. Think of the newly successful buying a rare sports car, or the newly rich purchasing a Monet. To the extent these individuals are insecure about their relative financial standing, acquiring these purchases may compensate for feelings of inferiority. But even if an item is accidentally scarce or people don't really have a strong cue for its value, just the fact that it is less available to others enhances people's preferences for that item [when they feel financially deprived].

Eesha Sharma

Photograph by Laura DeCapua

In one study, my colleague [NYU's Adam Alter] and I gave people the option to choose one of two types of candy from a vending machine, one of which was available in a smaller quantity. Some were told that prior participants had already consumed the less available candy, others were told we ordered less of one type of candy, and still others were told we just happened to have uneven amounts. We had led some of the participants to feel financially deprived before the candy was made available, and most of the participants who felt worse off

preferred the scarce item — except those told that the less available items were limited because prior participants had taken them.

The takeaway is that when people believe others are better off, they want scarce items — things they think others don't have. However, when those items are scarce because their peers already possess them, those items lose their appeal because they no longer offset the relative imbalance of resources.

S+B: What about savings habits?

SHARMA: I've found that people who feel financially constrained prefer to focus on ways to make money rather than finding opportunities to cut back. In other words, when people feel poor, their attention shifts away from saving opportunities and toward earning opportunities.

For example, my colleague [Dartmouth's Punam Keller] and I gave participants who felt financially constrained a choice between two jobs with the same salary, one job that offered an annual bonus of US$4,000, and another job that offered a bonus of $2,000 but that would save them $2,000 a year in transportation expenses. The majority of people chose the former option. We've controlled for a number of competing explanations, but participants still prefer the earnings-framed job even when we tell them that their bonuses and expenses will remain constant over time, and that there's an equal chance of promotion, raises, and job security. When we bumped up the transportation savings to $2,500, people were indifferent between the two jobs. The only thing that nudged them toward the savings-framed job was highlighting that the amount saved was akin to pretax earnings that they could spend on other things.

> "You might think that people who feel more constrained financially would be more likely to shop by price or use coupons. But we're actually finding the opposite."

In a follow-up project, we are looking at couponing behavior. You might think that people who feel more constrained financially would be more likely to shop by price, use coupons, and take advantage of discount offers. But we're actually finding the opposite: They are less likely to say that these are "good" offers, and they are more likely to experience feelings of embarrassment or shame when

taking advantage of them. People who feel wealthier, meanwhile, feel proud and financially savvy for taking advantage of these offers.

I'm trying to determine whether these tendencies can be eliminated, depending on a variety of factors. For example, what if we frame discounts as a way to earn, rather than save? I'm also looking at who people shop with (e.g., family versus friends), whether people are shopping for something for consumption in the public domain or the private domain, whether it's a discretionary purchase or a nondiscretionary purchase, and so on, to see which variables influence people's feelings and behavior.

S+B: You've also done research on how feeling poor can affect ethical decision making.

SHARMA: In this study, my co-authors [University of Toronto's Nina Mazar, NYU's Adam Alter, and Duke's Dan Ariely] and I started by talking to people about their perceptions of moral conduct. We asked: Do you think you would change your moral behavior if you were feeling worse off financially? Do you think you would lie, cheat, or steal if faced with financial pressures? How would you judge other people who committed moral transgressions, and do you think it would be any different if they did so because they felt poor?

> "When people feel they lack resources relative to others, they experience a sense of financial deprivation. Anyone can *feel* poor, regardless of his or her financial reality."

Overwhelmingly, people responded that feeling poor does not excuse immoral conduct. Nor do they think that it would change their own behavior, or that others deserve leniency because they commit moral transgressions out of feelings of financial deprivation.

S+B: And when those same people were led to feel financially deprived?

SHARMA: They suspended their initial beliefs. If you give people a task where they can cheat for financial gain, they are likely to cheat more if they feel worse off. Immoral conduct increases if it is [done] in the service of improving one's financial situation. Such actions are driven by feelings of unfairness; we don't

observe similar unethical conduct when people feel their financial standing (even if worse off) is justified or deserved.

We also asked people — after they were led to feel financially worse off — to read about others' transgressions, and to indicate how harshly or leniently they should be judged. Those participants thought people should be treated more leniently when their crimes were driven by their financial position.

S+B: How do people make decisions about others who are confronting financial hardships?

SHARMA: Much of my research in this area focuses on instances in which people tend to be less charitable. I'm trying to understand barriers to giving, and how they might be changed.

For example, people tend to be more sympathetic, and therefore generous, to single, identified beneficiaries: individuals with a name and a face. When a larger number of people are involved, we don't feel as emotionally attached. Another driver of giving is "perceived impact." When people talk about whether or not they want to give, they often say, "I don't know if I'm going to be able to make a difference."

When people don't think they can make a meaningful difference, they focus on a smaller, more manageable segment of need. For example, instead of donating to a global organization that seeks to end hunger for millions of people, they would choose to sponsor one specific child. But not all causes have the ability to match donors with specific targets given their mission or budget. And most of the attempts aimed at overcoming people's tendency to be less generous toward more than one target — to get people to give more to larger groups — have not been effective. Those attempts have tried to stress the inefficiency of helping just one person at a time, increase the tangibility of larger numbers of people in need, and change perceptions of the target charity or the cause itself. But unfortunately, those efforts generally make people less emotional and generous.

Instead, my colleague [NYU's Vicki Morwitz] and I take more of an ego-driven approach. We have people think about a time when they were able to take steps to accomplish a goal that was important to them. By encouraging people to consider ways that they have been effective — even if it's entirely separate from the donation context — you can increase their perception that their actions will have an impact. It's like the distinction between people's confidence in their abilities ("I know I am capable of studying for a test") compared with their confidence in how effective those steps will be in making something happen ("I know studying will lead to a good grade on the test"). When people thought about their "self-efficacy," it increased their belief that the money they donated to charity would actually make a difference. And when people feel that they are capable of being effective in this way, they give more to multiple beneficiaries.

"Often, in purchasing situations, I reflect on my behavior. I know exactly what I'm doing, and the biases that are affecting my actions. But for the love of all things good, I cannot help myself."

S+B: So self-perception is everything?

SHARMA: It's a big part of it. I teach a course on consumer behavior, and I spend much of that class talking about biases that creep into our decision-making process. We're all vulnerable. It's remarkable how often I find myself in purchasing situations, and I reflect on my behavior. I know exactly what I'm doing, and the biases that are affecting my actions. But for the love of all things good, I cannot help myself. We're talking about some powerful drivers of behavior stemming from forces that are difficult to overcome. So much of what we do is a function of how we perceive ourselves, and how comfortable in life we are. +

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Why Popular Strategies Always Fade

The most capable strategists see the real value, and big pitfalls, in new business concepts.

by Ken Favaro

For nearly 50 years, "strategy" has been a business of promoting universal prescriptions based on what appears to explain the success of a few revered companies. At first glance, this practice makes perfect sense. Why not draw lessons from those who seem to have figured it all out? In reality, though, the approach has the deadly effect of separating the true owners of a company's strategy (the prescription promoters) from those implementing it (management). No doubt, the promoters work hard to win management's acceptance of their concept. But when the inevitable bumps in the road appear, the strategy concept is ditched, often with management saying it doesn't work and its promoters blaming poor implementation.

In the 1960s and 1970s, the hot concepts were the experience curve, the growth-share matrix, and SWOT (strengths, weaknesses, opportunities, and threats) analysis. The 1980s gave us five forces, value chain strategy, scenario planning, and total quality management. In the 1990s, business process engineering, customer loyalty, competing for time, competing for the future (core competencies), and growth horizons gained traction. Those ideas were followed by co-opetition, BHAGs (big, hairy, audacious goals), growth adjacencies, and blue oceans in the 2000s. These hugely popular concepts, and many others, have largely faded after enjoying a few years of attention and acclaim. Very few have had a lasting impact on the art, practice, and substance of strategy — though they have left behind a lot of jargon.

Very few strategy concepts have had a lasting impact on the art, practice, and substance of strategy.

Nevertheless, the business of strategy will continue to churn out the next

big thing, because strategy concepts provide a modicum of comfort in an uncertain, complex world. But the most capable strategists are never swept up in the hype. They understand the limitations of such concepts and resist the allure generated by their popularity. Perhaps most important, they know that new concepts — however popular — lack the three essential characteristics of a great strategy. A great strategy is unique, specific, and complete; it stands on the shoulders of a big idea; and it is owned by a leader who is ultimately responsible for its implementation.

The Strategic Five

By their nature, big strategy concepts are not particular to any one company. That's problematic, because when they become wildly popular and widely adopted, no one gains advantage from them. In fact, the me-too pursuit of strategy concepts stymies their supposed benefits. For example, in 1972, DuPont adopted the experience curve concept as the strategy of its titanium dioxide business. It invested more than US$400 million in new capacity to maximize market share, following the concept's logic, until 1979, when in-

Illustration by André da Loba

dustry capacity utilization collapsed from 88 percent to 64 percent. DuPont's margins fell to half of what they were when the company first embraced the experience curve.

Great strategies answer five critical questions ("the strategic five") in ways that are unique to your company: (1) What business or businesses should your company be in? (2) How should you add value to your businesses? (3) Who should be the target customers for your businesses? (4) What should be your value propositions to those target customers? (5) What capabilities should differentiate your ability to add value to your businesses and deliver their value propositions?

You won't find the answers to these questions in most strategy concepts. Consider total quality management (TQM), a prescription for reducing cost by minimizing error. TQM is mostly silent on what kind of businesses should be in your portfolio and why, or who your target customers should be and why they're glad your company exists. It is also a dangerously narrow prescription for what you have to be better at doing than anyone else to achieve and sustain great success.

Instead of asking "Should we adopt TQM?" leaders should ask "How can TQM improve our answers to the strategic five?" A company such as Danaher, which actively seeks to add operational value to each business in its portfolio, would have an answer very different from those of Berkshire Hathaway or IKEA, because the three companies have different strategies for adding value to their businesses. Furthermore, because these companies can answer each of the strategic five questions with precision, they can be disciplined about whether they use TQM and, if so, how. In other words, their strategies are not just unique and specific, but also complete. This enables them to get the most out of strategy concepts without becoming hostage to them.

What's the Big Idea?

Too often, strategy concepts conflate goals with ideas. For example, competing for time and the experience curve are, respectively, prescriptions to operate faster than everyone else and to minimize cost by maximizing market share. But "maximize speed" and "increase quality" — or, for that matter, "maxi-

mize net promoter score," "expand growth horizons," and "occupy white space" — are really just generic goals that any company might adopt. They are not big ideas.

Big ideas are novel solutions to specific problems that are unique to particular companies. Sam Walton, founder of Walmart, had the idea to build a network of centrally coordinated shops to serve a regional population of millions. This solved the problem of profitably serving towns smaller than 100,000 people with full-line discount stores.

Likewise, Starbucks's strategy to create a nationwide chain of coffee shops as a "third place" between office and home originated in Howard Schultz's big idea to re-create the Italian espresso bar experience. Henry Ford's strategy to offer just one model (the Model T) in just one color (black) started with an idea that changed the world forever: the moving assembly line. A decade later GM replaced Ford as the world's largest automobile manufacturer by adopting Alfred Sloan's revolutionary idea of branding different price points (Chevrolet for the lowest price point and Cadillac for the highest). Lou Gerstner turned around IBM with his idea of being a fully integrated IT partner of corporate clients. None of the ideas that made (or remade) these great companies came from a strategy concept.

The concept of BHAGs, enormously popular in the 2000s, takes the conflation of big goals with big ideas to its ultimate extreme by suggesting that strategy starts with setting a big, hairy, audacious goal. This came out of *Built to Last*, by Jim Collins and Jerry L. Porras (Harper Business, 1994), a study of enduringly successful companies. One of the supposed common denominators across these companies was the best practice of setting ambitious goals. But big ideas never emerge from a best practice — the latter is someone else's solution, not your own.

Owning Your Strategy

Great strategies always go against the grain of accepted wisdom. Markets and organizations have powerful immune systems that erect multiple barriers to implementation. Leaders who own their strategies are more likely to persevere through such resistance, and prevail. Great strategies take leaders who believe

enough in them — and the ideas they depend on — to be willing to fight their own organization and the broader market for however long it takes to realize the strategy.

For example, only Walton believed that you could profitably serve small towns with a full-line discount store. Among the dozens of auto company leaders in the early 1900s, Ford was alone in seeking to "democratize the automobile"; everyone else was fixated on making better cars for the wealthy few who could afford them. Sloan faced fierce internal resistance to the pricing and style boundaries his branded-price-points strategy placed on GM's divisions. Gerstner had to resist loud, persistent calls to break up IBM in order to implement his new strategy for the company. Schultz was just an employee of Starbucks when he proposed his strategy to build a chain of espresso bars for enjoying high-quality coffee drinks. His bosses — the company's founders — repeatedly rejected it, in large part because they could not see U.S. customers paying for expensive espresso. Larry Page and Sergey Brin sought to "organize the world's information" with their idea to rank Web pages the way academic publications are ranked. They started Google because no one would buy their idea.

Capable strategists know that great strategies are like children: You never love someone else's as much as you love your own.

Capable strategists know that great strategies are like children: You never love someone else's as much as you love your own. Thus, leaders must be their own strategist. In-house and third-party experts can help you make your strategy great, and keep it that way. But the choices that form the backbone of your strategy and the big idea that gives your choices economic power have to be yours. You cannot delegate these to anyone else, and simply be the chief "reviewer and approver" of their thinking, inspiration, and work. This goes for boards, too. A board that sees itself as responsible for the company's strategy cannot then just sit back and give a thumbs-up or thumbs-down to the CEO's presentation.

There Are No Shortcuts

Strategy concepts go viral when they resonate with a widely shared problem in

the corporate community. TQM came to life during the Japanese quality invasion, business process reengineering hit it big in the wake of a recession, and growth horizons and blue oceans arose during a time of high growth for tech companies and growth stagnation for everyone else. Today, we are seeing the rise of a new generation of popular strategies, such as lean startup, disruptive innovation, digital strategy, transient advantage, and agile strategy. The conditions for wasting executive time and organizational energy are as ripe as ever.

The obvious solution might be to resist the ebb and flow of strategy concepts altogether. But strategy can never stand still. A great strategy can quickly become mediocre in a dynamic market. You should always be seeking ways to open your eyes to new possibilities for your strategies. Strategy concepts are one such way if they stimulate your thinking without substituting for it, and if they enhance your strategy without becoming it. Those are two big *if*s.

To exploit strategy concepts without allowing them to take over, consider each one that comes along to be an opportunity to challenge and improve the strategy you already have. If you don't already have a strategy to which you are truly committed, you are particularly vulnerable to being captured by the latest strategy fashion. If you do, ask how a new concept can enhance it. But never let that concept become a shortcut: a way to skip the hard work of identifying the big idea that will power your company's strategy; of formulating a unique, specific, and complete set of answers to the "strategic five"; and of owning your strategy through thick and thin. +

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Banking on Consolidation

The Capable Deal Maker

To gain the scale needed to compete, mid-tier firms need to join forces

by Doug Stotz, Arjun Saxena, and Sanchit Tiwari

The U.S. banking industry has largely sat out the impressive surge in M&A activity of the last few years. Total deal volume hit a record US$2.3 trillion in 2015 — up 64 percent over 2014. But banks accounted for just 3 percent of the total value, despite the fact that they account for 9.3 percent of total market capitalization. That's about to change: We believe the pace of M&A in U.S. banking will accelerate sharply in 2016.

The market structure of U.S. banking is obsolete, and the industry's profitability has been weak for nearly a decade. Regulatory and competitive pressures are making it hard for most banks to grow revenues and profits. The convergence of these trends makes it imperative that banks consolidate to gain scale and lower their cost structures. As a result, we expect significant consolidation among mid-tier players — those banks with between $10 billion and $250 billion in assets.

Despite the failures of several large banks and hundreds of mergers in the past decade, the U.S. banking market remains more fragmented than the markets of other large developed nations.

Despite the failures of several large banks and hundreds of mergers in the past decade, the U.S. banking market remains significantly more fragmented than the markets of other large developed nations. State and federal regulations — particularly a ban on interstate banking — that remained in place until the 1980s discouraged concentration in the banking sector. Although these restrictions have largely been repealed, the U.S. still has more than 15 times the number of regulated depositories as the U.K., Canada, or Australia.

The top four to six banks in each of those countries account for 90 percent or more of total deposits. But even the 20 largest banks in the U.S. control only 59 percent of total deposits.

Although the U.S. banking system is fragmented, the very largest banks are capturing most of the growth in key lines of business. Between 2011 and 2014, the three biggest U.S. banks — Bank of America, JPMorgan Chase, and Wells Fargo — accounted for nearly two-thirds of deposit growth and virtually all the net growth in debit cards, which is a good proxy for consumer checking accounts (*see Exhibit 1*).

Given their scale, these large players can significantly out-invest other banks in brand marketing, data analytics, and digital products and services.

The Revenue and Profit Squeeze

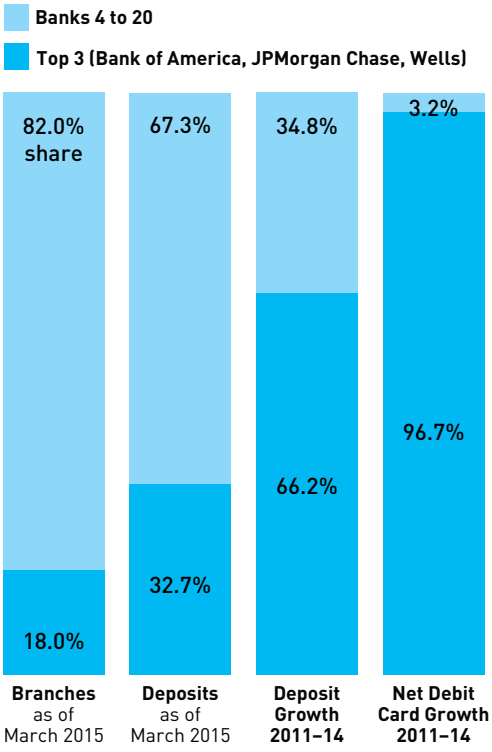
The primary driver for M&A activity is the difficulty that banks face in raising profits. Almost all U.S. banks are confronting significant profitability problems. Returns on equity for 74 percent of banks with $10 billion to $150 billion in assets were below their long-term cost of capital (approximately 10 percent) in 2014.

As a result, price-to-book-value ratios are low by historical standards. And that makes the U.S. banking sector an attractive hunting ground for potential foreign acquirers and for activist investors.

With activism rising throughout the industry, targets are no longer limited to small players, as shown by recent campaigns against larger specialized and regional banks. The activists include Trian Partners (which has targeted BNY Mellon and State Street), Greenlight Capital

Exhibit 1: **Top 20 Bank Market Shares by Consumer Banking Category**

The three largest banks have garnered the lion's share of growth in deposits and debit cards in recent years.



Note: Debit card growth used as proxy for checking account growth. Totals may not equal 100 due to rounding.

Source: FDIC Summary Data (Mar. 31, 2015), Nilson Report (Apr. 2015)

(Citizens Financial, CIT Group), Basswood Capital Management (Hudson Valley Bank, Synovus, Astoria Financial), and Hudson Executive Capital (Comerica, CIT Group). This activity will likely increase. PL Capital has announced a new private equity fund focusing on banks with between $3 billion and $75 billion in assets.

It is clear that banks will have difficulty boosting profits on their own. Merely to raise the return on equity in the sector to equal their 10 percent long-term cost of capital, banks would need to increase cumulative pretax profits by 35 percent — a total of $38 billion per year. This increase would need to come from a combination of cost reengineering and revenue growth.

Improving the bottom line is likely to be difficult because the top line isn't growing much. Overall revenues have been under pressure since their 2007 peak at the crest of the previous business cycle. Net interest income has been flat in the post-2007 era, thanks to low interest rates and a flat yield curve. Digitization and new regulations have also driven down volumes and margins across capital-markets and sales and trading businesses.

Noninterest income has also been flat, due to a series of postcrisis legislative initiatives that adversely affected fee-based revenue in deposit taking, credit cards, and payments. Ongoing scrutiny from the newly created Consumer Financial Protection Bureau has driven down pricing and ancillary revenues in consumer-facing businesses such as mortgages, deposit banking, credit cards, student lending, auto lending, and unsecured lending (*see Exhibit 2*).

Banks have also ceded market share to nonbank players in businesses such as subprime lending, asset management, proprietary trading, and wealth management. In particular, nimbler, nonregulated financial technology players such as LendingTree, Lending Club, and PayPal are intruding into the more lucrative, fee-based businesses of banks such as retail lending and global payments. Technology has lowered barriers to entry for these new competitors. Big data analytics and digital channels may be lowering costs of identifying and marketing to "cherry-picked" prospects.

How Consolidation Can Help

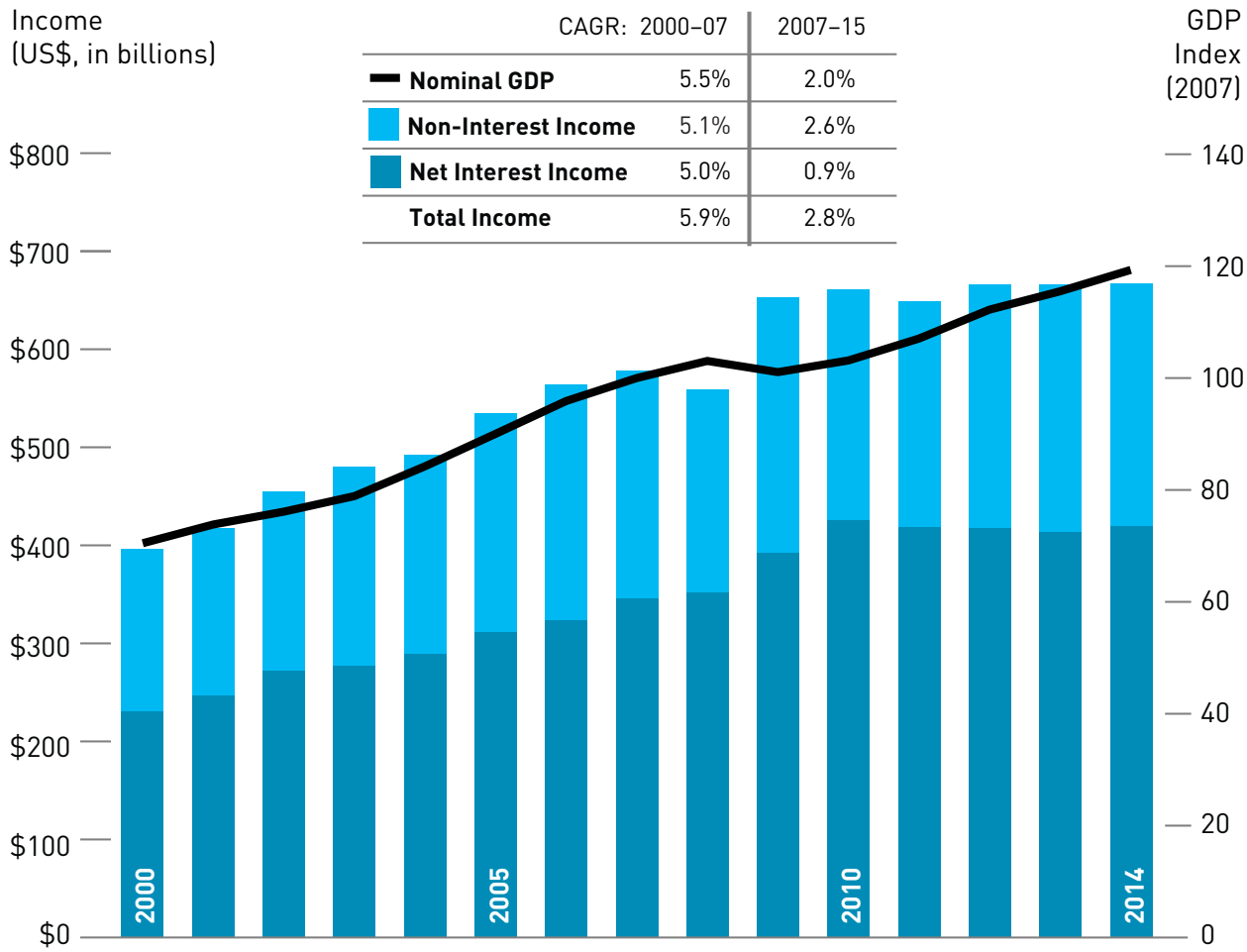
Given the anemic outlook for GDP and income growth, it will be difficult for the

U.S. banking industry as a whole to show impressive top-line growth. However, consolidation can yield significant cost benefits. For a typical regional bank with retail and commercial businesses, 30 percent of total costs are variable by volume, 35 percent are driven by the branch network, and another 35 percent are "scalable" costs driven by organizational complexity.

Consolidation can help control costs by shedding excess branch capacity, as well as by spreading fixed regulatory, legal, compliance, and other organizational costs over a larger base. KeyCorp's proposed $4.1 billion acquisition of First

Exhibit 2: **Keeping Up**

Over the past several years, growth in banks' income has kept pace with overall economic growth.



Note: 2009–14 data affected by institutions that converted to bank holding companies during financial crisis (e.g., AXP, CIT, DFS, GS, MS).
Source: FDIC HSOB, Federal Reserve of St. Louis, Strategy& analysis

Niagara Financial Group, announced in 2014, is an example. KeyCorp plans to drive significant cost savings via an 11 percent consolidation of branches. Then it intends to re-invest part of the cost savings into online and mobile solutions and digital channels — where transactions are growing significantly faster than branch transactions — as well as in strategic partnerships to improve automation, regulatory compliance, and customer experience.

For some smaller to midsized banks, building scale via M&A is crucial. Under legislation enacted in 2010, regulatory cost and complexity rise sharply for banks when total assets hit thresholds of $10 billion and $50 billion.

For banks nearing these levels, acquiring or merging with another bank can effectively lower these costs by spreading them over a larger base. For example, New York Community Bancorp ($50.3 billion in assets) agreed to purchase Astoria Financial Corporation ($16.5 billion in assets) in a $2 billion transaction

Illustration by Martin León Barreto

announced in 2015. The combined company will have assets of some $64 billion, moving decisively past the $50 billion threshold.

Deals to expand into adjacent products or markets or to add capabilities may also make strategic sense. Examples include RBC's recent acquisition of City National to add private banking and business banking to its U.S. retail brokerage and capital-markets franchise; Capital One's expansion into healthcare lending through the acquisition of GE Capital's healthcare lending business; and Barclays's acquisition of Logic Group to enhance payment and loyalty technology capabilities.

Vertical integration, such as CIT Group's 2015 acquisition of OneWest Bank, is another option. The $3.4 billion deal enabled CIT to add a branch banking franchise to its commercial lending and leasing platform, creating greater liquidity and growing net interest margin through replacing wholesale funding with cheaper retail deposits.

Shoring Up the Banking Sector

It is clear that a healthy U.S. banking sector that earns its cost of capital, and that can continue to support the credit, payments, and risk management needs of an expanding economy, would be in the interests of customers, bank shareholders, regulators, and other industry stakeholders. The developments and trends we have outlined, however, demonstrate that significant consolidation is needed to enhance profitability and enable more banks to invest in growing markets and key strategic capabilities such as digitization, analytics, and branding.

The challenge is that regulators are averse to the largest banking institutions (those deemed to be "systemically important") getting any bigger. As a result, they have argued against further consolidation among top-tier banks. In any event, the national deposit cap, which prevents any single bank from amassing more than 10 percent of total U.S. deposits, would prevent any acquisitions of major depositories by Bank of America, JPMorgan Chase, or Wells Fargo. Several of the nation's largest institutions are seeking to reduce their scale and complexity as a result of regulatory constraints. So, too, are systemically important nonbank institutions such as GE Capital and MetLife. As a result, these larger institutions are exploring divestitures and spin-offs.

For all these reasons, we believe that the needed consolidation will be concentrated among mid-tier banks. Based on our analysis, $600 billion worth of M&A would be needed to provide enough cost savings to boost the return on average equity of the sector by 2 percentage points — thus allowing it to earn its cost of capital.

Over the next year or more, U.S. bank CEOs, CFOs, and boards of directors should give serious consideration to M&A as a strategic lever. They need to analyze and develop a view on whether they could drive cost efficiencies and revenue synergies as an acquirer, or drive shareholder returns as a target. They should articulate a deal thesis as part of their three- to five-year strategy, and consider whether there are unique capabilities that they would seek to obtain from, or contribute to, a prospective deal. And they should conduct preliminary reviews of potential targets' balance sheets, as well as their capabilities and customer profiles. Finally, they should explore opportunities to accelerate growth of digital capabilities through investments in, or acquisitions of, financial technology players.

A merger won't always be a sufficient tactic for midsized banks to gain the scale and operating efficiencies needed to compete in today's environment. But given the field in which they now operate, it may be a necessary one. +

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How to Hijack Your Lazy Brain

In his new book, Charles Duhigg demonstrates that making the right choices is the key to boosting personal productivity.

by Susan Cramm

Everyone wants to be more productive. And as a result, there is a significant industry of books, conferences, and speakers pitching miracle cures for getting things done more effectively. To a degree, each addition to the genre seems counterproductive. Wouldn't it be more, um, productive to spend our time plowing through the dozens of primers already on our shelf than to spend the time and money to buy a new one?

In most cases, the answer to this question is *yes.* But in his writing and in a recent interview, Charles Duhigg makes a convincing case as to why his new book, *Smarter, Faster, Better: The Secrets of Being Productive in Life and Business* (Random House, 2016), deserves our attention. It is an engaging, fast, and worthwhile read.

Duhigg's first book, *The Power of Habit: Why We Do What We Do in Life and Business* (Random House, 2014), is a seminal guide for anybody wishing to understand why habits exist and how they can be changed. *Habit* was a *New York Times* bestseller for well over a year, was named one of the best business books of the year by the *Wall Street Journal*, and has been praised by such highly respected authors as Daniel Pink and Jim Collins. All of which makes it a hard act to follow.

By and large, however, the author delivers. Duhigg, an editor at the *New York Times*, writes that he embarked on a quest to understand productivity when his "life felt like a treadmill of to-do lists, emails requiring immediate replies, rushed meetings, and subsequent apologies for being late." As he met people who clearly "exist on a different plane of getting things done," Duhigg hit upon an important insight: Productivity isn't a function of resources or smarts, but of "making certain choices in certain ways."

In his book, Duhigg defines productivity as "the best uses of our energy, intellect, and time as we try to seize the most meaningful rewards with the least wasted effort." To convey his productivity message, he uses constructs similar

to those used in *The Power of Habit*. An excellent storyteller, Duhigg smartly interweaves captivating narratives with academic and scientific research. The book was designed with the right mix of substance and story to be credible and to capture attention and imagination.

In a recent conversation, Duhigg emphasized that the only thing that separates the truly productive from the rest of us is their ability to "design their lives in ways that force them to think more deeply." Duhigg asserts that the truly productive understand how to hijack their lazy brains using the eight contemplation devices outlined in his book. To support his thesis, Duhigg shares research from academia and brings it to life using case studies lifted from organizations including the FBI and Google, and from diverse, nontraditional sources such as Broadway theater, public education, and the Poker Hall of Fame. Each chapter is devoted to one of the contemplation devices, which he believes are "at the core of why some people and companies get so much done."

The eight devices are fostering motivation, tapping into collective intelligence, paying attention to the right information, managing the tension between SMART (specific, measurable, achievable, realistic, time-bound) goals and stretch goals, empowering people to act, guessing probabilistically, innovating through brokering, and manipulating data. Here are some of the ideas that I found particularly enlightening.

To increase the collective intelligence of teams, Duhigg cites research that confirms that smarter teams have members who feel psychologically safe to share information in a free and open manner. Google's research reveals that healthy teams encourage full participation, no interruptions, reflective listening, vulnerability, nonjudgmental response to emotions, and constructive conflict. The author dispels any notions that healthy teams are polite and courteous. In reality,

Illustration by John Hersey

interactions in healthy teams can appear counterproductive (they may exhibit rambling, interruptions, gossiping, losing track of their point, etc.), and the stories told of the "tensions and infighting" among the *Saturday Night Live* writing team highlight this point. The *SNL* writing staff "all felt safe enough with one another to keep pitching new jokes and ideas," according to Lorne Michaels, executive producer and creator, who added, "You know that saying 'There is no *I* in *TEAM*'? All I wanted were a bunch of *I*s. I wanted everyone to hear each other, but no one to disappear into the group."

In a chapter that reads like a thriller, Duhigg contrasts the tales of two plane disasters to illustrate the downfalls of cognitive tunneling and explain how to make the right decisions in the moment by focusing on the right information. Keeping our brains calm and focused in chaotic environments requires paying attention to the right things by creating mental models that serve as scaffolding "for the torrent of information that constantly surrounds us." Duhigg recommends taking control of attention by envisioning your day while driving to work, finding people "to hear your theories and challenge them," and "getting into a pattern of forcing yourself to anticipate what's next."

"You know that saying 'There is no *I* in *TEAM*'?" said Lorne Michaels, executive producer and creator of *Saturday Night Live*. "All I wanted were a bunch of *I*s."

Managing our brain's need for cognitive closure, defined as "the desire for a confident judgment on an issue," requires defining SMART goals in light of stretch objectives that are challenged as new information becomes available. To illustrate this point, Duhigg shares a captivating story. The need for cognitive closure left Israeli leaders off guard in the run-up to the 1973 Yom Kippur war — despite overwhelming evidence that Egypt was readying for an invasion. At the 40th anniversary of the war, Eli Zeira, the head of the Directorate of Military Intelligence, conceded that he had erred by ignoring the "seemingly impossible" because he "hadn't thought through all of the alternatives as deeply as he should." In a tragic oversight, he admitted that he had neglected to consider a simple note that he always kept in his pocket, reading "and if not?" We all have to continually challenge our assumptions about what we are doing and why we are doing it.

In one of my favorite chapters, Duhigg makes a convincing case for dusting off our college statistics textbooks. He shares the thinking of poker professionals to illustrate the point that playing the odds, with the long term in mind, is the key to success. To convince us that this skill is within our grasp, he describes research performed by scientists from the University of Pennsylvania and the University of California. Their studies demonstrated that "simply exposing participants to probabilistic training was associated with as much as a 50 percent increase in the accuracy of their predictions." The key is to envision the future as having multiple possibilities and to develop intuition about relative likelihood by exposing ourselves to a wide spectrum of successes and failures. This takes discipline, he says, because we are more inclined to focus on our successes, but it is well worth it: Successful people, Duhigg writes, "spend an enormous amount of time seeking out information on failures" by reading about companies that have gone bankrupt, asking colleagues who haven't gotten promoted what went wrong, and asking themselves why a certain meeting or phone call did not go well.

Duhigg performs a valuable service by cataloguing, critiquing, and curating the most important contemplation devices. He deftly combines insights from psychology and behavioral economics with lived experience. "For the first time," he says, "we understand how to train our brains to think better," by using "techniques that are often counterintuitive." *Smarter, Faster, Better* thus serves as something of a user's manual for one's own brain.

As is unavoidable with such books, not every insight is original and brilliant. It's my guess that readers will already be familiar with some portion of the insights shared in *Smarter, Faster, Better.* But it is still worthwhile to engage with it all the way through because Duhigg encourages readers to consider how to apply much of what they already know to improve their productivity.

We are more inclined to focus on our successes, but successful people, Duhigg writes, "spend an enormous amount of time seeking out information on failures."

I wish there were more discussion of how to apply the concepts practically — either in the book or on the author's website, as there was for *The Power of Habit*. In the appendix, Duhigg attempts to illustrate the ideas by sharing how he applied them when writing the book and being held accountable by his editor.

In his conversation with me, Duhigg recommended that people stop and think about whether they are falling further and further behind, and whether they feel panicky under the weight of excessive stimuli, no matter what they do. If you feel these things, he says, it's a signal that you are "not tackling the right problems." As a result, you are likely to act out in ways that are reflexive and counterproductive, such as pushing your child aside when she reaches out for help or lulling yourself into a false sense of accomplishment by checking email rather than digging into an important but difficult assignment. Duhigg believes that everyone knows which parts of their lives they are "failing at." To improve, it's a matter of reviewing the contemplation devices and acting on them.

Duhigg admits that it's not going to be easy to adapt the insights from *Smarter, Faster, Better* to redesign our lives amid the nonstop meetings, voluminous emails, and weekly grind. Realistically, the book will be only as valuable as

the extent of our willingness to "toggle from automaticity," think deeply about the challenges we face, and act accordingly. +

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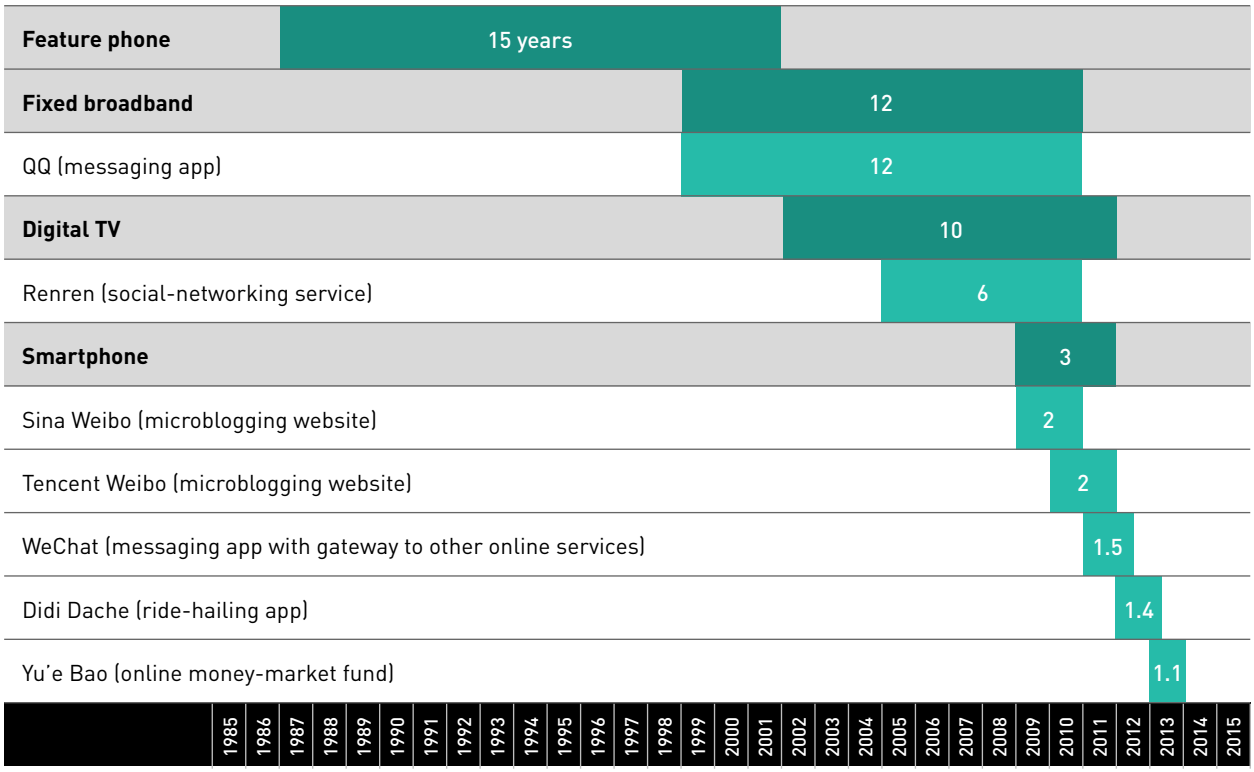
s+b Trend Watch

China's Digital Embrace

More broadband access and the proliferation of smartphones have quickened the pace at which technologies saturate the Chinese market. The messaging app WeChat shot to 100 million users in just 18 months beginning in 2011, but its pre-smartphone predecessor QQ took a dozen years, starting in 1999, to hit that mark.

Number of years, from launch, to reach 100 million users in China



Note: Gray bars indicate broad technologies.
Source: PwC, "The Rise of China's Silicon Dragon," May 2016

When Startups Spread Their Wings

Successful new companies must eventually face the chrysalis effect: a difficult metamorphosis into a mature company.

by Juliette Powell

Illustration by Lars Leetaru

In 2013, Jawbone, a leading maker of wearable activity-monitoring devices, acquired a startup called BodyMedia, reportedly for more than US$100 million. The leaders of the two companies shared a grand ambition: They dreamed of scaling up to become a multibillion-dollar wearables company, selling devices that collected not just health and fitness data but any data related to driving safety, travel, and the gamut of human experience, physical and emotional.

They knew that this was a long-term goal; devices of that scope would need hundreds of millions of dollars more in investment. But they were convinced that the newly combined company would outpace its competitors, including some of the largest companies in high tech.

"As one of the first consolidations of experience, technologies, and IP, the merger with Jawbone was a statement," recalls John ("Ivo") Stivoric, who had been a BodyMedia cofounder and chief technology officer and then became VP of Jawbone's research and development. "It was a show of force in the face of giants like Apple, Google, Microsoft, Samsung, even Amazon."

And indeed, the newly merged enterprise expanded quickly. Yet as the company grew, its momentum slowed. "In the early days," recalls Stivoric, "our team developed a track record for disruptive innovation — repeatedly. People would say we couldn't do something technologically, and we would go ahead and do it, as well as proving our solutions clinically. But over time, we got less and less nimble in taking risks."

This pattern is prevalent among startups. As they mature, they shelve their breakthrough innovations and move toward incremental releases such as feature updates. This problem is generally attributed to lags in market demand for new products. It takes time for the relatively small number of early adopters to expand into a broad base of customers.

But market demand is not always the main problem. Startups face internal challenges that hold them back even more. Once a company expands beyond a few hundred people, the informal, entrepreneurial management style of the early days no longer works. Fledgling companies need to grow large but keep the fluidity and productivity of a startup, and it's not obvious how to do so; first-time founders typically have little experience running bigger companies. Add to

that the vagaries of competition and the challenges associated with recruiting and retaining good people, and it's no surprise that so few companies grow past the startup phase.

You could call this the "chrysalis effect." Several years after it's founded, an organization experiences something like the metamorphosis of a larva into a full-grown butterfly. Even in the insect world, this is a brutal transition; the caterpillar molts its skin four or five times and then, as a pupa, literally digests itself. Its old body becomes broth. Formerly dormant cells called imaginal discs, released by new hormones, replicate rapidly, forming eyes, wings, and color patterns. Only one in 400 caterpillar eggs survives to take flight.

The chrysalis metaphor is apt because the process of maturation for startups also involves severe winnowing. In 2015, startups died at a rate of one per week, according to venture capital database CB Insights. When it comes to "scale-ups" — companies moving from startup status to a global presence — the chances of survival are even lower. The survivors become famous: Google, Amazon, Facebook, Netflix, and Apple are among them. But to get through the transition successfully, leaders have to radically change their organizations and the way they manage, while still growing. During this necessary transition, many companies are sold or taken over. But if the upstart leaders have anticipated the transition — for example, by creating new roles for the founders, attracting people who have experience with similar transitions, developing collaborative networks, and borrowing established practices in their own deliberate way — they can restructure and soar.

Leaders have to radically change their organization and the way they manage, while still growing.

Chronicles of the Chrysalis

When I first began asking technology leaders about the chrysalis effect, the phenomenon didn't yet have that name. But I knew startup leaders who talked about it informally, often with pain and in hushed tones. Scaling up was often more challenging than these leaders had expected, and most declined to be in-

terviewed on record about it. However, some of their advisors and funders were willing to talk, and a few are beginning to codify the practices of transition.

One place where the transition is becoming codified is Stanford University. Silicon Valley investor Reid Hoffman (cofounder of LinkedIn and Greylock Partners) and his colleague Allen Blue — LinkedIn's cofounder and vice president of product management, and member of the U.S. Department of Commerce Data Advisory Council — taught a class on "blitzscaling" at Stanford in 2015 (which they then aired on YouTube). They billed the course as focused on rapid growth. But much of it covered the management disciplines needed for a company to expand beyond its early days. (Since the course was posted, LinkedIn made its US$26.2 billion deal with Microsoft, but the precepts still resonate.)

"First-mover advantage doesn't go to the first company that launches," said Hoffman, introducing the first session. "It goes to the first company that scales." He described a typical startup's transition from a "tribe" — with a handful of employees, and a market capitalization typically below $10 million — to a "village," with thousands of employees and a market cap in the billions. "You move past [the tribe stage]," he said, "not because you want to, but because you need to."

Another expert chronicling the transition is Steve Blank, who founded the software company e.piphany (now part of Infor). In his book *The Startup Owner's Manual: The Step-by-Step Guide for Building a Great Company* (with Bob Dorf; K&S Ranch, 2014), he labels this transition as a move from post-customer development to customer creation (typically after a series C funding round): "A radically different stage during which the company suddenly shifts from 'searching for a business model' to 'executing one.' [It now has] revenue targets and timetables to hit, product and plans to deliver, and more granular and precise accountability to investors and board members."

For Micheál J. Kelly, dean of the Lazaridis Institute, a management research center at Wilfrid Laurier University in Toronto, the transition requires knowledge that few startup leaders have. "Entrepreneurs are very comfortable when they have 20 employees in their company," he says, "but as soon as they need to build structure around it, they have no idea what to do."

Thus, any company that truly wants to shape its future as a technological innovator must be ready to scale when the time comes. Or as Hoffman said in his class about the early days of entrepreneurship: "You [should be] thinking, what happens when it's 1,000 people; 2,000 people; 3,000 people? Because the mistake people frequently make in organizational stuff is they say, 'OK, let's wait until it's all broken and then try to fix it.' That's much harder." He added that the need to scale up was a factor in his 2008 decision to replace himself as LinkedIn CEO with Jeffrey Weiner. Weiner was recruited from Yahoo, where he had been executive vice president of the network division and had led a team of 3,000 people.

Four Basic Principles

In the conversations I've had on this subject, and in forums such as the blitzscaling course, four factors keep coming up: setting up the founder in new roles that take advantage of his or her creativity; recruiting for scale by seeking talented people who have experience with the transition you're about to enter; developing meaningful networks within the company, so people can communicate even across large organizational structures; and selectively adopting a few key mainstream management practices, the kind that don't swamp you in bureaucracy.

> "The things that are embedded in the DNA of a company — its purpose, passion, and energy — need to be retained while expanding the team."

These practices all have a key principle in common: to "remain the same but be different," as Hap Klopp puts it. Klopp, author of *Almost: 12 Electric Months Chasing a Silicon Valley Dream* (with Brian Tarcy; Motivational Press, 2015), has been a Silicon Valley entrepreneur since the mid-1980s, after cofounding outdoor retailer The North Face. "The same things that are embedded in the DNA of a company — its sense of urgency, singleness of purpose, passion, devotion, and energy — need to be retained while simultaneously expanding the team and expanding the horizon," he says.

• **Repositioning the founder.** In 1998, an engineer named S. Scott Crump and his wife, Lisa, were tinkering in their Minnesota garage to create a toy frog

for their 2-year-old daughter. He discovered he could set up a hot glue gun to be programmed to shape 3D objects by affixing the device to a robotic gantry system (a movable hoist used to position tools on workbenches). This led him to invent fused deposition modeling (FDM), the 3D printing process on which many digital fabrication machines rely. The Crumps founded Stratasys, one of the first companies in this field. Crump was chairman and CEO of Stratasys until December 2012, when it merged with Objet Geometries. At that point, he was replaced as CEO and remained chairman. But he also took a role as the chief innovation officer — symbolically and operationally retaining a connection between the founder's role and the strategic direction of the enterprise.

This pattern is common in mature technology startups. At Google, for example, Larry Page took a new role in forming Alphabet, Google's innovation-driven parent company. It allowed Page to focus his attention on fostering breakthrough innovation within the company.

• **Recruiting for scale.** With expansion comes rapid hiring, which can erode internal trust. To counter this tendency, companies that have successfully navigated the chrysalis effect put a great deal of time and effort into recruiting, even though they often face pressure to add staff quickly. They seek people who fit their original culture, who bring energy and a sense of accountability to their enterprises, and who know how to push back against positions they disagree with in a respectful, constructive way. These companies also look for people with a broad perspective.

"The people who survive the transitions from startup to scale-up," says Jawbone's Stivoric, "are sponges for learning, interested in all aspects of the business. It doesn't matter whether they are senior management material or deep into technical detail. You want them. They can flow with the phases and changes of the business because they see where and how the pieces connect."

Jawbone, for example, hired Jason Child as chief financial officer during its scale-up. Child had 20 years of experience in leadership roles at companies including Amazon. He had direct experience with the pitfalls of poor management and the triumphs of good leadership.

Silicon Valley's famous tolerance for failure stems from this factor. "Some VCs say it's essential to hire experienced people because they've learned hard-

earned lessons from past mistakes," says Amish Shah, founder and CEO of the recruiting firm Millennium Search. "You want the double OPM: other people's mistakes on other people's money." However, the truly successful mature companies can also attract success stories, and prosper accordingly. On July 16, 2015, when the new CFO of Google and Alphabet, former Morgan Stanley CFO Ruth Porat, led her first earnings news conference at Google, its market capitalization jumped $60 billion — the biggest one-day gain in market value for any company in history, according to *New York Times* columnist James B. Stewart. Investors knew the value of having someone in place who had run a finance function effectively, especially for an investment bank.

"The most successful entrepreneurs have been in [big] business before," says startup veteran Annette Kramer, who advises entrepreneurs and venture capitalists on strategy. "They've seen how poor management severely curtailed growth in enterprises when they were employees. Their first priority now is to develop the company with an eye on growth, right from the beginning."

Below the executive levels, staffing an organization with the right people requires the same intensive attention. The strategy employed by Regeneron, a biopharmaceutical company whose staff size tripled in four years, shows the importance of organizational culture. Faced with the need to swiftly add many experienced scientists to staff large research projects, Regeneron invested first in articulating what was special about its high-engagement, high-integrity culture. "Once these cultural values were clearly articulated, they were able to attract new employees who fit," says Benoit Hardy-Vallée, an executive advisor with IBM who wrote a case study about the initiative.

• **Developing collaborative networks.** Having recruited the right people, bring them together regularly in ways that enable them to learn together, particularly across internal boundaries. This can be done in large-scale gatherings focused on the company's goals. In 2015 at Makerbot, a manufacturer of 3D printing technology, Jonathan Jaglom, then the general manager of the Asia-Pacific and Japan business, was promoted to CEO and charged with overcoming a slowdown and revitalizing the company's growth. "One of the first things I did," he recalls, "was to set up a 50-person voluntary creative staff council." His team identified the top influencers in different departments, and he

asked them to meet regularly with him as a group, to collaboratively redefine Makerbot's culture.

Meaningful networks can also be built through one-on-one conversations. When Jeff Weiner became CEO of LinkedIn, he arranged in-depth meetings with each senior team leader to talk about the company's strategy, priorities, and measurable objectives. He asked them what they would focus on, and instructed them to think about the company's culture and values in that context. He then synthesized this into a common set of priorities, articulated on a single page so everyone could understand what they were working toward.

"This is still the same mission that we work with today.… It's important to have this, because it is actually the touchstone which becomes part of daily decision making among the people who are within the company," explained Hoffman in the blitzscaling course.

• **Selectively adopting mainstream management practices.** "Any product that becomes popular and spreads through the Internet can see revenue jump from $1 million to more than $100 million," says J.F. Gauthier, head of business development at Compass (formerly Startup Genome), which provides a management dashboard and benchmarks for tech startups and e-commerce. "But that's just the tip of the iceberg." Now comes the time to bring in the established management practices that will allow you to move forward. These may include better ways of training and evaluating people, designing business processes, working across internal boundaries, keeping track of performance, marketing and selling at scale, building relationships with customers, incorporating data analytics into your products, and managing technology teams.

In conventional companies, these jobs are typically handled by staff in functional departments: IT, human resources, and organizational design. That tends to slow an organization down. In startups, as Reid Hoffman said in a *Harvard Business Review* interview, the company moves more quickly, scaling faster than its competitors, taking on more risk, and seeking, as he put it, "freedom from normal rules" of management.

You can't avoid controls entirely; for example, you need them to ensure quality throughout your company. You therefore have to selectively borrow those practices, metrics, and organizational designs that fit well with your com-

VIDEO FEATURE

How Startups Can Avoid the Chrysalis Effect

Last year, startups died at a rate of one per week. When it comes to scaling, the chances of survival are even lower.

pany — and that allow you to keep tapping the insight and experience of the people you hire. For example, Alphabet defined itself within Google through its organizational design. It has a division called X (or Google X) where entrepreneurs such as Stivoric — who left Jawbone to join Alphabet two weeks after our interview — can develop new businesses separately from the rest of Google, but with the support they need to grow. X has set up recruiting and management processes, long-term funding, and collaborative practices that will presumably help these new businesses overcome the chrysalis effect.

The Unicorn and the Butterfly

Devouring your old practices and consciously creating new ones may be painful. But the alternative, for many startups, is worse. In the blitzscaling video, Hoffman recalled how entrepreneurs facing this transition think: "Now I'm going to really crank up my burn rate. I'm going to hire a whole bunch of people. I'm going to really make a go at this." But if you're wrong, he said, "it's pretty painful. It may be death. If it's not death, it's a massive retrenchment and loss of opportunity."

To Silicon Valley's unicorns — the tech startups that have gained a market capitalization of $1 billion or more — the challenges of growth may not seem relevant. They have, in effect, won for themselves the capital with which to scale. But capital is not enough for reliable growth.

The world may celebrate the unicorns of technology, but the economy needs butterflies: companies that can introduce and manage innovative tech-

nology with the maturity to stay afloat. Navigating through the chrysalis effect, growing wings, and developing the ability to fly afterward may differentiate your enterprise. The process represents a rite of passage for today's generation of startups, and it may be a necessary factor for our future economic health. +

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10 Principles of Strategic Leadership

How to develop and retain leaders who can guide your organization through times of fundamental change.

by Jessica Leitch, David Lancefield, and Mark Dawson

Illustration by Lars Leetaru

Most companies have leaders with the strong operational skills needed to maintain the status quo. But these organizations face a critical deficit: They lack people in positions of power with the know-how, experience, and confidence required to tackle what management scientists call "wicked problems." Such problems can't be solved by a single command, they have causes that seem incomprehensible and solutions that seem uncertain, and they often require companies to transform the way they do business. Every enterprise faces these kinds of challenges.

A 2015 PwC study of 6,000 senior executives, conducted using a research methodology developed by David Rooke of Harthill Consulting and William Torbert of Boston University, revealed just how pervasive this shortfall is. Respondents were asked a series of open-ended questions; their answers revealed their leadership preferences, which were then analyzed to determine which types of leaders were most prominent. Only 8 percent of the respondents turned out to be strategic leaders, or those effective at leading transformations (Rooke and Torbert refer to them as "strategist" leaders).

The study suggests that strategic leaders are more likely to be women (10 percent of the female respondents were categorized this way, versus 7 percent of the men), and the number of strategic leaders increases with age (the highest proportion of strategic leaders was among respondents age 45 and above). These leaders tend to have several common personality traits: They can challenge the prevailing view without provoking outrage or cynicism; they can act on the big and small pictures at the same time, and change course if their chosen path turns out to be incorrect; and they lead with inquiry as well as advocacy, and with engagement as well as command, operating all the while from a deeply held humility and respect for others.

It may seem disheartening that such a small percentage of senior leaders can operate this way. The trend over time is almost as bad. When the same survey was conducted in 2005, only 7 percent of respondents were identified as strategic leaders. In other words, in the course of a transformative decade marked by the collision of technological breakthroughs, financial crises, demographic shifts, and other major global forces, the leadership needle barely moved.

VIDEO FEATURE

Find Your Strategic Leaders

Most companies lack people in positions of power with the experience and confidence required to challenge the status quo.

Given the small percentage of senior leadership equipped to manage large-scale transformation, companies are often forced to bring in leaders from outside. But as we've observed in countless organizations over the years, significant change in a company is more likely to succeed if it is led from within. Perhaps most alarming, the leadership gap is typically hidden from view. No one recognizes that the company's top executives aren't acting strategically. Or people do realize it, but no one is willing to call attention to the problem. The gap thus comes to light only when a company faces a major challenge to its traditional way of doing business. It's in the do-or-die moments, when companies need a strategic leader most, that they discover the current leadership isn't up to the task.

> Distribution of responsibility gives potential strategic leaders the opportunity to see what happens when they take risks.

Fortunately, companies can build the capacity for strategic leadership. It starts with recognizing that your organization undoubtedly already has emerging strategic leaders whose skills are being overlooked or even stifled. The problem can be traced back to how organizations traditionally develop and promote their leaders. In many companies, the individuals who make their way to the top of the hierarchy do so by demonstrating superlative performance, persistent ambition, and the ability to solve the problems of the moment. These are valuable traits, but they are not the skills of a strategic leader.

The following 10 principles can help unlock the potential strategic leadership in your enterprise. These principles represent a combination of organizational systems and individual capabilities — the hardware and software of transformation. You may have already adopted some of these tenets, and think that's enough. But only when you implement all of them together, as a single system, will they enable you to attract, develop, and retain the strategic leaders who've eluded you thus far.

Systems and Structures

The first three principles of strategic leadership involve nontraditional but highly effective approaches to decision making, transparency, and innovation.

1.

Distribute responsibility. Strategic leaders gain their skill through practice, and practice requires a fair amount of autonomy. Top leaders should push power downward, across the organization, empowering people at all levels to make decisions. Distribution of responsibility gives potential strategic leaders the opportunity to see what happens when they take risks. It also increases the collective intelligence, adaptability, and resilience of the organization over time, by harnessing the wisdom of those outside the traditional decision-making hierarchy.

At an oil refinery on the U.S. West Coast, a machine malfunction in a treatment plant was going to cause a three-week shutdown. Ordinarily, no one would have questioned the decision to close, but the company had recently instituted a policy of distributed responsibility. One plant operator spoke up with a possible solution. She had known for years that there was a better way to manage the refinery's technology, but hadn't said anything because she had felt no ownership. The engineers disputed her idea at first, but the operator stood her ground. The foreman was convinced, and in the end, the refinery did not lose a single hour of production.

When individuals like the plant operator are given responsibility and authority, they gain more confidence and skill. And when opportunities to make a difference are common throughout an organization, a "can-do" proficiency becomes

part of its identity. At Buurtzorg, a Dutch neighborhood nursing organization, most decisions are made by autonomous, leaderless teams of up to a dozen nurses. A small central management team supports and coaches the frontline nurses; there is no other middle management. The company achieves the highest client satisfaction levels of all community nursing delivery in the Netherlands, at only 70 percent of the usual cost. Patients stay in care half as long, heal faster, and become more autonomous themselves. And the nurses gain skills not just for leading their part of the enterprise, but in community leadership as well.

2.

Be honest and open about information. The management structure traditionally adopted by large organizations evolved from the military, and was specifically designed to limit the flow of information. In this model, information truly equals power. The trouble is, when information is released to specific individuals only on a need-to-know basis, people have to make decisions in the dark. They do not know what factors are significant to the strategy of the enterprise; they have to guess. And it can be hard to guess right when you are not encouraged to understand the bigger picture or to question information that comes your way. Moreover, when people lack information, it undermines their confidence in challenging a leader or proposing an idea that differs from that of their leader.

> Strategic leaders know that the real power in information comes not from hoarding it, but from using it to create new opportunities for growth.

Some competitive secrets (for example, about products under development) may need to remain hidden, but employees need a broad base of information if they are to become strategic leaders. That is one of the principles behind "open-book management," the systematic sharing of information about the nature of the enterprise. Among the companies that use this practice are Southwest Airlines, Harley-Davidson, and Whole Foods Market, which all enjoyed sustained growth after adopting explicit practices of transparency.

Transparency fosters conversation about the meaning of information and the improvement of everyday practices. If productivity figures suddenly go down, for example, that could be an opportunity to implement change. Coming to a better understanding of the problem might be a team effort; it requires people to talk openly and honestly about the data. If information is concealed, temptation grows to manipulate the data to make it look better. The opportunity for strategic leadership is lost. Worse still, people are implicitly told that there is more value in expediency than in leading the enterprise to a higher level of performance. Strategic leaders know that the real power in information comes not from hoarding it, but from using it to find and create new opportunities for growth.

3.

Create multiple paths for raising and testing ideas. Developing and presenting ideas is a key skill for strategic leaders. Even more important is the ability to connect ideas to the way the enterprise creates value. By setting up ways for people to bring their innovative thinking to the surface, you can help them learn to make the most of their own creativity.

This approach clearly differs from that of traditional cultures, in which the common channel for new ideas is limited to an individual's direct manager. The manager may not appreciate the value in the idea, and may block it from going forward and stifle the innovator's enthusiasm. Of course, it can also be counterproductive to allow people to raise ideas indiscriminately without paying much attention to their development. So many ideas, in so many repetitive forms, might then come to the surface that it would be nearly impossible to sort through them. The best opportunities could be lost in the clutter.

Instead, create a variety of channels for innovative thinking. Some might be cross-functional forums, in which people can present ideas to a group of like-minded peers and test them against one another's reasoning. There could also be apprenticeships, in which promising thinkers, early in their careers, sign on for mentorship with leaders who are well equipped to help them build their skills. Some organizations might set up in-house courses or sponsor attendance

at university programs. Reverse mentoring — in which younger staff members share their knowledge of new technology as part of a collaboration with a more established staff member — can also be effective.

Google has made use of a number of channels to promote innovation. A few examples: Employees can directly email any of the leaders across the organization; the company established "Google cafés" to spark conversation by encouraging interaction among employees and across teams; and executives hold weekly all-hands meetings (known as TGIFs) to give employees at every level in-person access to senior leaders. People at Google learn to make the most of these opportunities — they know the conversations will be tough, but that genuinely worthwhile innovative thinking will be recognized and rewarded.

People, Policies, and Practices

The next four principles involve unconventional ways of thinking about assessment, hiring, and training.

4.

Make it safe to fail. A company's espoused statement of values may encourage employees to "fail fast" and learn from their errors. That works well until there is an actual failure, leading to a genuine loss. The most dreaded phone call in the corporate world soon follows; it's the one that begins: "Who authorized this decision?" Big failures are simply unacceptable within most organizations. Those who fail often suffer in terms of promotion and reward, if not worse.

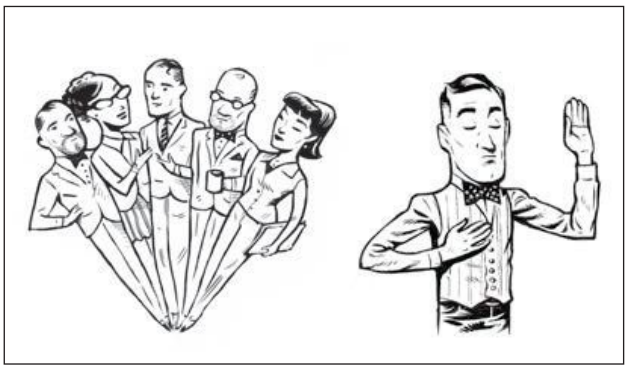
You must enshrine acceptance of failure — and willingness to admit failure early — in the practices and processes of the company, including the appraisal and promotion processes. For example, return-on-investment calculations need to assess results in a way that reflects the agreed-upon objectives, which

You must enshrine acceptance of failure — and willingness to admit failure early — in the company.

INFOGRAPHIC

A Guide to Strategic Leadership

Ten principles that can enable you to unlock your company's potential.



may have been deliberately designed to include risk. Strategic leaders cannot learn only from efforts that succeed; they need to recognize the types of failures that turn into successes. They also need to learn how to manage the tensions associated with uncertainty, and how to recover from failure to try new ventures again.

Honda is one enterprise that has taken this approach to heart. Like several other industrial companies, the automaker has had a dramatic, visible failure in recent years. The installation of faulty equipment from its favored airbag supplier, Takata, has led Honda to recall about 8.5 million vehicles to date. Although the accountable executives were fired, the company's leaders also explicitly stated that the airbag failure, in itself, was not the problem that led to dismissal. The problem was the lack of attention to the failure at an early stage, when it could have been much more easily corrected. As one Honda executive told Jeffrey Rothfeder, author of *Driving Honda: Inside the World's Most Innovative Car Company* (Portfolio, 2014) and an *s+b* contributing editor, "We forgot that failure is never an acceptable outcome; instead, it is the means to acceptable outcomes."

Some organizations have begun to embrace failure as an important part of their employees' development. The Bill & Melinda Gates Foundation and the U.K.-based innovation charity Nesta have held "failure fests," at which employees discuss decisions that went wrong and derive lessons from them. In addition to establishing such forums, you can provide managers with opportunities to oversee smaller change initiatives, some of which may not work out, to develop the skills they'll need to lead larger-scale transformations.

5.

Provide access to other strategists. Give potential strategic leaders the opportunity to meet and work with their peers across the organization. Otherwise, they remain hidden from one another, and may feel isolated or alone. Once they know there are others in the company with a similar predisposition, they can be more open, and adept in raising the strategic value of what they do.

The first step is to find them. Strategic leaders may not be fully aware themselves that they are distinctive. But others on their team, and their bosses, tend to recognize their unique talents. They may use phrases like "she just gets it," "he always knows the right question to ask," or "she never lets us get away with thinking and operating in silos" to describe them. A good way to learn about candidates is to ask, "Who are the people who really seem to understand what the organization needs, and how to help it get there?" These may be people who aren't traditionally popular; their predisposition to question, challenge, and disrupt the status quo can unsettle people, particularly people at the same level.

Of course, you don't want to create the impression that some people deserve special treatment. Instead, cultivate the idea that many managers, perhaps even most, have the potential to become strategic leaders. Then bring the first group together. Invite them to learn from one another, and to explore ways of fostering a more strategic environment in the rest of the enterprise.

6.

Develop opportunities for experience-based learning. The vast majority of professional leadership development is informative as opposed to experiential. Classroom-based training is, after all, typically easier and less expensive to implement; it's evidence of short-term thinking, rather than long-term investment in the leadership pipeline. Although traditional leadership training can develop good managerial skills, strategists need experience to live up to their potential.

One vehicle for creating leadership experiences is the cross-functional "practice field," as organizational learning theorist Peter Senge calls it. Bring together

a team of potential strategic leaders with a collective assignment: to create a fully developed solution to a problem or to design a new critical capability and the way to generate it. Give them a small budget and a preliminary deadline. Have them draft plans and financial estimates of their solutions. Then run the estimates through an in-depth analysis. This project might include a simulation exercise, constructed with the kind of systems simulation software that has been used to model and participate in wargames since the 1980s. You can also let reality be their practice field. Have them create the new capability or initiative on a small scale, and put it into effect. Then track the results assiduously. Assign mentors with experience to help them make the most of their effort — without sidetracking it.

Whether you set up the project in reality or as a simulation, the next step should be the same. Schedule a series of intensive discussions about the results. Explore why these results appeared, what the team might have done differently, and how things could be different in the future if the group changed some of the variables. The goal is to cultivate a better understanding than would be possible without this type of reflection, and to use that understanding as the basis for future efforts.

7.

Hire for transformation. Hiring decisions should be based on careful considerations of capabilities and experiences, and should aim for diversity to overcome the natural tendency of managers to select people much like themselves.

Test how applicants react to specific, real-life situations; do substantive research into how they performed in previous organizations; and conduct interviews that delve deeper than usual into their psyche and abilities, to test their empathy, their skill in reframing problems, and their agility in considering big-picture questions as well as analytical data. In all these cases, you're looking for their ability to see the forest and the trees: their ability to manage the minutiae of specific skills and practices, while also being visionary about strategic goals. The better they are at keeping near and far points of view simultaneously available, the better their potential to be strategic leaders.

For those hired, the on-boarding processes should send explicit signals that they can experiment, take on more responsibility, and do more to help transform the organization than they could in their previous position. They need to feel that the culture is open to change and to diverse views.

Focus on the Self

The final three principles are aimed at the potential strategic leaders themselves. Following these tactics can help them prepare for their personal evolution.

8.

Bring your whole self to work. Strategic leaders understand that to tackle the most demanding situations and problems, they need to draw on everything they have learned in their lives. They want to tap into their full set of capabilities, interests, experiences, and passions to come up with innovative solutions. And they don't want to waste their time in situations (or with organizations) that don't align with their values.

> Reflection helps you learn from your mistakes, but it also gives you time to figure out the value of your aspirations.

Significantly, they encourage the people who report to them to do the same. In so doing, strategic leaders create a lower-stress environment, because no one is pretending to be someone else; people take responsibility for who they truly are. This creates an honest and authentic environment in which people can share their motivations and capabilities, as well as the enablers and constraints in their life.

9.

Find time to reflect. Strategic leaders are skilled in what organizational theorists Chris Argyris and Donald Schön call "double-loop learning." Single-loop learning involves thinking in depth about a situation and the problems inherent in it. Double-loop learning involves studying your own thinking about the situation

— the biases and assumptions you have, and the "undiscussables" that are too difficult to raise.

Your goal in reflection is to raise your game in double-loop learning. Question the way in which you question things. Solve the problems inherent in the way you problem-solve. Start with single-loop learning, and then move to double-loop learning by taking the time to think: Why did I make that decision? What are the implications? What would I do differently next time? How will I apply this learning going forward?

Strategists have the humility and intelligence to realize that their learning is never done.

Reflection helps you learn from your mistakes, but it also gives you time to figure out the value of your aspirations, and whether you can elevate them. It allows you the chance to spot great ideas using what you are already doing or things that are going on in your life. Managers are often caught up in the pressures of the moment. A mistake or a high-pressure project can feel overwhelming. But if you take a minute to step back and reflect on these problems, it can provide the space to see what you did right.

Some reflection is more productive than others. Psychologists warn about "rumination," or dwelling on deceptive messages about your own inadequacies or the intractability of problems in a way that reinforces your feeling of being stuck. To avoid this pattern, deliberately give yourself a constructive question on which to reflect. For example, what are the capabilities we need to build next? How can I best contribute? Human capital teams can help by training individuals in these practices and ensuring that all managers support their team members who take the time to reflect.

10.

Recognize leadership development as an ongoing practice. Strategists have the humility and intelligence to realize that their learning and development is never done, however experienced they may be. They admit that they are vulnerable and don't have all the answers. This characteristic has the added benefit of allow-

ing other people to be the expert in some circumstances. In that way, strategic leaders make it easy for others to share ideas by encouraging new ways of thinking and explicitly asking for advice.

Their thirst for learning also gives potential strategic leaders the space to be open to less obvious career opportunities — new industries, different types of roles, lateral moves, stretch assignments, secondments, or project roles — that may help them fulfill their potential.

At some point, you may advance to the stage where you are not concerned solely with your own role as a strategic leader, but also with cultivating opportunities for others. This will require a clear-eyed, reflective view of the talent pool around you. It isn't easy for any leader to accept that others in the company may not have what it takes. Or, worse, to learn that the people with the potential to demonstrate leadership feel constrained by current organizational practices, and they are taking their talents elsewhere.

But if you can come to terms with reality, as uncomfortable as it may be, then you're in a position to help change it. By following the 10 principles we've outlined here, you will give yourself the skill and influence to pave the way for others who follow. That's fortunate, because the ability to transform amid societal and business challenges and disruptions is essential to your company's success — and perhaps even to its survival. +

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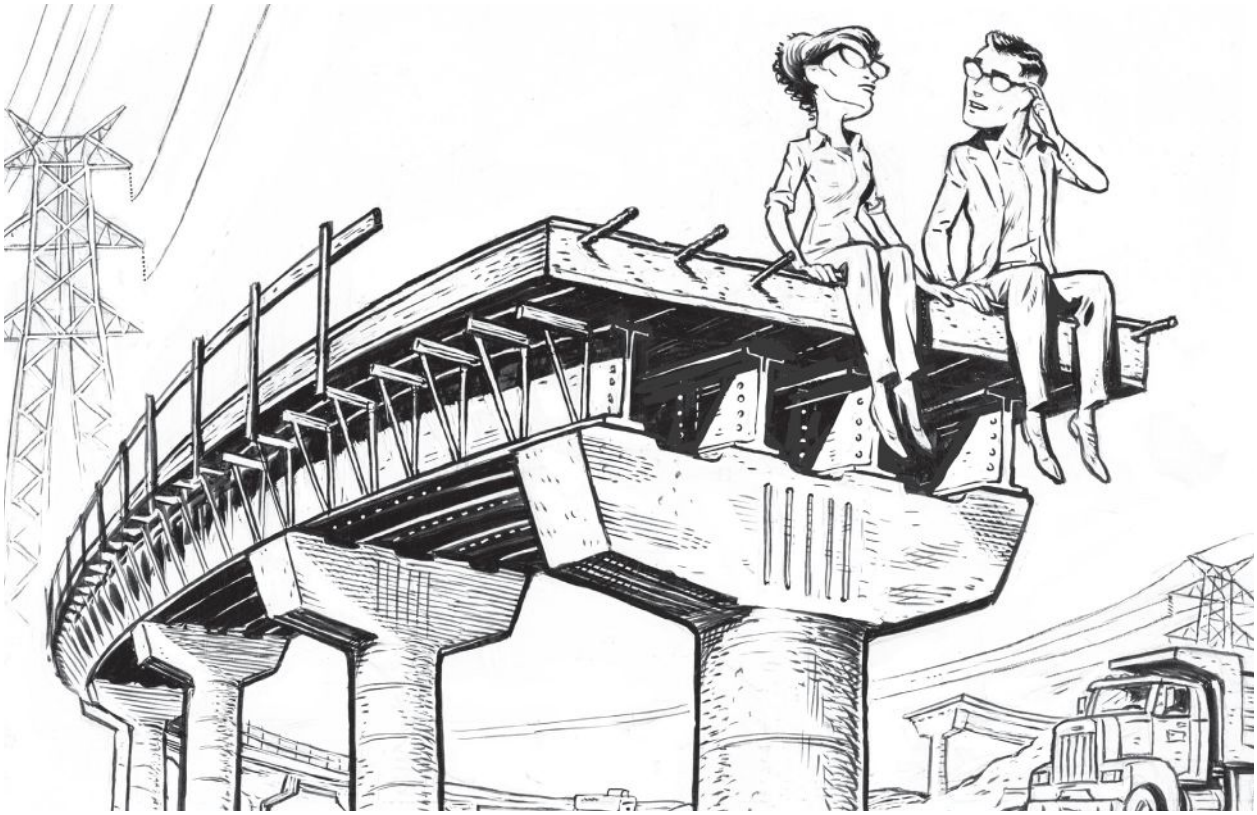

Hedge Fund, Meet Highway

New investments in infrastructure by private asset managers are changing the way the world finances its cities, power systems, and transportation links.

by Julien Courbe and Peter Raymond

Illustration by Lars Leetaru

The deal was inked in 2007, and at the time it garnered little attention. The New York–based private equity firm Blackstone Group Holdings had cobbled together a group of financiers to put up US$120 million for a two-thirds stake in a dam on the White Nile in Uganda.

Any way you looked at it, the move was risky. The hydroelectric project had kicked off more than a decade earlier and had languished ever since. Progress had been hindered by construction delays, cost overruns, corruption, and even pirate attacks. Nonetheless, Blackstone decided to take a chance. It hammered out a deal that would provide the firm with a cash annuity from energy fees in a country badly in need of electric power. When Blackstone signed the agreement, only 10 percent of Uganda's population had electricity.

The investment made a difference — especially because of the expertise and oversight that Blackstone added. In 2013, the 100-foot dam was completed, and it now supplies half of the Ugandan population with electricity. Blackstone may sell the asset in a few years, in keeping with its usual short-term approach to buying businesses. Or it may hold on to it and enjoy the reliable and plentiful cash flow, which is hard to come by in the global low-interest-rate environment. Either way, Blackstone's success with the Ugandan dam represents an investment trend that is changing the way infrastructure projects are planned and funded.

Since the financial crisis, asset management companies, including some private equity firms and hedge funds, have become the backers of choice for huge, multiyear infrastructure development efforts like this one. Following on the heels of Blackstone's success, many of the world's largest private investment firms have begun to view these projects — mostly involving basic services like energy, transit, and water, but also medical and educational facilities — as an attractive channel for investment-grade credit. J.P. Morgan, Allianz Global Investors, BlackRock, and KKR are among the asset managers pouring hundreds of millions of dollars into capital projects in both the operating and construction phases. Pension funds have also begun to invest, finding that they can hire the expertise themselves instead of paying fees to asset managers. This unlikely romance between private asset management and infrastructure development could become the critical factor enabling industrial society to keep pace with the ever-growing needs of billions of people around the world.

Many of these global infrastructure investments have traditionally been the province of major commercial banks (U.S. projects tended to be funded by municipal bonds). The banks viewed these investments as desirable because the returns they offered were generally higher than those from sovereign or corporate debt. But the global banking collapse changed the investment landscape. When the dust settled from the crash and money began to flow again around the world, the banks were left with very different rules of engagement. Increased capital-to-debt requirements forced them to clean up their loan books, and tighter controls on derivatives and other proprietary trading activities limited their ability to invest widely. Seeking more liquidity and wanting to simplify their portfolios, many banks pulled out of infrastructure investments, which are generally long-term instruments and complex to manage.

The biggest rewards go to firms that act as aggressive investors and become partners in the projects.

With the banks sitting on the sidelines, asset management firms suddenly found that a huge number of capital investment opportunities had been unleashed into the marketplace. They have moved in, albeit somewhat gingerly, to take advantage of the unexpected prospects.

Meanwhile, the supply of opportunities is growing rapidly; indeed, some forecasts suggest it will grow exponentially. A recent PwC analysis found that worldwide annual infrastructure spending will expand to more than $7 trillion by 2025, from $4 trillion in 2012. As much as 60 percent of these investment opportunities will be located in Asia and Africa, where urbanization and economic development are boosting the need for roads, bridges, airports, public transportation, power distribution, and water systems.

Other projects represent responses to demographic shifts. For example, aging populations in Western Europe and Japan will necessitate the construction of more hospitals and clinics, whereas countries bulging with younger residents in the Middle East will need more schools. And in developed regions such as the U.S. and Europe, local governments are seeking to privatize infrastructure projects, such as the modernization of highways and water systems, as a way of overcoming the budget shortfalls that leave them unable to support new construction efforts.

Less Risk, More Ripple

As financing opportunities become more common, more asset management firms will move into global infrastructure investment. The most persuasive rationale for doing so, of course, is the money to be made. Infrastructure investments are an excellent fit for asset management firms. The assets are long-term: Post-construction concession agreements can run from 30 to 99 years. This matches the preferred time horizon of many asset management programs because their aging clients need investments that preserve capital. Moreover, at a time when neither fixed income nor equity has been able to deliver reliable returns, infrastructure projects offer relatively stable returns with low correlation to other markets. And for knowledgeable investment managers, they offer potential double-digit earnings. In short, these investments can provide high-yield returns with relatively low risk.

Infrastructure investments can also have positive ripple effects on the rest of the economy. Analysts estimate that in the U.S., for each dollar of GDP invested in

infrastructure (above current spending), there would be an increase of about $3 in overall economic output. In less developed regions, the data is not as clear-cut, primarily because legal and regulatory trends, literacy, labor availability, and corruption could have an effect on GDP growth separate from public and private investments. Still, no one will dispute the idea that emerging countries need modern roads and airports, reliable electricity, clean water, and schools to develop their economies.

The returns for investors, however, are contingent on getting it right. They must choose the highest-potential projects and ensure they have the management and financial acumen needed for success. Asset managers have both a big opportunity and a big challenge. Until now, banks have played a relatively passive role, financing projects by providing loans to private-sector infrastructure development companies. But most asset managers hope to squeeze out better paybacks from infrastructure investments than the banks received, even if that entails additional risk, because their investors expect more. And in infrastruc-

ture funding, the biggest rewards go to firms that act as aggressive investors and become partners in the projects.

In fact, given the potentially significant returns for investors helping shape projects, some of the more aggressive pension funds — traditional sources of capital for many of the infrastructure funds — are setting up their own origination teams. They eschew the conventional ways of finding opportunities, such as working through infrastructure funds that tend to charge high fees for a stake in a project. Instead, they research their own prospects, put up seed and development money, navigate the permitting process, oversee construction, manage the facility once it is completed, and pay the necessary fees to government regulators. In return, they control the eventual revenue stream, which is often exceptionally reliable.

Investment activities by Caisse de Depot et Placement du Quebec (CDPQ), a huge Canadian management firm specializing in pension funds, illustrate this

tactic. The firm has taken the lead in a series of infrastructure investments in Mexico and the U.K. and is looking at similar projects in India. It also recently signed a deal with the province of Quebec to plan, finance, and manage two new rail projects, including transit links to Trudeau International Airport and across Montreal's Champlain Bridge, that will together cost about C$5 billion (about US$3.8 billion). Quebec's provincial government is drowning in debt and could not have funded these efforts without CDPQ's help. For its part, CDPQ says that it expects "significant commercial returns" from what should be well-traveled routes.

Other institutional investors taking a more active stance include the Ontario Teachers' Pension Plan and the California Public Employees' Retirement System. They are motivated by factors such as the declining number of so-called brownfield projects (existing facilities whose track record is well established) and the sudden influx of sorely needed new projects with less public and private banking money to pay for them.

Private equity firms typically view investments in infrastructure through a more creative lens than banks do. And they draw untapped value out of these projects. For example, in 2009 the Carlyle Group led a consortium that took over nearly two dozen service plazas on highways in Connecticut. This group invested almost $200 million to upgrade the sites, and added revenue opportunities by installing new tourist-attracting shops and eateries. The state's transportation department collects rent from the Carlyle Group, which is based in part on receipts.

Five Point Capital Partners has taken a similarly novel approach to enhancing infrastructure returns. In January 2016, the private equity firm kicked off a $200 million campaign to fund the acquisition of water management systems developed by oil companies. As the price of oil has dropped, some energy producers have sought to offload their water infrastructure to raise capital for continued exploration and to support the "balance sheet." Under this plan, Five Point's partner Waterbridge will pay to take over these systems. Waterbridge will use its expertise and industry-wide scale to bring down the costs of running them, in exchange for long-term annual payments that are well below the outlays that energy companies had previously earmarked for water management.

Tapping the Potential

Even with a growing number of projects under way, asset managers have barely tapped the potential of infrastructure investment opportunities. As of 2014, of the $50 trillion of capital managed by pension funds, sovereign wealth funds, insurance companies, and other institutional investors, only 0.8 percent was allocated to infrastructure, according to the *Economist*. Many have resisted the allure of infrastructure investments out of fear that they may get in over their heads. They worry that they lack the expertise to assess the quality of these projects, or that they may be vulnerable to regulatory, currency, or political crises.

But that attitude is slowly changing. In the first quarter of 2016, private investors completed 224 infrastructure deals, up about 50 percent over the same period in the prior year, according to Preqin, an alternative assets market researcher. And in 2015, the average infrastructure deal size rose to $521 million from $493 million the year before, Preqin reported. One of the more emphatic signs that international infrastructure investments are finally moving to the front

burner was the inaugural meeting in 2016 of the Global Infrastructure Forum, an event held this year in the U.S., sponsored by the United Nations, the World Bank, the African Development Bank, the Asian Development Bank, and 193 countries. The 300 or so attendees got an earful about the enormous potential for these investments as well as the dire need for them — and also heard about the corruption and regulatory constraints that hold them back.

Yet many asset managers, especially institutional investors, still remain relatively passive. They tend to take minority positions in stable existing projects with reliable revenue streams. They offload risk, usually to an infrastructure fund, and are satisfied with a somewhat lower return than they would get in a riskier environment. (To be sure, that return is still higher than typical returns from public or private bonds.) They feel they are unable to bridge the skills gap that separates them from more aggressive investors.

The Capabilities Required

But as investors lose patience and demand ever-higher returns in a world of low interest rates, a passive infrastructure investment stance could become more difficult for asset managers to justify. They should then undertake a significant internal transformation to gain the capabilities they need. These changes can be put into three critical categories: location, regulation, and digitization.

• **Location.** Asset managers new to infrastructure must initially determine which regions and which types of projects to invest in. Developed countries tend to be the most popular, because of the lower risk. But they also yield lower returns than emerging markets.

Some firms have entered emerging markets safely by recruiting local talent — those who understand the commercial culture and who are sufficiently clued in to navigate finance idioms and challenges. Leaders may be tempted to give them a broader set of tasks, such as portfolio and risk management, or to integrate them immediately into the larger organization. But they are more valuable when kept close to the reason they were hired: to uncover local infrastructure opportunities and to be the eyes, ears, and visible presence of the firm in the market.

The most successful asset management firms develop brand awareness campaigns that increase their recognition in local markets. They court local

investors, regulators, politicians, financial instrument distributors, and infrastructure experts, and bring them all into the firm's orbit. A well-known and well-respected name is a useful calling card for building these relationships. For example, Blackstone's globally recognized brand allowed it to forge a partnership with Nigerian billionaire Aliko Dangote, chairman and CEO of the Dangote Group and Africa's richest person. He is supporting the private equity firm's African infrastructure investments with his valuable local knowledge and relationships.

These asset management firms use social media and other modern public relations tools to further elevate their presence. They develop campaigns highlighting examples of their investments, especially when they can point to environmental sustainability and positive social impact. They also invest in information technologies that allow them to work in an integrated fashion with local governments and sources of capital.

• **Regulation.** Regulatory pressure on the banking sector after the 2008 recession has so far played into asset managers' hands. They have been able to broaden their activities and take advantage of opportunities that they were cut off from before. But as asset managers move more aggressively into infrastructure investments, it is likely that regulators will take a close look at this trend and impose new reporting measures on them. These regulations will be intended to improve financial data transparency and enforce portfolio safeguards.

To address these and other potential regulatory issues proactively, private equity firms such as Blackstone, Macquarie Group, and 3i Infrastructure have recruited former government policymakers to manage their infrastructure efforts. These managers provide expertise and contacts that make it easier to choose the most profitable projects and avoid costly mistakes. For example, in 2014 Blackstone hired two former water infrastructure executives from the financing arm of the World Bank to head up its new Global Water Development Partners business. That same year, when investment firm Rothschild Australia lost its infrastructure specialist Bruce MacDiarmid to Deutsche Bank, it replaced him with Danny Bessell, who had led government road projects in Australia and utilities and infrastructure banking at Goldman Sachs.

Some asset managers heavily invested in infrastructure could be subject to global rules involving "too big to fail" finance companies, particularly the so-

called systemically important financial institution (SIFI) regulations. These policies require SIFI firms to maintain ostensibly safe levels of capital to cover risky investments, thus preventing failures from cascading across international markets. To a lesser degree, money laundering laws, which are regularly tightened, could also lead to increased scrutiny of asset managers working with infrastructure assets. Other rules vary from one country to the next. Nigeria imposes tough restrictions on agricultural land use, but is relatively lenient in allowing foreign companies to fund projects and repatriate the gains. Meanwhile, new wind farms in Scotland, Australia, Canada, the U.S., and parts of Asia can easily run afoul of local environmental and noise abatement laws.

Tax regulations are equally inconsistent, and outside investors may be subject to residency requirements or specialized taxes. Reporting rules also vary widely among municipalities, provinces, regions, and central governments. It may be difficult to keep track of these differences and factor their costs into an infrastructure investment strategy, but it is essential.

• **Digitization.** The IT networks in most asset management firms are not designed for local infrastructure investments. They do not collect the specific types of data needed to determine which infrastructure projects are worth backing and what kind of returns can be anticipated under various outcomes and scenarios. While evaluating investments, for example, few asset managers consider geopolitical risks or the frequency of natural disasters and their impact on the region. Nor do they take into account environmental constraints or the biases inherent in any local culture. Yet this is precisely the type of information that could determine the success of an infrastructure effort.

This shortcoming was highlighted in a 2015 survey of asset managers who fund infrastructure projects. In this study, conducted by the Infrastructure Asset Management Exchange, the top investor priority, chosen by 29 percent of respondents, was to improve data management and data quality. Fifty-one percent said they planned to invest in data-gathering tools. But of the asset managers who selected data management gains as a priority, 49 percent said that current tools "are not able to support business decisions."

These results point to a remarkable opportunity for asset managers. Firms can still achieve a competitive edge by adopting technology that helps them outthink

their rivals. These systems must manage huge flows of data from financial documents, newsfeeds, historical investment patterns, and public records, and then extract the patterns that drive unique insights to bolster exposure and performance models. In addition, robotic cognitive intelligence and machine learning capabilities are critical enhancements that could facilitate high-quality decision making.

Advanced data systems can also help in client relations and acquisition, providing real-time information and customized financial products to investors. With these tools, asset managers can attract clients interested in infrastructure investments by educating them about the risks and the potential of individual programs. Unfortunately, many asset management firms are not ready to put up the resources required for new big data strategies. They have yet to fully comprehend the essential value of distinctive data in furthering long-term asset management strategies.

Although asset managers have still not enthusiastically embraced infrastructure investments, much of their reticence has to do with a lack of familiarity with these instruments. But events will no doubt eliminate this shortcoming. Indeed, one thing is clear: Governments in rich and poor countries alike are loath to finance infrastructure improvements alone anymore; they lack the political will and financial wherewithal to do so. Public–private or solely private infrastructure projects will thus be the norm for the foreseeable future. This trend should translate into more attractive and reliable returns for private investors, as each regional improvement builds momentum toward overall local economic gains that result from predictable economic development. For asset managers, this presents a stunning opportunity that only the wariest would ignore. +

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DIAGNOSING DISLOCATION

DON'T ASSUME *the new entrant in your market is a disruption. Learn to recognize different types of threats and design the best strategic response.*

by Alexander Kandybin

Imagine that you run a large company, prominent in its industry, with a loyal customer base and strong profit margins. Suddenly, a new product comes along that threatens your existence. It could be a technological development that will render your main product obsolete, just as streaming video is doing to cable television. It could be a more user-friendly way to obtain a similar product or service: Think of the sharing economy versus the traditional hospitality industry. Or it could be a creative new approach to existing offerings, such as the use of mini-clinics and telemedicine services instead of conventional physicians' groups and hospitals.

Illustration by Ryan Peltier

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As the incumbent being threatened, you want to preserve your business and compete effectively. You quickly confront challenging questions: Should you rapidly emulate what the new entrant is doing? Or would it be better to double down on your existing products and services? All too often, when deciding how to respond, companies assume that they are facing a disruption — following the term coined by Harvard Business School professor Clayton M. Christensen. He defined a disruption as an innovation that allows upstarts to build a new market from the bottom up by initially offering simpler, cheaper products and services, often with fewer features or reduced capabilities, but also with a much lower price that appeals to a customer group the incumbents have ignored.

But new products and services can enter your market from other directions, each distinct in terms of how, where, and when it affects your business. These are *market dislocations* — radical breakaways from the existing market that occur when a company introduces a business model or a product that sits apart from those of competitors.

Some dislocations come from the top down: They expand the market by giving high-end customers prestige and luxury at a premium price at first. Then, as the new entrants gain prowess and reputation, they add middle-range alternatives that compete with incumbents. One recent example is Tesla's move from high-end electric sports cars to sedans with a US$35,000 list price. Elsewhere, as solar technology has become cheaper, renewables have begun to threaten traditional energy companies.

Still other dislocations, such as the trend toward home- and room-sharing through online rentals, threaten incumbents from the side. Here, there may be no significant price difference. But the upstart provides accessibility and features that incumbents cannot offer or have chosen not to offer.

Then, of course, there are bottom-up dislocations, or disruptions. In these cases, as the new entrants gain market share and proficiency, they add features and versatility. This combination of lower prices and innovation ultimately allows them to replace the old market leaders entirely. For example, as Christensen recounted in *The Innovator's Dilemma* (Harvard Business School Press, 1997), the first hydraulic earth movers, in the 1950s, were too small and imprecise for the industry's typical customers: large construction firms that dug sewers and mines with expensive cable-based heavy equipment. The hydraulic upstarts (companies such as Caterpillar, Deere & Company, and Komatsu) sold instead to an emerging market — house builders. Gradually, they improved their equipment and expanded their customer base. Similar dynamics have been observed in personal computers, disk drives, steel, entertainment retailing (bookstores, video stores, and record stores), home furnishings (for example, from IKEA), digital photography, and many other industries.

Clearly, not all upstart threats are alike — and misdiagnosing your new competition can lead you to respond in a way that can bring further harm to your business. Incumbents often move early into new technologies, even if it means undermining or cannibalizing their existing businesses. Sometimes that's the right thing to do. But other times it can backfire in devastating ways. Instead of acting rashly, incumbents should take a step back, determine what type of dislocation they are facing, and respond with the appropriate tools and strategies. Not doing so can lead to lost customers and slipping profits — or worse.

Anatomy of the Threat

The key to understanding any upstart threat is to study the way its innovations alter the marketplace. This can be boiled down to the curves shown in Exhibit 1: product/service price versus functionality. The blue curve represents industry incumbents, which have a range of potential price-versus-functionality variations that they profitably offer. They can't put forward all possible variations — they can't

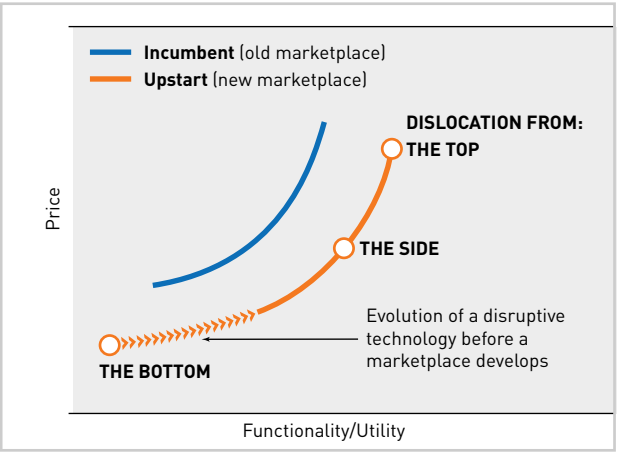
fill in the entire curve. But everything the incumbents offer will fall somewhere on that blue curve, because that's where the constraints of the incumbents' technology and capabilities will place all its products.

The orange curve represents the new technological frontier. Each startup that changes the market enters with its own point on this curve. And every combination of price and functionality will expand the market in some way, drawing in customers. The challenge for the incumbent is to identify where the upstart is breaking in. Is it capturing previously overlooked or underserved customers at the bottom of the market, with lower price and less functionality? Is it capturing customers at the top, with highly valuable offerings that few can afford? Or is it coming in from the side, luring some of the incumbent's existing customers with extra accessibility or features at similar prices?

Thus, for example, in a typical city, the blue curve could represent the transportation offerings of an existing taxi service or mass-transit agency. New offerings by an Internet-managed ride-sharing service, such as Uber, Lyft, Sidecar, or Haxi, might come in at the bottom, with lower-cost ride-sharing and carpooling apps; they might come in at the top, with premium services as comfortable as limos; or they might come in from the side, offering convenience in hailing, scheduling, and paying for vehicles. Sooner or later, they might migrate to offer all three levels, thus pressuring the existing taxi and mass transit providers to adapt or fail.

Exhibit 1: **Market Dislocation**

The two curves show the price–functionality, or price–utility, trade-offs for an incumbent's existing line of products (blue) and a new entrant's potential threat (orange). Dislocations at various points along the orange curve will capture different segments of customers.



Source: Strategy& research

No matter where they enter, dislocations do not simply extend the existing market. Rather, they establish a radically new position with respect to price and functionality. Whereas price is defined purely by the market, functionality is a matter of customer perception. Of course, different customers prefer different options. Purchasers of all-electric cars, for example, have about a dozen manufacturers to choose from, and customers have their own reasons for preferring one over the others.

Similarly, solar power may be highly prized by some customers, and not at all important to others. Therefore, functionality will always be partly subjective.

New entrants develop their sustainable competitive functionality in several different ways. For example, technological advances often lead to upstart products with superior functionality. Customers defect en masse to the products they perceive as having greater value. The smartphone gained its enormous market share in this fashion. In other instances, the dislocation benefits from being hard to copy. Strong practical, legal, financial, or other barriers make a response difficult. The apparel company Inditex (known for its brand Zara) achieved success this way. Its seamless integration between manufacturing and sales is very difficult for others to emulate, and makes it possible to change clothing designs quickly, without resorting to money-losing markdowns or inventory gluts. At other times, customer frustration or dissatisfaction with existing products or services, whether widely recognized or not, increases the demand for alternatives. Ride-share services have thrived, in part, because customers find existing taxi services problematic. Finally, social considerations can drive adoption. These considerations may be rooted in regulations or cultural influence, but they help upstarts with products and services perceived (for example) to help the environment or improve people's health.

As an incumbent, you need to find a strategy that will improve your functionality and price-competitiveness compared with those of the new entrants. You can do this in several ways. Your choice should depend in part on your own capabilities and in part on what type of upstart threat you face. In a recent in-depth analysis of six industries currently undergoing dislocation, which included more than two dozen interviews with executives, industry analysts, innovation experts, and entrepreneurs, we studied the characteristics of each type of dislocation and its growth phases; most important, we also studied how companies can recognize and respond correctly to each threat before it eats away at their core business. *(Editor's note: Except where noted, the case studies cited are based on PwC's internal research and represent the author's opinions, rather than the views of the companies mentioned.)*

The research revealed four strategies that companies can adopt in the face of dislocation. Two of them, matching the threat and absorbing the threat, can

WHEN A DISLOCATION STARTS AT THE MID-MARKET OR HIGHER, THE INCUMBENT MUST CHANGE ITS CORE PRODUCT LINE TO STAY COMPETITIVE.

be effective when incumbents are facing new entrants coming from any direction (from the top, side, or bottom). A third, leapfrogging the threat, is most effective in dealing with dislocation from the top and from the side. And finally, the strategy of ignoring the innovation is most commonly associated with disruption from the bottom. Each strategy has risks, especially when it is used at the wrong moment or against the wrong threat. But when you understand where the threat is coming from and how it is changing your market, you can choose a strategic response that is likely to sustain your business.

Strategy 1: Match the Threat

The first strategy involves improving your existing offerings to keep your existing customers, and expanding the market. This is the most obvious response to dislocation and can be effective in confronting threats from all directions. Taxi companies, for example, seek to match the threat posed by ride-sharing companies when they create their own ride-sharing apps and "frequent rider" cards, which they market by reminding passengers that taxis don't have surge pricing.

Of course, company leaders often resist the idea of launching an inferior, lower-priced product to match a newcomer that isn't yet competing for its primary customers. Yet the strategy can work in a bottom-up scenario. The incumbent needs to create a product or service line distinct from its core line, often as part of a separate division, and have that new product line compete with the core one. Basically, these companies cannibalize themselves before the new entrant can.

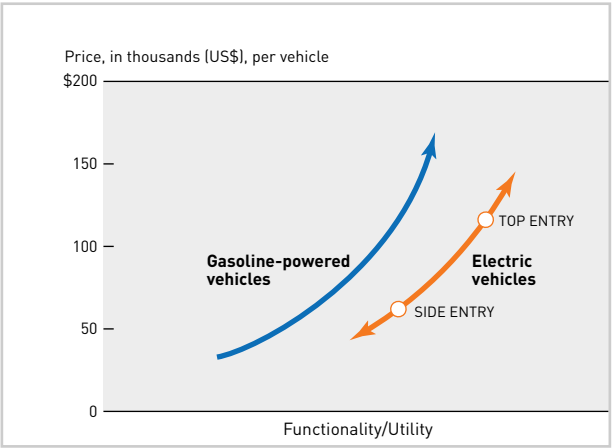
Consider HP's moves to create a separate division for inkjet printers, allowing it to compete with the company's established and highly profitable laser printer business.

When a dislocation starts at the mid-market or higher, however, the incumbent must change its core product line to stay competitive. The automobile industry, for example, faces a dislocation from electric vehicles (*see Exhibit 2*). Since 2009, according to the fuel efficiency research firm Baum & Associates in West Bloomfield, Mich., 2.7 million gas–electric hybrids, 217,000 plug-in hybrids, and 240,000 all-electric cars have been sold in the United States. Although this represents only a small portion of overall sales, shifts in federal and state policies are pushing electric vehicles into mass production. California will require carmakers to show that zero-emission vehicles (ZEVs) account for 15.4 percent of their sales within the state by 2026.

The regulatory pressure on carmakers is reinforced by social sentiments among early adopters, who typically want to increase their fuel efficiency in a way that helps the environment and reduces dependency on offshore oil supplies. These trends are expected to translate into 800,000 ZEVs sold annually by 2025 in the Golden State and in 10 other U.S. markets that are following its lead. This dislocation is essentially a story of electric car buyers spending more than they would spend on an equivalent gas-powered vehicle. The high price point of Tesla's original offerings, for example, has given other automakers time to develop a response.

Exhibit 2: **Automobiles**

Electric cars dislocated the automotive market from the top, but also at a more reasonable mid-market price point.



Source: Baum & Associates, Strategy& research

To be sure, when Tesla started taking orders for its Model 3 in 2016, with an announced price of $35,000, the company received more than a quarter-million $1,000 deposits in the first weekend. Tesla's market value is now approaching that of General Motors. But it is hardly alone in the field. Nissan, Honda, Kia, Fiat, Chevrolet, BMW, and Smart are among companies offering electric cars in all price ranges.

VIDEO FEATURE

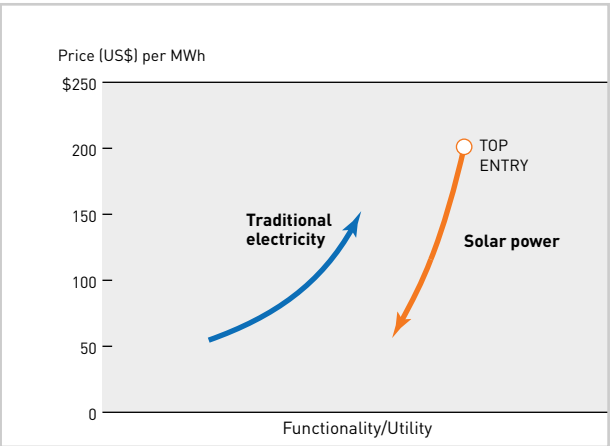
Threatened by Dislocation

Not every new entrant in your market is a disruption. Learn how to diagnose and respond to threats.

Another example of matching is the power utility industry facing solar energy. As battery and solar panel technology come down in price, it becomes worthwhile for many customers to install photovoltaic panels, which they often see as either home improvements, ways to survive during power outages, or gestures with environmental impact. By 2016, 784,000 homes and businesses in the U.S. had solar panels in place; solar and wind energy provided a combined 5.3 percent of the electricity generated in the U.S. in 2015, up from only 2 percent in 2008, according to the U.S. Energy Information Administration. The trend appears to be accelerating (*see Exhibit 3*). "The integration of renewables, the reduction of reliance on coal, and those sorts of things are changing our industry dramatically," said Ron DeGregorio, president of Exelon Power.

Exhibit 3: **Electric Power**

Solar power is becoming increasingly affordable and accessible to consumers.



Source: Lazard, Strategy & research

Finally, matching is happening as the healthcare industry faces dislocation from the bottom up — people are seeking convenience and price breaks. Since the early 2000s, new clinics have appeared by the thousands to serve patients. They include basic consultation services in retail stores such as Walmart, Walgreens, and CVS; walk-in urgent care centers that offer a cheaper and more convenient alternative to a hospital emergency room;

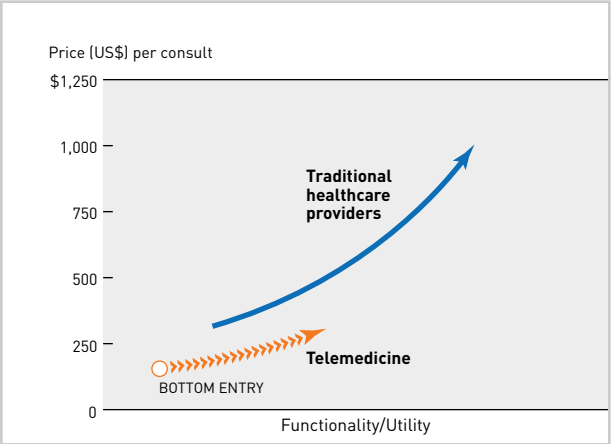
and virtual medical groups that provide online consultations with doctors for as little as $40 (*see Exhibit 4*). The last are particularly popular with working mothers; for example, the online service Doctor on Demand claims that nearly 70 percent of its customers are women and more than half of them have school-age kids. Having a sick child used to mean a trip to the doctor, making the child's mother late for work. "Now she fires up the iPad [and] types in the symptoms, and within a few minutes she's chatting with one of our family practice doctors or pediatricians," said Adam Jackson, CEO and cofounder of Doctor on Demand. "Ten minutes later, if appropriate, we've sent a prescription to her local pharmacy."

Doctor on Demand is an upstart, but so is retail giant Walmart in this case. Half of its 4,600 in-store health assessment kiosks (from Pursuant Health) average 50 to 60 risk assessments each on a typical day. "Within a few years, we will do more health risk assessments than the entire existing health system," predicted Marcus Osborne, Walmart's vice president of health and wellness transformation.

The incumbents are large hospital groups, established healthcare providers, and payors. Many of them welcome dislocation; it takes pressure off their emergency rooms and other beleaguered facilities. Some incumbents are creating collaborative partnerships in order to match new offerings. They are eagerly working with smaller innovative healthcare providers to cut costs, widen profit margins on core services, and improve patient service with referrals to local clinics. Through these efforts, incumbents are developing some upstart-like attitudes of their own.

Exhibit 4: **Healthcare**

Telemedicine is disrupting traditional healthcare with affordable virtual options for everyday care. The market for these services will likely take shape over the next five to 10 years.



Source: Strategy& research

In the past, said Walmart's Osborne, "consumers have been characterized as not able to manage their own care. [New] solutions and technologies are completely changing that." These solutions, he added, "basically assume that the consumer actually is very intelli-

gent, very rational, and will do the right things if you give them the right tools at the right place at the right time to engage their care." As this perspective takes hold in incumbent hospitals, it makes them more nimble and effective as well.

Strategy 2: Absorb the Threat

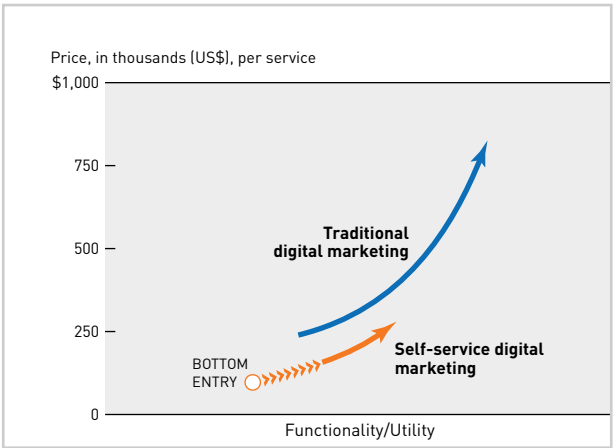
With dislocation, one effective response is to bring the upstart into your own system — through M&A or venture capital funds that invest in upstarts directly. The absorption strategy can work for dislocations that come from any direction. But it mandates a high level of skill in all cases: Deal making requires post-merger integration capabilities, partnerships require ongoing and often arduous collaboration, and venture capital requires investment acumen. When making an acquisition, the incumbent must enhance the new business and create conditions for its success. Acquiring a company with an objective to kill the threat is a waste of money, and serves only to invite more upstarts to enter.

Facebook has deftly managed absorption through M&A — perhaps because it was an upstart itself not so long ago. The company drew some Monday-morning quarterbacking in 2014 when it paid a jaw-dropping $19 billion for WhatsApp. But the upstart messaging platform had already attracted more than 400 million monthly users, including many Gen Z customers who preferred messaging over writing Facebook-like posts. The bet has paid off; Facebook's share price has nearly doubled, and the number of WhatsApp users has grown steadily since the deal was signed.

You can find absorption in the digital marketing industry (*see Exhibit 5*). Here, disruption is happening, with the dislocation appearing at the bottom. Upstarts with data-rich analytic software can scour thousands of attributes about potential customers and send them exactly the right offer at the perfect time over the best channel. This has dramatically altered the price and quality of marketing efforts,

Exhibit 5: **Digital Marketing**

Digital marketing upstarts are offering inexpensive, but increasingly sophisticated, services. After entering at the bottom of the market, they are now competing with some traditional firms.



Source: Strategy& research

ACQUIRING A COMPANY WITH AN OBJECTIVE TO KILL THE THREAT IS A WASTE OF MONEY, AND SERVES ONLY TO INVITE MORE UPSTARTS TO ENTER.

triggering a highly complex dislocation involving thousands of new companies.

Scott Brinker, an industry analyst who is also CTO and cofounder of Ion Interactive, began tracking this area in 2011, when there were about 100 vendors involved in digital marketing and the technologies that support it, including mobile app development tools and marketing databases. Based on his original criteria, he now estimates there are about 4,000 upstart companies, ranging from tiny startups to giant global software companies. That's about a 40-fold increase in around five years.

Venture capital firms have been involved in many of these marketing-firm absorptions. An example is Signpost, which targets small businesses, a segment of the market typically ignored by larger players. There are tens of millions of small businesses — mostly mom-and-pop retail shops — that could use marketing automation to attract and retain new customers. But they aren't interested in costly enterprise-level technologies. Signpost has built its business with this bottom-of-the-market group. For just over $200 a month, the company collects phone numbers, email addresses, and point-of-sale data from local customers, then uses that database to gather feedback, generate reviews, drive social media awareness, and encourage return customers through offers and promotions. Signpost can keep the price low because it provides one automated service to all its customers. "We're in the automation box, and Salesforce is in the do-it-yourself box," explained Brad Kime, senior vice president of business development. Signpost has attracted $35.6 million in venture funds in its quest to democratize the digital marketing revolution.

The continuing opportunities to compete in the new market thrill entrepreneurs such as Adam Marchick, chairman of Kahuna. The mobile marketing automation company started in 2012 with a relatively humble $300,000 investment from SoftTech VC. A former venture capitalist himself, Marchick said he thinks Kahuna could make acquisitions of its own to better compete with Salesforce and other giant enterprise software companies. In 2015, Kahuna recruited Fayyaz Younas, a vice president of engineering who was leading Salesforce's analytics initiative. "I've seen what it takes to build a billion-dollar company and I've learned a ton," Younas said in a *Wall Street Journal* article at the time. "I see that in Kahuna."

Some incumbent software companies have augmented their internal innovation by acquiring "best-of-breed" startups. Salesforce.com, for example, acquired the upstart digital marketing firm ExactTarget for $2.5 billion in 2013 as the heart of a $4 billion acquisition spree. Salesforce has also invested in well over 100 startups through its corporate venture fund, which often leads to integration into its cloud. Salesforce's Marketing Cloud CEO Scott McCorkle, who joined the company as part of the ExactTarget acquisition, notes that digital marketing lends itself to mass experimentation. "I think you're just seeing an explosion of innovation around that," he said, stressing that Salesforce also has a strong internal culture of innovation. "I have never seen a company so driven to reinvent itself."

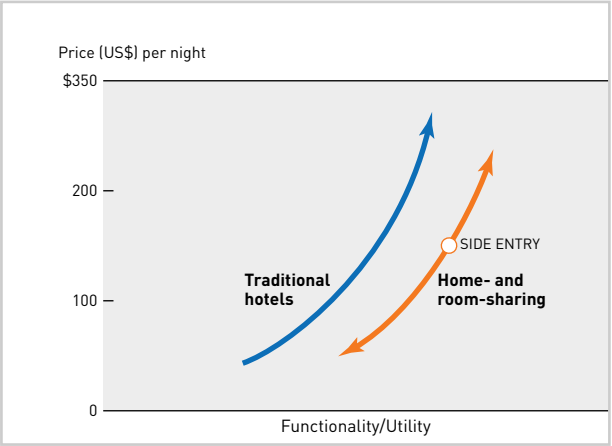
Strategy 3: Leapfrog the Threat

To leapfrog is to expand your offerings, enabling you to protect your core business while providing something better than your new competitors can. To accomplish this, you develop a strategy and invest in innovation that results in a major shift in your own business. The goal is to offer higher-quality and more desirable products or services, ideally at a somewhat lower cost, and thus to move rapidly past your threatening competitors. Consider the trajectory of the smartphone, as the iPhone and Android models have wrestled for dominance, or the moves by some carmakers to design connected vehicles to stay ahead of potential competitors from outside the traditional auto industry. Incumbents need to build the capabilities that can sustain their new identity, because the new business might well become their main source of revenue.

The leapfrogging strategy works best when the threat comes from the side or from above. It is hard to leapfrog a disruptor that has a much lower cost proposition and pursues the least profitable customers. But customers who are defecting because of features you lack may well be interested in what you can offer to draw them back. For example, consider the struggle between home- and room-sharing companies such as Airbnb, HomeAway, FlipKey, and HouseTrip, and conventional hotels. The rapid ascent of shared-lodging services has dramatically affected the global hospitality industry and may become even more of a factor. For example, Airbnb has an inventory of more than 2 million rooms globally, whereas each of the eight largest hotel chains in the U.S. has, on average, 500,000 rooms.

Exhibit 6: **Travel Accommodation**

By offering a greater variety of lodgings at competitive prices, sharing companies appeal to traditional hotel industry consumers.



Source: Priceonomics.com, CBRE Hotels, Strategy& research

Shared-lodging services are often described as a disruption, competing from the bottom. But they are more accurately a dislocation from the side, competing effectively at all price levels (*see Exhibit 6*). Data from Priceonomics, using Airbnb as the example, shows average rates in its 10 priciest cities ranging from $130 to $185 per night, which is below the average range of $180 to $245 for hotels. However, data can be misleading. A

CUSTOMERS WHO ARE DEFECTING BECAUSE OF FEATURES YOU LACK MAY WELL BE INTERESTED IN WHAT YOU CAN OFFER TO DRAW THEM BACK.

CBRE Hotels study that included 59 cities and 229 submarkets found the average rate paid for an Airbnb unit was $148 compared to $119 for hotels. Furthermore, both hotels and Airbnb offer options at a below-average cost; we found basic rooms for both starting under $50 that appeal to travelers on a tight budget.

Shared-lodging service providers offer several functional differences as distinct advantages over hotels. These may include a simple mobile app, comfort-of-home accommodations, and the personal attention of a local host (the property owner). "They've taken a process that was a social process — getting to know people and trust them — and transformed it into a weightless and massless Internet process that can grow," said Andy Lippman, associate director of the MIT Media Lab.

Both social factors and technology have bolstered the lodging industry. For instance, Airbnb's low-overhead business model is hard to match for traditional hotels; it has few employees, no construction costs, and no furnishings. Those are provided by the property owner, while the company collects a fee for the referral. The company's mobile app enables guests to choose a room by price, location, and features, and also to gain detailed information about the hosts.

Given the vastness of the hospitality industry — it accounts for close to 10 percent of worldwide GDP — there has been little measurable reaction to the dislocation caused by new lodging service providers. And, to be sure, the shared-lodging industry faces its own risks as governments add taxes and regulations that bog down the sharing economy model. Still, hotels cannot ignore the threat

of sharing services much longer, particularly if luxury and business travelers, the core customers of the hotel trade, join in.

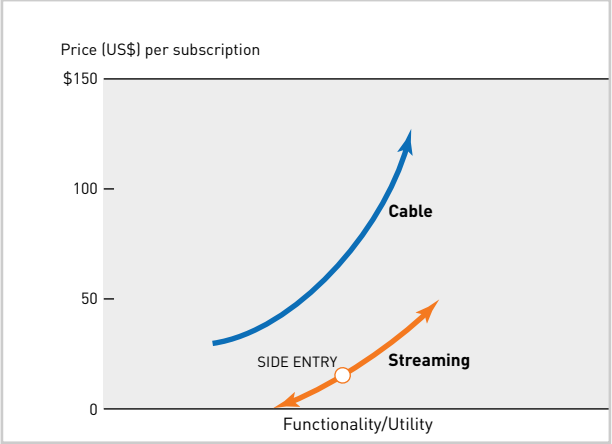
The solution is for major hotel chains to develop models that would leapfrog lodging service providers, by creating branded networks of private rentals as an option for core customers. Customers might still stay in private homes, but they would have access to branded amenities such as delivered breakfasts, gifts, or inclusion in frequent-traveler programs. This blend of new and old, coupled with updated apps, could offer traditional customers a broader range of options. It would also leverage some of the cost-effective advantages that lodging providers hold now, such as reducing the need to build and maintain facilities.

Traditional cable is another industry for which leapfrogging can be a powerful strategy. Cable television providers face a mounting threat from over-the-top video streaming providers. Streaming offers convenience, and is often lower in cost because viewers can either watch free programs or subscribe to specific services such as Netflix, Amazon Prime, or Hulu for less than $10 a month — much less than the typical cable subscription (*see Exhibit 7*). (Of course, many consumers end up subscribing to multiple streaming services, and the costs add up.) Although most consumers have traditional subscriptions, millions are "cord shavers" who now opt for low-cost basic cable while streaming premium shows on their own schedule. This dislocation is changing the financial outlook for networks and cable providers, and affecting the way people watch TV.

Incumbents are feeling the pressure acutely, as conversations with industry analysts have revealed. But will cable go the way of video rental stores? Hardly. The answer for traditional cable providers may be to leapfrog their upstart competitors by rethinking their business model. As reported in PwC's Videoquake 3.0 study, some incumbents have begun experimenting with "skinny bundles" — allowing consumers the option to

Exhibit 7: **Video Entertainment**

Streaming video providers offer consumers convenient and affordable alternatives to cable, as well as popular original content.



Source: Strategy& research

customize the specific channels they want, rather than having to purchase a package of hundreds of channels (many of which they will never watch). That trend, combined with providers' ability to enable consumers to access programming from any device, both at home and on the go, gives incumbents an edge. They can provide consumers with the ideal viewing experience: the broadband access they need, the channels they prefer, the flexibility they want. It will require incumbents to think differently about how they provide and sell services, but if they do so successfully, they could keep their customers and attract new ones — for example, millennials who might never have subscribed to traditional cable.

Strategy 4: Ignore the Threat

Although some bottom-up disruptions capture the entire market and can drive incumbents out of business, many other disruptions can capture only a portion of the market — leaving a significant share for incumbents. In these latter situations, companies must decide whether to react to the upstart using the match or absorb strategies, or to ignore the upstart.

However, *ignore* in this case does not mean *do nothing*. Incumbents may not need to respond to the disruption by trying to re-create or improve on it themselves. It may make more sense for them to pay greater attention to their core customers in order to maximize their portion of the market. For instance, consider Southwest Airlines, which was clearly a disruptive market entry. Some airlines decided to fight Southwest by launching low-cost airlines as separate subsidiaries. In most cases, that response was unsuccessful. Examples include Delta's Song and United's Ted, both of which operated for just a few years before being shuttered.

Many other incumbent airlines instead focused on improving their services and making them more efficient for their core customers. Today, we see a niche of budget airlines led by Southwest, but also many full-price airlines that survived and emerged as stronger players. Those incumbents who took no action at all — not even improving their core business — fell victim to the consolidation that has swept the airline industry in recent years.

The healthcare industry, discussed earlier as an example of the matching

MANY DISRUPTIONS CAN CAPTURE ONLY A PORTION OF THE MARKET — LEAVING A SIGNIFICANT SHARE FOR INCUMBENTS.

strategy, may also benefit from using the ignore strategy. Should providers (hospitals) directly respond to new entrants, and fight for price-sensitive patients who can potentially migrate? Or should they ignore them and concentrate on making services better for their core customers? The answer may not be clear for several years to come.

Sometimes, multiple dislocations occur at once, and thus the question becomes: Which dislocations require an action and which don't? A good example was when Betamax (Sony) and VHS (JVC) were dislocating the television programming market in the late 1970s and early 1980s. Incumbents first tried to prevent the new technology, claiming that recording infringed upon the programming ownership rights. But the time came when they had to select which format to respond to. It was not an obvious choice, given that Betamax had superior picture quality. Eventually, VHS gained small business advantages that led to its victory: JVC's early video players were cheaper, and one of its tapes could hold an entire movie (Betamax could only hold one hour of video). Both business and technology foresight are essential for making the right bet.

Of course, many industries offer examples of prominent companies whose failure was associated with ignoring their upstart rivals too long; among them are Kodak in photography, Smith-Corona in typewriters, and Nokia and Research in Motion in mobile devices. Ignoring a threat is risky. But responding to the threat is also risky, especially when the response involves a major up-front investment or a cannibalization of existing sales.

The secret to ignoring a disruption is thus not to ignore it at all. Every company needs to determine the appropriate balance between waiting and responding. If and when the time comes to respond, you should be prepared with an appropriate strategy. And in the meantime, you have an opportunity to respond through incremental innovation, particularly in your operations. If you can lower your own costs and expand the perceived functionality of your products and services, bit by bit, you will make things harder for upstarts.

The easiest way to ignore them is by having a platform where the switching costs are difficult. Microsoft, Google, and Facebook have been able to ignore many potential threats because their customers are virtually locked into their systems. To change, core users would have to transfer their systems and rework their practices.

Making Your Diagnosis

Companies facing a serious threat to their market often first respond by trying to ban the innovation. Powerful incumbents may lobby government and regulatory agencies, or use economic and social arguments to slow or hinder the innovation in some way so that it becomes less economically viable. Yet such knee-jerk reactions are rarely successful in the long run, and they can slow progress and industry evolution.

Instead, incumbents need to recognize the distinctions among the various types of dislocations they may face. Disruptors typically first go after nonusers or the least profitable low-end customers. Only later do the disruptors start cap-

turing an incumbent's core customers. In response to disruption, the incumbent should create an offering or business that is separate from its core product offering. You don't want to change your core business and risk losing existing profitable customers while competing (initially) for low-end customers and nonusers. You can make your move through matching or through absorption. Of course, on those occasions when your market assessment reveals major flaws in the new technologies being offered, consider whether you should ride it out, rather than jumping into competition too hastily.

New entrants coming from the side or from the top, meanwhile, go after an incumbent's core customers right away — thus presenting a more immediate threat. In these cases, the incumbent *should* change its core product offering. This can again be accomplished through matching, and also through leapfrogging, both of which enable the incumbent to pursue new customers while keeping the existing profitable customer base intact.

The choices are never easy, but with a complete framework for analyzing new entrants, you, as an incumbent, can feel confident that your response is appropriate for the threat at hand. Market dislocations can come from anywhere, and knowing that is half the battle. ✚

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Resources

Brian D. Carey and Michael A. Herman, "2016 Utilities Industry Trends: Power Companies Cannot Afford to Ignore Energy Storage," Strategy&, 2016: A look at the challenges and opportunities facing energy industry incumbents.

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Chris Lederer and Megan Brownlow, "A World of Differences," *s+b* Special Report: PwC's Global Entertainment and Media Outlook 2016–20: The key trends shaping the entertainment and media industry, and how companies can identify pockets of growth.

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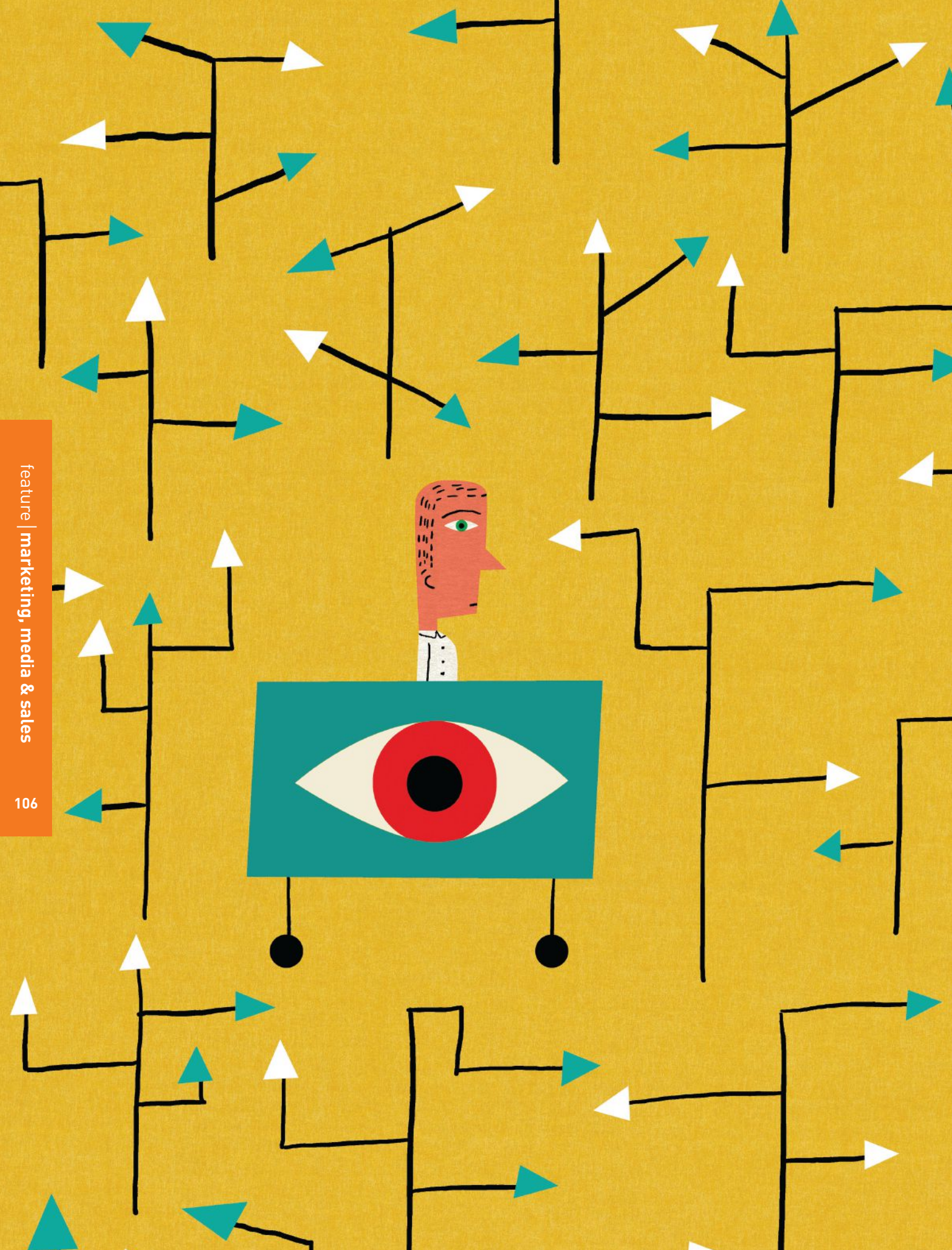

YOU'RE A MEDIA COMPANY. NOW WHAT?

Outlook 2016–20

Four strategies that work in this dynamic new world.

BY DEBORAH BOTHUN AND JOHN SVIOKLA

Sometime in the future, when Tesla, or Chinese automaker BYD, or Apple produces a digitally enhanced, connected, self-driving car, it could unlock as much as a billion hours per day of customer attention now devoted to watching the road. Instead of checking the speedometer and the rearview mirror, passengers could be watching videos, playing games, reading blogs, or shopping. And it's unclear whether this new commercial real estate will be owned by automakers, retailers, entertainment studios, or wireless providers.

The possibility that the car will emerge as the next great media platform is but one example of how digitization and the resulting shifts in user behavior are eroding the once-solid borders defining industries and sectors. In a variety of industries, an eclectic mix of new players is importing new capabilities, and competitors armed with new business models are on the attack. In PwC's 2015 Global CEO Survey, 58 percent of 2,200 CEOs said they were concerned about being disrupted by new market entrants.

Illustration by James Yang

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Nowhere are these porous and evolving borders more evident than in the entertainment and media (E&M) industry. The past 20 years have brought a wave of disruptions to distribution, formats, technologies, and consumption patterns. As a result, in many of the 156 countries in which PwC operates, companies — not just E&M companies — are investing in content and direct customer media relationships.

There has always been an intimate and complex relationship among consumer and industrial companies, on the one hand, and E&M on the other. The 1950s-era daytime serials were known as "soap operas" because they were sponsored by the companies that made soap. In 1940, at the dawn of the radio era, listeners tuned in to the Texaco Metropolitan Opera broadcasts. *The Wonderful World of Disney*, the television show that debuted in 1969, integrated media, experience, entertainment, and merchandising. Hello Kitty was born in Japan in 1975 as a way to cute-ify merchandise, and then developed into television series, comics, and video games. Still, through the 20th century, most brands relied on the creativity and expertise of the media, advertising, and entertainment companies to create content and deliver audiences.

In the 21st century, however, as consumers have been gradually shifting away from traditional forms of media content and distribution, the media universe has become both more fragmented and more digital. Consumers can choose from seemingly limitless content, on their own terms and on their own devices. In parallel, new platforms and technologies have arisen that can connect marketers in all industries more directly with users and customers, through

websites, blogs, apps, and social media. Meanwhile, the battle for the consumer's attention has become brutal, and requires new strategies and capabilities. Companies have recognized these developments and are reaching the same conclusion: We all have to be in the media business.

The evidence is ubiquitous. Nike has become a major presence in social media, digital video, mobile apps, and e-commerce — witness the company's recently launched YouTube miniseries focusing on a fitness bet between two sisters. ANZ Bank, one of Australia's largest financial institutions, has built a finance news portal, BlueNotes, which is staffed by well-known business journalists. Marriott has created a content studio, supported by Hollywood talent, to develop videos for distribution in social media and elsewhere, all with the business objective of increasing the hotel brand's appeal to millennials. FairPrice, a Singapore-based supermarket, maintains the highly popular food content platform *Food for Life*, which hosts 2,000 video assets in a range of languages. And the list goes on.

Empowered by digitization, compelled by competitive pressures, enabled by data, and eager to connect directly with customers, companies are now expanding their marketing playbooks to include more E&M-like capabilities. In so doing, they have forged new segments in the entertainment and media industry — especially in advertising. Native advertising, or content marketing, became a US$10.7 billion business in 2015, up 35 percent from the previous year, according to BI Intelligence. Given this simultaneous redefinition of what it means to be a media company and the rekindled investment by many, many companies in new content and in direct audience relationships, it's not too much of a stretch to say every company is a media company — or will be one soon.

But whether they are dabbling, experimenting, or going all in, companies need to proceed carefully. The media ecosystem includes many different kinds of companies: creators, packagers, distributors, service providers, and aggregators. Companies must grasp how they fit in best. They must have clarity about the type of media company they aim to be, understand who they need to hire, and discern how to design and execute high-quality offerings that meet their business requirements. To a degree, such efforts represent a strategic challenge to traditional entertainment and media players. But these developments also represent an op-

portunity, especially if the incumbents can reposition their capabilities to thrive in a remixed entertainment and media landscape where those that excel at capturing user attention with a digital-first approach will be those that reign supreme.

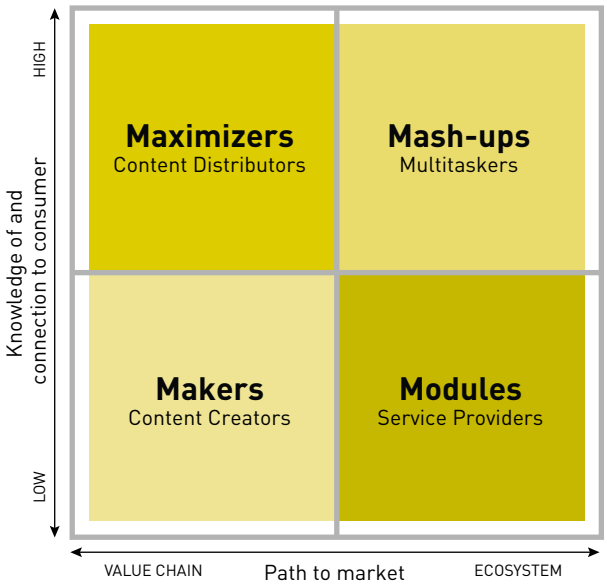
Pick a Way to Play

Our insight suggests that companies need to choose a clear "way to play" based on two dimensions: the level of direct insight and data that companies have about their customers and users, and whether their products and services are sold in a linear and structured value chain or in a more circular and fluid ecosystem. MIT Sloan research scientist Peter Weill and Stephanie L. Woerner first articulated this two-variable method of characterizing digital strategy in a June 2015 *Sloan Management Review* article, "Thriving in an Increasingly Digital Ecosystem." Our structure applies Weill and Woerner's basics to the specifics of media. The four main options for media companies are Maker, Maximizer, Module, and Mash-up (*see exhibit*).

In the lower left quadrant are **Makers**. These companies are content creators that may not have a direct relationship with the target consumer. They focus on creating distinctive, compelling intellectual property and then selling it to other distributors and aggregators. Examples of Makers include film and TV studios, music labels, book and video game publishers, and creative agencies, as well as actual creators and artists themselves. Increasingly, the best Makers excel at creating content experiences across a wider variety of formats, knowing how and where to connect with fans at the ideal point of consumption. Maker strategies deliver paying audiences for traditional media companies and help define the brand of, and deepen customer engagement for, non-media companies.

Exhibit: **Media Models**

Four ways to play in the evolving media industry.



Source: Adapted from Peter Weill and Stephanie L. Woerner, "Thriving in an Increasingly Digital Ecosystem," *Sloan Management Review*, June 16, 2015

Lionsgate, the fast-growing, independent filmed entertainment studio behind the *Hunger Games, Twilight,* and *Divergent* film franchises, is the classic definition of a Maker. Lionsgate has excelled at making films and TV shows with huge audience demand, such as *Mad Men,* and then forging new distribution agreements with subscription streaming providers such as Netflix (e.g., *Orange Is the New Black,* which Lionsgate produced). More recently, Lionsgate has announced a series of new initiatives that target the over-the-top video space, partnering with comedian Kevin Hart as well as with such entities as Comic-Con International.

Non-media companies are also acting as Makers. To reach millennials, Kraft Foods has developed a vast inventory of recipes and sophisticated instructional videos available on its website and YouTube channel. In India, Dewars created a television series, *The Dewarists*. Part music documentary and part travelogue, it ran for three seasons on MTV India. Lego, the Danish toy company, has realized that more content creates more engaged fans — and more engaged fans drive more sales of Lego bricks. So over the past few years, it has increased its presence in entertainment and media in a variety of ways. Lego has linked its physical toys to the digital world through video games, including Minecraft; social media; and e-commerce. Following on the success of *The Lego Movie*, the company has developed multiple television series for boys and girls, including the *Lego Elves* fantasy stories, all of which were launched in conjunction with Lego brick sets, books, and other merchandise.

Maximizers, shown in the top left quadrant of the exhibit, enjoy a direct relationship with the customer while operating in a distribution environment characterized by their own curation and control. These players effectively own "the last mile," creating channel access to the customer as well as packaging, managing, and selling an assortment of products or services. Maximizer companies include cable, satellite, and mobile operators as well as theater chains and other entertainment venues. Digital-first Maximizers include Spotify, the music streaming service, and Google's YouTube. Inexpensive and extensive data on customers and the wide diffusion of complex consumer analysis models have made the Maximizer route easier for more firms to pursue. Because it is getting progressively cheaper to create and execute cross-platform efforts, Maximizers

can reap many of the same rewards that Makers receive — as well as being able to deliver more multi-touch campaigns and engagements.

Major retailer Target is a prominent example of a non-media Maximizer. Every day thousands of companies vie for positioning on Target's physical and digital shelves. Target understands its customers deeply enough to know how it can drive premiumization, preference, and differentiation by building distinctive assortments of merchandise and shopping experiences — in the store or online. That's why well-known Makers such as Marimekko, Lilly Pulitzer, and Missoni eagerly partner with the chain. Target has developed in-house media capabilities to balance brand demands with guest needs, whether it is engineering product placement through its owned Web and mobile assets; driving in-store sales promotions through its private television network, Channel Red; or connecting with guests in mobile through Cartwheel, a coupon mobile app, in conjunction with Facebook. Target teamed directly with Gwen Stefani, the music and style icon from NBC's *The Voice*, as part of its #MoreMusic campaign to create the video for Stefani's single "Make Me Like You," which debuted live on the 2016 Grammys and spread quickly across social media channels.

Modules reside in the lower right quadrant. Many modules are service providers that offer a specialized or technical set of plug-and-play products. These companies have little or no direct relationship with the end customer and exert less control over the environment in which their products or services are distributed. Modules in media can work with many industry sectors — music or television, print or games. And they often introduce new capabilities into the broader ecosystem. Major League Baseball Advanced Media is an example of a Module. It provides Major League Baseball with a wide range of digital services. The company builds and manages websites for the league and all its teams; manages cable and radio assets for teams; creates content advertising and traditional ad campaigns; and provides online ticketing, game streaming, fantasy games, and other digital assets. Oculus Rift, the virtual reality company purchased by Facebook for $2 billion in 2014, and audio technology company THX are other examples of Modules.

The first three ways to play have been present in the E&M business in different forms for many years. But the fourth strategic type has come to the fore only

THE MASH-UP BRINGS TOGETHER MULTIPLE PIECES FROM DIFFERENT SOURCES TO FORGE SOMETHING NEW THAT IS MORE VALUABLE AND COMPELLING THAN ITS SOURCES.

since the advent of the Internet as a robust business platform. **Mash-ups**, shown in the top right quadrant, are firms that have direct customer relationships while exerting a high level of control over the user experience, including the packaging of their own products and services alongside those of third parties. Dominant Mash-ups grow quickly and present both great opportunities and great threats for the other players. They have expertise in content, distribution, physical infrastructure, customer insight, and services. Functioning as a true Mash-up requires a company to have the status and authority to holistically broker partnerships, curate content, and orchestrate a compelling user experience. Like the eponymous art form in music, the Mash-up brings together multiple pieces from different sources to forge something new and distinctive that is in turn more valuable and compelling than its sources. Although many large entertainment and media companies may see themselves as Mash-ups, the reality is that true Mash-ups are rare.

Amazon is the archetype for an outsider Mash-up in E&M today. It started out in retail as a digital store for physical books, operating in an established value chain. In the years since, Amazon has expanded into music, filmed entertainment, and video games, and more broadly into many other categories, including consumer electronics, grocery, and fashion. As a Mash-up, Amazon now remixes multiple capabilities involving two core consumer experiences to drive monetization: shopping and media consumption. Amazon has built a connected portfolio of offerings that include devices (Amazon Kindle, Amazon Fire TV stick for streaming

COMPARATIVELY FEW COMPANIES HAVE MASTERED THE DUAL CAPABILITIES OF INNOVATION AND EXECUTION — AT SPEED OR AT SCALE.

video, and the popular Echo home assistant), content (Amazon Video, Amazon's own publishing imprints such as Kindle Worlds and Amazon Music), services (Amazon Prime, Amazon Fresh), and, most recently, voice interfaces such as Alexa, which is available on the Echo. With all these touch points, Amazon is able to know what a user is reading or listening to, what is on her shopping list, what size jeans she wears and the brand of cosmetics she prefers, which shows she watches on Amazon Prime, where she lives, and, of course, how she pays for it all.

The benefits of this Mash-up strategy for Amazon are numerous and powerful. Each new offering is designed to integrate easily with other Amazon products, and each offering encourages new shopping occasions on Amazon.com or additional product sales. As user activity scales and widens, Amazon generates more data and insights, which in turn drive deeper personalization of the user experience and more innovation in Amazon's own products. As the home itself becomes more interactive and interconnected, and as users buy products and services to support that trend, Amazon is in a position to be the essential partner for third parties (e.g., manufacturers, studios, application developers, other Internet of Things device players) that need access to consumers as well as the infrastructure (e.g., Amazon Web Services) to connect with them. Amazon's bold move to manage and control key aspects of the consumer's home has obvious strategic implications for every major player in entertainment, media, and technology.

Non-media companies can succeed in any of these four quadrants. But we have seen firms that are stuck in the middle — executing half a Maker or Maxi-

mizer strategy, with predictably poor results. Firms do need to "declare a major," and concentrate their capabilities agenda accordingly in terms of partnership management, innovation, and human capital/talent. Those that are confused about their placement in the quadrants will not execute their remix successfully.

Remixing Your Skills and Talent

Steve Jobs had it right. The key to success is "technology married with liberal arts, married with the humanities." Thus, the mix of talent should shift depending on which of the four Ms one is pursuing. PwC's recent book *Strategy That Works: How Winning Companies Close the Strategy-to-Execution Gap* (by Paul Leinwand and Cesare Mainardi, Harvard Business Review Press, 2016) shows that successful companies choose their way to play based on the capabilities they can develop that will distinguish them and win in the marketplace. The competition for professionals who can balance art with science, and creativity with efficiency, has never been more intense in the business of entertainment and media. Writers, designers, producers, user experience and social media experts, product managers, software engineers, deal makers, and others with special minds who have the ability to weave diverse elements into something new and compelling are in high demand.

What skills and talent does your firm need to succeed in a world of remixes? The talent focus will depend on which E&M quadrant your company chooses to occupy. For example, Makers need to put their emphasis squarely on creative talent: writers, designers, and editors who have a flair for storytelling that is increasingly video-centric, visually attractive, shorter, and shareable in mobile and social environments. In New Zealand, Contiki, which operates youth tours, has staffers curate the company's music channel on Guvera, a popular streaming service. In 2013, Marriott recruited a team of media veterans from companies such as Disney and CBS. The team produced short narrative videos set in major world travel destinations, and developed capabilities designed to follow world events, leverage social media influencers, and develop relevant campaigns quickly. Marriott has found that these efforts in original content are driving stronger engagement with its target consumers, which in turn is translating into more e-commerce revenue.

Maximizers need to maintain strong supplier relationships to build and sustain reliable, information-rich platforms and to orchestrate experiences that increasingly connect the physical with the digital and connect proprietary offerings with those of third parties. The talent mix should include people skilled in negotiating and maintaining partnerships with a broad variety of companies. Because the customer experience should be flawless, Maximizers will also need technologically skilled talent adept at building operational systems that effectively capture and analyze customer data. A competitive Maximizer has to know when the same customer has two homes, two landlines, three mobile devices, and multiple connectivity types (cable, Internet, mobile), and provide a compelling experience among them. Target, for example, has recognized that it needs new kinds of talent to make its in-store and digital shopping experiences more personalized, more localized, and more visually appealing. As a result, the retailer has prioritized merchandising and supply chain hires who can use data science to make smarter, more anticipatory decisions based on insights into customer behavior, purchase preferences, and location.

Modules need creative talent to develop products and services useful to a range of companies. But Modules also need to understand the value of their product, and must have the ability to broker deals in a way that optimizes revenue opportunities. Likewise, a Module's ability to plug its service into many different platforms requires deep understanding of technology infrastructure and business models. Many of the most successful Module companies, including Oculus Rift and THX, are fueled by deep engineering talent.

A Mash-up depends on the greatest variety of talent, reflecting the breadth and depth of capabilities that need to be woven together to be successful in this quadrant. On the front end, Mash-ups need customer insights and relationships. They thus need a deep pool of talent capable of acquiring and engaging users and integrating content and experiences from their own sources as well as from other Makers. Thoughtful product development and business model innovation are further required to enable Mash-ups to translate their user engagement into monetization. Behind the scenes, these companies need skills in the areas of business intelligence and analytics, as

well as behavioral science, so that insights into consumption can be fed rapidly into the next version of the experience, product, or service. Netflix provides a great example. The company's team has built a world-class streaming system, uses analytics in a sophisticated way to anticipate consumer interest, continually makes deals with studios, and hires A-list Hollywood talent to produce and direct original content.

Innovation and Execution

Whether your company is a Maker, a Maximizer, a Module, or a Mash-up, a focus on recruiting and retaining the "must have" talent needs to be matched with an urgency to innovate, and to make it possible to execute the strategy.

Because the digital world is so fluid, the design aspects of innovation have gained a high profile over the past five or 10 years, as design-led thinking and design-led strategy have become in-demand capabilities in many industries. In its simplest form, design thinking involves using the design process to solve in-house problems. For innovation, it starts by framing the user problem from the user's point of view and identifying the specific need that can be addressed; generating as many solutions as possible; and choosing and then prototyping those considered the most viable, desirable, and feasible. The innovation process focuses on testing and learning directly with the target user until product/market fit is achieved. Once that occurs, the object of the game is to scale the winning option as quickly as possible.

Buzzfeed is a good example in the news segment of the E&M industry of how a digital platform can be leveraged positively in the design and experimentation process. The company employs a handful of writers and editors who draft multiple headlines for a piece of content and then place those headlines on different social media platforms such as Facebook and YouTube. Proprietary technology and analytics allow editors to track how content spreads across the social Web, and let them assess quickly which content elements (headlines, listicles, GIFs, videos, etc.) attract the most users and on which platforms, and then update and adjust specific content elements on the basis of those insights. The seemingly minor adjustments can add up to big changes in audience, which gives Buzzfeed a capability advantage as it pitches its services to advertising clients.

Comparatively few companies have mastered the dual capabilities of innovation and execution — at speed or at scale. Often, it's because *execution* refers to the path a good idea takes through the decision makers of the organization before it can land in the hands of customers. Execution touches the business model, the revenue model, the partnership structure, the delivery approach, ownership, and any number of structural issues. Companies often don't pay enough attention to how important it is to be fast.

Also, executive leaders — especially in media companies — worry about cannibalization. They are reluctant to launch products that are different from what they have been known for in the past, and they worry about channel conflict and alienating loyal audiences. As a result, many great new ideas don't come to light, or they are so altered and changed to fit within existing limitations that they aren't all that new anymore. Those firms that are willing to cannibalize themselves are often the ones that continue to grow and prosper, while their competitors try to hold on to old products and services.

In recent years, a number of core media companies have been more willing to bring new ideas and great execution together to launch products that 10 years ago would have had difficulty getting executive approval. Showtime Anytime, Showtime's streaming app for cable subscribers, is one example. Showtime has an established reputation for hits — it's the channel behind such popular shows as *Homeland* and *Ray Donovan*. But it has long been a premium cable network — a Maker, in our model, dependent entirely upon multichannel video programming distribution to reach its fan base. With Showtime Anytime, the channel can go over cable providers to meet customers directly. In so doing, it has made a move into the Maximizer quadrant.

Disney is actively pursuing an even more "upstream" approach to innovation through its own startup accelerator. The Disney Accelerator is designed to give Disney an earlier first look into exciting new technologies — sometimes important new Module companies — and digital products that could be amplified by the company's roster of E&M brands. These companies tend to be early-stage ventures that can also benefit from mentorship and collaboration with senior Disney executives. Launched in 2014, the Disney Accelerator has already given birth to some success stories. Sphero, a company from the Accelerator class of

2014, developed the technology for the BB-8 droid that became not only a star of *Star Wars: The Force Awakens* but also one of the hot-selling toys during the 2015 Christmas season. The most recent round of Accelerator activities has focused on technologies such as social media geo-fencing, 3D printing applications for toys, and virtual reality.

Because innovation capability and experimental capacity are complicated and difficult, it is important to have innovation structures in place that allow the great ideas the best potential for success. There is not just one right answer. Some companies will find that they want to keep their innovators close. For them, a "patron" model — in which one or more company leaders support one or more in-house teams pursuing a specific innovative idea — can work. Traditional companies may find it more efficient to rely on partners with new media chops. For them, joint ventures with partners, investments, or acquisitions kept outside the core may produce the best results. This goes beyond the tried-and-true method of contracting with small, specialized shops for specific projects, such as app design or new product creation. India's MTS, a mobile telecom service provider and handset manufacturer, has struck a content agreement with Hungama Digital Media, an aggregator, publisher, and distributor of Bollywood and Asian content, to provide media to its subscribers.

Getting a Strategy That Works

Throughout the world we see the simultaneous forces of the digital redefinition of the media and content industry and a deep reinvestment by many companies in media and content of their own. These two great tectonic plates won't stop shifting anytime soon, which means that the single most important decision for leaders is which way they are going to play — which quadrant they choose. In our world of four Ms, confusion leads to waste, and often to failure. The new developments discussed above have implications for incumbent media companies. It is natural for established players to view retailers, technology companies, and financial-services companies as competitors. And in many ways, they are all competing for talent. But media companies should also view these new entrants as potential partners and customers. After all, they have a lot to learn, and who knows better than media what it really takes to capture and hold audiences?

Deeply understanding the specific customer base they are targeting, knowing where those customers can be reached in the media landscape, and developing the type of content and experience the customers desire — few companies understand these issues as well as the incumbent entertainment and media companies do.

As they plunge into media, most companies will be seeking partners that can help them tell stories, distribute content, engage customers, build relationships, and employ data. And as companies from a wide range of industries look to build, buy, and borrow media capabilities to reach the customer on his own terms, core media firms will find a new set of customers seeking to establish a new set of relationships. Instead of consisting largely of transactional arrangements, these relationships will be ongoing, dynamic, and responsive. Those with the clearest vision, the strongest talent, and the best innovation and experimentation capabilities will achieve more voice, brand engagement, and returns in a media world that grows both more crowded and more complex every second of every day around the globe. +

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Bullish on Media

Red Bull, the Austria-based energy drink company, has had one foot in media since founder Dietrich Mateschitz, who had been a marketing executive at Unilever and Blendax, launched the company in the late 1980s. He garnered early success in earned media by convincing Austrian Formula One driver Gerhard Berger to appear on camera holding a can of Red Bull. That was the opening round in Mateschitz's long game of linking the brand to high-speed, extreme sports. Red Bull is far more today than the energy drink that bears its name. It owns Formula One teams and multiple soccer franchises (e.g., Red Bull Salzburg, New York Red Bulls), and sponsors extreme athletes in a wide range of sports. These resources give the company direct access to the talent starring in proprietary content the Red Bull team produces for its own media properties, including one of the first marketer-branded channel apps on Apple TV.

Brand Makeover

Burberry, the classic British retailer and luxury brand, has been surprisingly innovative in plunging into media. Media innovation has today become core to both company strategy and operating culture. The brand received a major overhaul in 2007 when Angela Ahrendts took over as CEO and joined forces with design director Christopher Bailey (Bailey became CEO in 2014 when Ahrendts left to serve as Apple retail chief). Part of Burberry's reinvention involved enticing the millennial generation to embrace the trench coat, a onetime must-have that had grown a bit dusty through age and poor brand management. Modern Bailey designs were highlighted in ad campaigns staring young British stars such as Emma Watson and Rosie Huntington-Whiteley. Burberry used digital media to transform into a luxury Mash-up — producing original content, building its own media channels, reimagining its stores to connect more deeply with customers, and exerting more control over its e-commerce presence. Burberry streamed its major fashion shows in real time in stores and via social platforms. For the first time, customers saw the designs at the same time as the fashion world's elite. Those social media–savvy customers could react to and buy designs via a Burberry app before they hit the stores. Once in the store, customers can scan an RFID chip on an item to see videos about the creation of that product — artisans turning collars, for example, or a presentation on the inspiration behind the design. Most recently, Burberry became one of the first brands to curate its own channel on Apple Music. The company has also executed live-streaming experiments with Twitter's Periscope as well as a personalized fashion show experience with the messaging app WeChat (formerly Weixin).

Resources

Paul Leinwand and Cesare Mainardi, with Art Kleiner, *Strategy That Works: How Winning Companies Close the Strategy-to-Execution Gap* (Harvard Business Review Press, 2016): Describes how companies can gain the skills they need to outperform their competition.

Peter Weill and Stephanie L. Woerner, "Thriving in an Increasingly Digital Ecosystem," *Sloan Management Review,* June 16, 2015: Source of the two-variable system for defining digital strategy.

More thought leadership on this topic: strategy-business.com/outlook

Entertainment and media companies can tap into many pockets of growth and opportunity. Our intensive analysis of five shifts roiling the industry can help you identify them.

A WORLD OF DIFFERENCES

BY CHRIS LEDERER AND MEGAN BROWNLOW

Entertainment and media (E&M) companies are making great strides in pivoting to serve digital consumers around the world. However, at first glance, the outlook for E&M companies worldwide still may seem troubling. Declining pricing power, disinflation, and the trend toward free media and sharing all make it fundamentally challenging to grow organically. Despite growing 5.5 percent last year, this US$1.7 trillion global industry is likely to have difficulty keeping up with the economy as a whole. The Global Entertainment and Media Outlook 2016–2020 projects that E&M will rise at a compound annual growth rate (CAGR) of 4.4 percent in nominal terms through 2020 — lagging behind overall economic growth (*see Exhibit 1, page 125*).

Illustration by Guy Billout

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But a closer examination brings a different picture into focus. E&M is a dynamic, diverse industry with steady and sustainable growth. Although the strong aggregate growth is not shared equally by all participants, impressive growth and opportunities can be found in many areas of the industry. Drastic slowdowns in some areas and stagnation in others coexist with spectacular expansion in "hot" countries, regions, and sectors. Which is to say: This global media landscape is multi-shifting.

In fact, for the majority of the countries we looked at — 36 out of 54 — E&M spending is growing more rapidly than GDP, often by a factor of more than 50 percent. Venezuela tops the list; E&M spending growth there is likely to outpace GDP growth by more than 14 percentage points in 2016. Many of the most populous E&M markets, including Brazil, Pakistan, and Nigeria, will also produce comparatively higher E&M growth rates (*see Exhibit 2*). But that's just the beginning of the story.

At a global level, one of the most significant shifts evident is a reordering of the industry's sectors (*see Exhibit 3,* page 126). On the left side of the exhibit, we've aggregated segments into five broad groups: Internet, video entertainment, publishing, music, and video games. As the chart shows, revenue across E&M is steadily shifting from publishing businesses to video and Internet businesses — in particular those that provide over-the-top (OTT) services and monetize consumer data. When we break down global spending by business model on the right side of the exhibit, direct consumer spending models remain strong, while spending on Internet

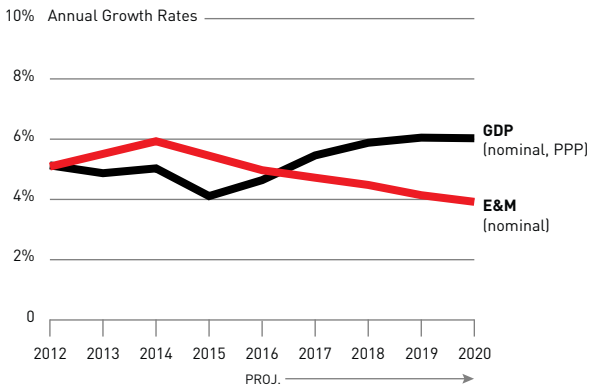
access, including mobile data, will rival advertising. This development creates more fertile ground for new entrants and traditional players alike — think OTT video and new e-commerce offerings, for example — to jump directly into new markets and segments.

We expect the transitions we've described to continue, as powerful macroeconomic, technological, and social trends work to change the face of many industries, not just E&M. But the obvious changes under way throughout E&M mask a series of counterintuitive shifts that are apparent only to those deeply immersed in the industry. Each year, in putting together the Global Entertainment and Media Outlook, we and our colleagues collect and aggregate an immense amount of data, gain insight through discussions with colleagues and industry leaders, test hypotheses, and formulate strategies. This process enables us to pinpoint shifts that few others can see — and the ones we've identified this year promise a host of opportunities across the E&M sector. They should serve as a serious call to action for many of the industry's incumbent leaders, which can take control of their future.

The biggest of these shifts are occurring in five dimensions of the global E&M landscape: demography,

Exhibit 1: **Growing but Slowing**

Over the next five years, growth in spending on entertainment and media will lag overall economic growth.

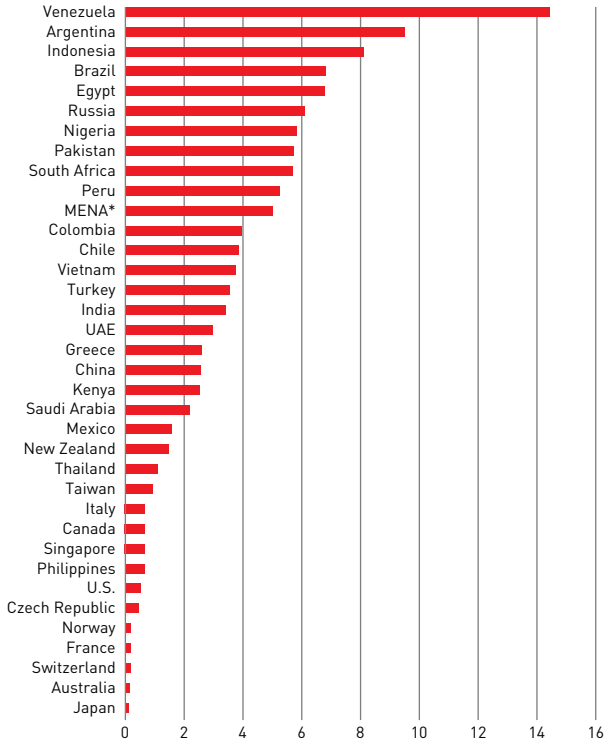


Source: Ovum, IMF

Exhibit 2: **A World of Differences**

In many developing markets, E&M spending is growing more rapidly than the economy at large.

Percentage-point difference in growth rates of E&M spending and GDP, 2016



*MENA (Middle East and North Africa) = Algeria, Bahrain, Jordan, Kuwait, Lebanon, Morocco, Oman, and Qatar. Saudi Arabia, UAE, and Egypt are broken out separately.

Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

competition, consumption, geography, and business models. Simultaneous and interrelated, they influence and play off one another. We'll look at each shift in turn.

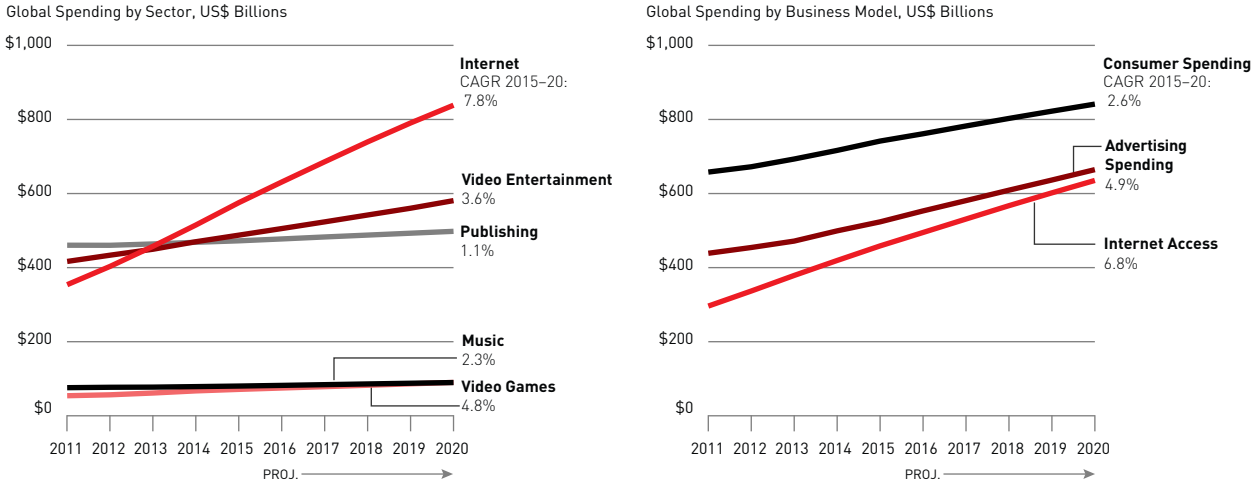
Shift 1. Demography: Youth Will Be Served

A great deal is made — in the U.S. in particular — of the financial struggles of millennials. But the cultural trope of 20-somethings living in their parents' basement and cutting the cord on cable TV obscures a larger trend. We've all seen the speed at which younger consumers adopt new consumption behaviors and their startling ability to multitask in different media. These same attributes allow them to lead the way in setting trends and driving consumption in E&M markets around the world. Companies may find it easier and more comforting to pitch their products and services at putatively more affluent older people. But our data suggests that in many countries in many parts of the world, the young will propel E&M growth through 2020.

As shown by our mapping of 54 countries' population percentage under 35 against their projected E&M spending growth rates, there's an almost perfect correlation between markets with more youthful populations and those with higher E&M growth (*see Exhibit 4*). Why? Here's our hypothesis. Younger

Exhibit 3: **A Decade of Divergence**

Differential growth rates for sectors and business models are reshaping the E&M industry.



Note: *Internet* includes Internet access, search, and online classified advertising. *Video entertainment* includes TV/video, TV advertising,and cinema. *Publishing* includes magazines, newspapers, business-to-business, and books. *Music* includesmusic and radio.

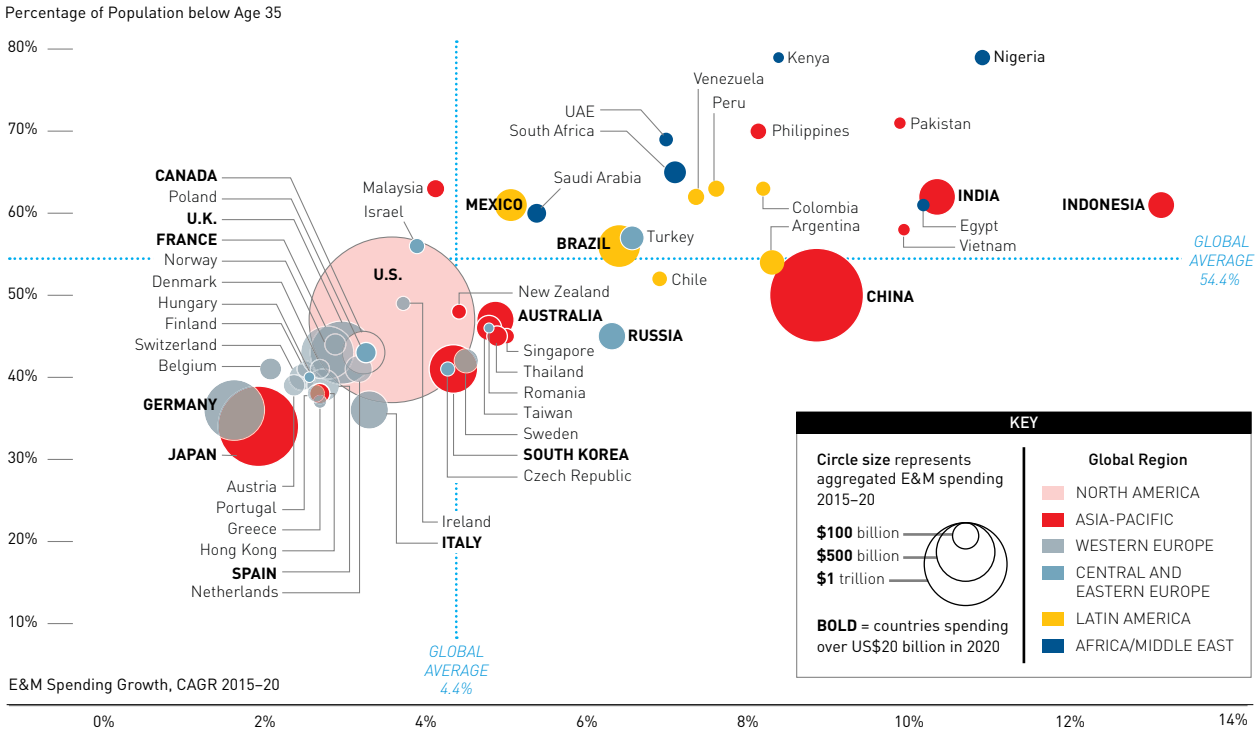
Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

Note: *Consumer spending* includes subscription revenues (from TV and radio), ticket sales, and product purchases (books, video games, etc.). *Advertising spending* includes advertising revenue from TV, publishing, radio, Internet advertising, and out-of-home advertising. *Internet access* includes Internet subscription fees.

Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

Exhibit 4: **Youth Movement**

Across countries, there is a strong correlation between the relative size of the under-35 population and growth in E&M spending.



Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

people consume more media than older people, and are more open to adopting digital behaviors — and therefore more open to digital spending. Although some analog segments remain robust, digital media is where aggregate growth is strongest globally. In addition, many of the most youthful markets have rapidly growing middle classes whose discretionary spending power is on the rise — and E&M spending is usually discretionary. The opportunity for media companies is to understand how the young spend on digital content, and to be able to predict, for example, when they will pivot from paying for music downloads to streaming music services.

Of course, E&M providers entering new markets or seeking to accelerate growth in existing ones should take into account a country's demographics along with its wealth or rate of economic growth. A number of lower-growth, relatively older markets, such as the U.S., remain fundamentally important because of their size and absolute growth. In older, less digitized markets, it may make sense to focus more on managing the decline of legacy media — in other words,

THE OPPORTUNITY FOR MEDIA COMPANIES IS TO UNDERSTAND THE YOUNG AND BE ABLE TO PREDICT, FOR EXAMPLE, WHEN THEY WILL PIVOT FROM MUSIC DOWNLOADS TO STREAMING.

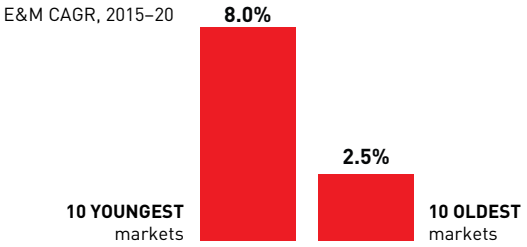
in these markets, a large base of consumers comfortable with traditional media will make it possible to sustain profitability for some time, whereas pushing new technology too hard will risk alienating the considerable number of older consumers. In Japan, for example, the average daily newspaper circulation is 45.6 million, a number that has declined by only 6.3 percent in the past four years. There's no immediate rush for Japanese newspaper companies to go all-digital.

In younger markets, by contrast, there will be a significant incentive for providers to shift completely to digital media, or to offer bundles, the better to target the large number of youthful consumers with less ingrained habits and preferences. India's growing middle class has supported print newspaper growth. But the ranks of Indian social media users surged by 26 percent in 2015, to 134 million. That suggests more digital reading is imminent. (See "India's Triple Play," by Suvarchala Narayanan, page 140.)

Our analysis of total E&M revenue growth in the world's 10 youngest and oldest markets in demographic terms further underscores the vital importance of youth (*see Exhibit 5*). On average, E&M spending in the 10 youngest markets is growing three times as rapidly as in the 10 oldest markets. In Pakistan, where around 70 percent of the population is under 35, E&M spending is projected to grow at a 10 percent

Exhibit 5: **Age Matters**

Between 2015 and 2020, E&M spending will grow far more rapidly in the world's youngest markets than in the oldest ones.



Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

CAGR through 2020; by contrast, Germany and Japan — two much wealthier countries with among the lowest proportions of people under 35 — sport a meager E&M CAGR of about 2 percent. Put another way, growth in E&M spending is more influenced by the age of a country's population than by its comparative wealth. So youth will be served.

Shift 2. Competition: Content Is Still King

In 2015, the stocks of many of the world's largest traditional media conglomerates, especially those based in the U.S. and Europe, suffered in comparison to both technology-driven platforms such as Netflix and communications platforms such as Verizon. Declines in media stocks were especially significant in the summer (*see Exhibit 6*).

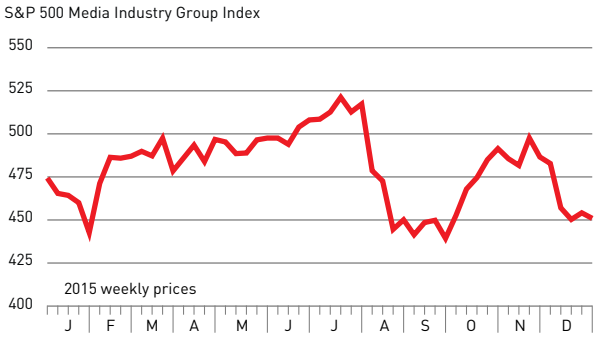
Content was deemed to have taken a backseat to technology and communications. The symptoms: slowing ad markets for traditional, content-producing media; big ratings declines for cable and broadcast television; the currency drag from a strong dollar; and a slowdown in TV affiliate fees. As a result, it might seem that the mantra from the 1990s, "content is king," had become outdated. But in fact, in an important yet widely overlooked shift, we believe that content will reign supreme as platforms seek to differentiate and expand internationally.

In a world in which Netflix can launch its streaming services in 130 new countries in a single day, it's easy to assume that content is becoming more globally homogeneous. But the reality is that content is being redefined by forces of globalization and localization simultaneously. In the global coffee market, a homogenizing force such as Starbucks, now present in 70 countries around the world, can thrive alongside local chains and coffee shops. The same holds true in E&M. Netflix, for example, has said that locally produced content is its future.

Much of the E&M industry is growing more global, but cultures and tastes in content remain steadfastly local. The international opening week-

Exhibit 6: **Content Struggles**

In 2015, stocks of media companies encountered significant headwinds.



Source: S&P Capital IQ

end of *Batman v Superman: Dawn of Justice* (in March 2016) grossed $254 million globally on 40,000 screens in 66 markets outside the U.S., the fifth most successful international opening in history. But the year's biggest opening in China thus far, the Hong Kong–produced fantasy comedy *The Mermaid*, grossed $120 million on its opening weekend in February 2016.

Content-based business models across the world are being transformed to support this coexistence of global and local content offers. South Africa–based Naspers has an impressive portfolio including pay-TV operations that serve 48 African countries, and Nation Media is the biggest media house in East Africa, having expanded from its origins in Kenya to build major operations in Uganda and Tanzania. Such companies thrive by blending international reach and local focus. A host of global television formats are produced domestically, in local languages with local talent. More than 100 international variations of the British-created quiz show *Who Wants to Be a Millionaire?* have been produced since the original U.K. version debuted in 1998. Talent shows, dating shows, and cooking shows have also proven to have universal appeal, but they succeed in domestic markets largely because of their local characteristics.

The dichotomy of global and local may be seen most clearly in those markets that combine well-developed digital distribution infrastructure and platforms with strong local content industries. The preference for local content over "global" (often code for *U.S.-produced*) content is evident even in a mature, developed, English-speaking country such as Australia, where locally produced sports, reality shows, news, and drama offerings, such as Shaun Micallef's political satire *Mad as Hell*, rank as the 10 most-watched television programs every year. Local tastes are even more prevalent in India, the world's most prolific producer of movies; in Nigeria, where Nollywood produces about 1,000 films a year (more than U.S. studios do); and in China, which will overtake the U.S. in 2017 as the world's largest market for box office revenue.

These factors carry implications for media companies' strategies. In particular, it's important not to assume that past patterns in spending on "global" content in mature markets are a valid guide to future spending in emerging markets, which often have their own, even more deeply held tastes in content and cultures, on top of a variety of native languages. As companies tailor their

MUCH OF THE E&M INDUSTRY IS GROWING MORE GLOBAL, BUT CULTURES AND TASTES IN CONTENT REMAIN STEADFASTLY LOCAL.

decisions about market entry, they also need to consider the mix of global versus local brands they will deploy in order to build audiences.

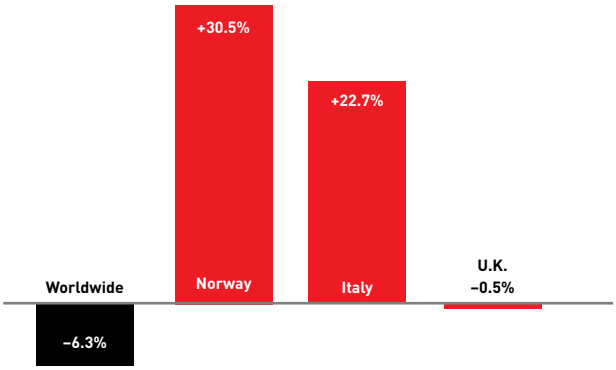
A particularly striking example of counterintuitive trends driven by local content demand can be seen in physical recorded music revenues in 2015. Global spending on physical recorded music — mainly CDs and vinyl — fell in 2015 by 6.3 percent. Yet spending on physical music formats in the U.K. was almost flat, which is quite an achievement considering the downward trend. And in Italy and Norway, the spending growth was remarkable: 22.7 percent and 30.5 percent, respectively (*see Exhibit 7*).

What happened? In each market, the impact of global music streaming was offset by specific local tastes. In the U.K., Adele's new blockbuster album, *25,* which was not made available for streaming, was almost single-handedly responsible for the strength of physical music; the legions of fans among Adele's countrymen and -women were willing to pay for CDs. In Italy, a strong domestic repertoire, led by the 13th studio album of singer–songwriter Jovanotti, *Lorenzo 2015 CC,* accounted for the rebound in physical music. And in Norway, where the popular electronic dance music scene promotes record-

Exhibit 7: **Local Tastes Dominate**

Consumers in three European countries bucked the trend of sharply declining sales of physical recorded music.

2015 Spending on Physical Recorded Music



Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

spinning DJs as rock stars, vinyl sales accounted for 24 percent of all physical music revenue, a high proportion compared with vinyl's 2 percent share of music revenue globally. Faced with an array of choices, consumers decide at the local — and indeed personal — level what to purchase. And that leads to wildly different outcomes, even in markets that might appear superficially similar.

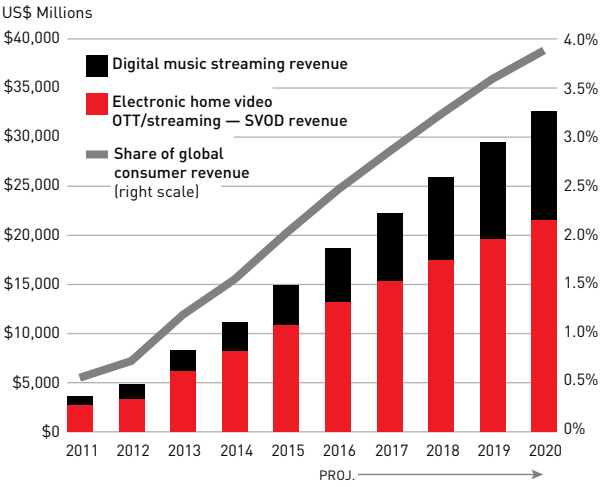
Shift 3. Consumption: The Joy of Bundles

The ability to design and curate your own media diet has been one of the most powerful trends to emerge in the industry. Whether in the U.S. or Uzbekistan, consumers have never had a greater ability than they do now to curate their own playlists — through apps, YouTube, streaming services, social media, and OTT offerings. Broadly speaking, many pundits have proclaimed the end of the bundle — the set of offerings that radio stations, cable and record companies, or even newspapers and magazines have traditionally sold together. And indeed, the rise of subscription content streaming services has been a major feature of the E&M landscape in recent years (*see Exhibit 8*). Global subscription spending on Netflix and other OTT subscription-video-on-demand (SVOD) services grew by 33.8 percent in 2014 and 32.3 percent in 2015 — that's 77 percent in two years. The launch of Apple Music provided a major boost to digital music streaming revenue, and other streaming companies, such as Tidal, Beatport, Deezer, Earbits, Pandora, Spotify, and Rhapsody — to name but a few — arguably saw a boost due to the enhanced awareness Apple Music created among consumers. Partly as a result, global music streaming spending rose by 41.8 percent in 2015, to $4.07 billion.

But the bundle isn't dead, not by a long shot. The rapid growth in on-demand streaming revenues is starting from a very low base, and even today on-demand streaming accounts for

Exhibit 8: **A Stream Runs Through It**

Revenues for streaming services are growing rapidly.



Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

IN 2017, WHEN CHINA OVERTAKES THE U.S. IN BOX OFFICE REVENUE, IT WILL BE THE FIRST TIME THE U.S. HAS NOT HELD THE LEADING POSITION IN AN E&M SEGMENT.

little more than 2 percent of global consumer E&M revenue. Meanwhile, video and cable incumbents, which were initially slow off the mark, are fighting back with gusto by offering their content on an integrated omnichannel basis, on TV, laptop, tablet, and smartphone. In numerous markets, many consumers — including cord cutters — still love the convenience of having their content aggregated in one place, rather than needing to root it out across a bunch of disconnected services. In the U.K., Sky's Now TV stand-alone streaming service had more than 700,000 subscribers in early 2015. But Sky also offers those who subscribe to their main service a new multidevice streaming capability.

As such services gain traction, it's clear that some consumers may opt for a set of "pure" à la carte offerings to keep costs down. And fewer will pay a premium price for a mundane collection of channels that they can watch only on television. But the traditional bundlers are adapting rapidly, and they have substantial advantages and large customer bases. As a result, we believe the bulk of digital OTT mass-market services will gradually be reabsorbed into aggregated offerings that will echo the traditional analog-style bundle, but that will be more flexibly priced and available on a full range of devices. These offerings will have features such as intelligent integration, which permits a consumer to watch part of a movie on one device and then finish it on another.

When this happens, the competitive battle may move up a notch from the OTT service level to the realm of service aggregators, which range from giants such as Apple, Google, and Verizon to small entrants such as WeShow and Aggrega. The big battles will no longer be fought mainly over networks, cable chan-

nels, and upstarts gaining access to content. The new battles will be among cable incumbents, technology giants, and telecommunications companies, fighting over gaining access to distribution. The heightened importance of ownership of broadcast spectrum will make spectrum auctions such as the one currently under way in the U.S. potentially pivotal. Whoever buys and owns spectrum may be better placed to enter and win the race to offer streaming bundles. As bandwidth comes up for grabs, so too will the role of aggregator.

We also see bundles popping up, or reappearing, in other sectors. In Europe, newspaper publishers are enabling custom bundles by mashing content onto new digital platforms. Blendle, based in Utrecht, the Netherlands, launched an English-language version in March 2016 with 20 high-caliber publishing partners including the *New York Times* and the *Economist*. This experiment, which leverages micropayments, may prove attractive to digital consumers used to paying small amounts for apps, songs, and mobile games.

Shift 4. Geography: Growth Markets

Generally, companies have had one set of expectations about developed markets (slow growth, low regulation, easier to access) and another about developing markets (rapid growth, high regulation, more difficult to access). The result was that a company might have one strategy for developed markets, and another, somewhat generic strategy for developing markets. But the dynamics are shifting rapidly. In 2017, for example, when China overtakes the U.S. in box office revenue, it will mark the first time the U.S. has not held the leading position in an E&M segment. China is also well advanced in segments such as digital advertising. In 2016, three countries — China, the U.K., and Denmark — will become the first to reach the tipping point at which total digital advertising revenues surpass their non-digital equivalent.

Disruption is pushing markets to develop in different ways. The divergences are being driven by several factors. One is the differential growth rates among sectors. The table in Exhibit 9 (page 135) demonstrates that beyond zeroing in on the fastest-growing markets, such as Indonesia, India, and Peru, E&M companies must focus on those that are generating the greatest *absolute* dollar growth — namely, the U.S. and China. In addition, in every country, different sectors are driving growth

Exhibit 9: **Hot Spots**

In every country, a different mix of factors is propelling growth.

TOP 10 rank in category

BOTTOM 10 rank in category

COUNTRY	COMPOUND ANNUAL GROWTH RATES 2015–20						E&M SPENDING 2015 US$ MILLIONS
	E&M SPENDING	INTERNET	VIDEO GAMES	VIDEO ENTERTAINMENT	MUSIC	PUBLISHING	
Indonesia	13%	21%	8%	15%	4%	4%	$12,672
Nigeria	11%	15%	12%	4%	7%	2%	$4,311
India	10%	14%	11%	12%	7%	4%	$25,126
Egypt	10%	15%	7%	13%	11%	1%	$2,859
Vietnam	10%	13%	5%	12%	2%	3%	$3,103
Pakistan	10%	14%	5%	9%	9%	2%	$3,066
China	9%	12%	7%	9%	6%	1%	$168,826
MENA	9%	14%	4%	7%	7%	0%	$10,180
Kenya	8%	9%	14%	10%	7%	4%	$2,254
Argentina	8%	9%	9%	10%	9%	4%	$11,645
Peru	8%	12%	9%	8%	9%	2%	$3,944
Philippines	8%	12%	7%	9%	5%	2%	$5,675
Venezuela	8%	12%	6%	6%	11%	3%	$5,135
Colombia	7%	10%	10%	7%	8%	2%	$5,264
South Africa	7%	13%	6%	6%	5%	1%	$9,567
UAE	7%	10%	9%	5%	4%	-1%	$3,785
Chile	7%	10%	7%	5%	5%	3%	$4,340
Turkey	7%	10%	8%	6%	6%	2%	$11,533
Brazil	6%	10%	11%	5%	4%	2%	$35,657
Russia	6%	10%	6%	6%	0%	2%	$15,380
Saudi Arabia	5%	6%	8%	14%	6%	-1%	$7,472
Mexico	5%	7%	4%	4%	6%	3%	$21,616
Singapore	5%	9%	5%	3%	2%	2%	$5,148
Thailand	5%	8%	7%	6%	5%	2%	$9,005
Australia	5%	8%	3%	4%	0%	1%	$29,856
Taiwan	5%	8%	2%	1%	5%	2%	$13,685
Romania	5%	9%	7%	2%	1%	2%	$2,171
Sweden	5%	11%	4%	3%	5%	-1%	$12,767
New Zealand	4%	10%	5%	3%	1%	1%	$4,784
South Korea	4%	6%	6%	2%	6%	0%	$51,107
Czech Republic	4%	7%	6%	2%	0%	2%	$4,351
Malaysia	4%	8%	6%	3%	4%	2%	$7,321
Israel	4%	7%	4%	2%	0%	0%	$5,110
Ireland	4%	9%	5%	2%	4%	-1%	$4,476
U.S.	4%	8%	4%	1%	2%	2%	$602,973
Italy	3%	6%	4%	3%	1%	-1%	$32,751
Poland	3%	7%	6%	2%	0%	1%	$9,196
Canada	3%	7%	4%	1%	2%	2%	$40,329
Netherlands	3%	7%	5%	2%	2%	0%	$16,402
U.K.	3%	6%	3%	2%	1%	1%	$89,428
Norway	3%	7%	2%	2%	3%	-1%	$10,023
France	3%	6%	2%	2%	0%	1%	$63,493
Spain	3%	4%	3%	4%	4%	0%	$24,215
Greece	3%	6%	5%	2%	4%	-1%	$4,056
Denmark	3%	7%	4%	1%	2%	-1%	$8,304
Hong Kong	3%	5%	6%	1%	4%	0%	$8,797
Portugal	3%	4%	6%	3%	0%	-1%	$6,738
Hungary	3%	4%	7%	3%	2%	1%	$2,564
Finland	3%	7%	3%	1%	1%	0%	$6,413
Switzerland	3%	6%	4%	3%	2%	-1%	$16,055
Austria	2%	7%	3%	3%	1%	-1%	$10,655
Belgium	2%	5%	2%	2%	2%	0%	$11,242
Japan	2%	3%	5%	3%	-3%	-1%	$148,961
Germany	2%	4%	3%	2%	2%	0%	$85,712
GLOBAL ▶	**4.4%**	**7.8%**	**4.8%**	**3.6%**	**2.3%**	**1.1%**	**$1.7 TRILLION**

Note: *Internet* includes Internet access, search, and online classified advertising. *Video entertainment* includes TV/video, TV advertising, and cinema. *Publishing* includes magazines, newspapers, business-to-business, and books. *Music* includes music and radio.

*MENA (Middle East and North Africa) = Algeria, Bahrain, Jordan, Kuwait, Lebanon, Morocco, Oman, and Qatar. Saudi Arabia, UAE, and Egypt are broken out separately.

Source: Global Entertainment and Media Outlook 2016–2020, PwC, Ovum

to different degrees. The result of these divergences is that "opportunity" economies — even within the same region — can display significantly varied growth patterns.

In addition to understanding the where and how of growth by country, companies must grasp the importance of a third factor: regulation. In the E&M context, regulatory interventions include blocking entry of international companies, requiring a certain percentage of airtime to be dedicated to local market content, mandating government review and approval of content before content can be aired, and imposing different tax structures for local and international companies. And once again, the conventional E&M wisdom is often undermined by the facts on the ground. Simply put, some of the most heavily regulated markets are also those with the most growth.

In China, companies may face significant obstacles due to regulation. The websites of U.S. companies such as Facebook, Google, and Netflix are blocked, and the number of foreign films shown annually is limited. Yet China remains one of the most robust markets for E&M growth in terms of absolute dollars. The more restrictive environments tend to limit what media companies can broadcast and publish, and also limit who owns them, with a common focus on maintaining indigenous ownership and control. This often takes the form of governments funding local content or enacting regulations to prevent "excessive" outside cultural influence and protect local artists.

Regional inconsistency in regulation and market access affects business models, the shape of the market, and the revenue outlook in different territories. German publisher Axel Springer quit the Russian market in 2015 owing to foreign ownership limits. But other countries are improving the regulatory environment for E&M companies. In Nigeria, which in 2014 created an online copyright registration system, the government is working to enact legislation to protect publishers more effectively against copyright infringement. Malaysia's government has blocked tariffs on books in order to promote reading and literacy.

The fundamental and ingrained differences between markets represent a key factor that E&M companies must take into account when planning their global strategies. And it's clear that despite globalization, such differences won't go away anytime soon. The challenge for E&M companies is how to navigate around or through the barriers and thus gain access to these markets' expanding

consumer opportunities and growing revenues. One option is creating new, tailored business models and local joint ventures or partnerships, and then localizing content and advertising experiences to comply with local regulations on such issues as decency and public health, as well as to suit local tastes.

Shift 5. Business Models: Transforming with Trust

In 2013, Netflix CEO Reed Hastings (now) famously said he wanted to build Netflix into a company that actually resembled a premium cable network. This was a technology company racing to become a new kind of hybrid content company. Meanwhile, traditional publisher Time Inc. is emerging as a hybrid technology company. In March 2016, it acquired the data-driven marketing specialist Viant Technology. Such moves highlight another noteworthy shift. In many areas, the growth of technology and digitization acts as a powerful centrifugal force — breaking up existing relationships; pushing large, generalist entities to give way to smaller specialists; and allowing smaller, nimbler competitors to beat out incumbents. But the reality is that the historic shifts now under way are forging the creation of new business models, and perhaps even new industries. Those that are able to integrate the capabilities and approaches that create value for customers will continue to thrive.

Let's take advertising as an example. The rise of large integrated data sets, smart analytics, and new visualization and delivery platforms — combined with the growth of programmatic advertising and the advent of native content — would seem to significantly undermine the role of the traditional agency and media company. This view is reinforced by a migration of advertising revenue away from companies whose core product is "the big idea" and toward those, like Google and Facebook, whose differentiator is their algorithmic buying platform. At the same time, multichannel networks, social media, and content marketing businesses are seeking to grab a slice of the advertising pie.

But what if all these changes are creating an opportunity for incumbent agencies to reorient themselves to become invaluable to markets? One might argue that the established agency holding companies are uniquely well positioned to bring together programmatic capabilities, analytics, data aggregation, and native content. And in fact, they're already doing it. The biggest holding companies

are scaling world-class programmatic capabilities, while also developing software to buy digital advertising faster and more efficiently. What they cannot build, they buy or access through partnering. Enter the new "super" agency.

In September 2014, the advertising holding company WPP injected $25 million and the ad server platform from its programmatic media arm Xaxis into ad technology provider AppNexus, in return for a significant stake in the business. (See "Thought Leader Interview: Sir Martin Sorrell," by Deborah Bothun and Daniel Gross, page 172.) Announcing the deal, WPP, whose Kantar unit represents one of the largest consumer retail data sets available, said the move continued its strategy of investing in fast-growing sectors such as ad technology and programmatic media buying. Other savvy, forward-looking agencies also have large and valuable data assets, and are working to evolve them to world-class levels. For instance, Publicis bought Sapient, which includes SapientNitro and Razorfish, thus enabling the company to build a portfolio of leading technology and digital assets.

As these players in the advertising value chain develop their data strategies, the new linchpin for competitive advantage could be bundling in content marketing (or, as some say, "brand to demand") at scale. This next-generation marketing strategy offers promise not just to the agencies, but to content creators as well. In Australia, the three biggest newspaper publishers — News Corp, Fairfax, and APN News and Media — have all set up or bought a content marketing business in the last couple of years. These organizations may be very well suited to capture this opportunity because of the trust equity that lives in the brands, especially when it comes to assuring consumers who have privacy concerns. Globally, revenues from the creation and provision of content marketing grew 13.3 percent in 2014, to reach $26.47 billion, according to PQ Media. E&M companies that embrace technology and combine it with industry-centric assets — such as relationships, customers, and knowledge — will thrive and evolve.

Navigating Multispeed Markets

As the five shifts that we've described play out, so will changes in the E&M landscape. This industry is learning from experience and becoming nimble; more and more, it will position itself to seize the opportunities that appear. The

E&M industry is getting used to the new normal — a multispeed marketplace that expects and plans for disruption.

Why do we say this? From the vantage point of today, it might seem that any strategy for the next five years will be rendered not just obsolete but irrelevant by 2018, let alone by 2021. Just think about how E&M companies' five-year pro forma plans from 2011 look today in light of the disruption we've seen.

Even so, E&M companies are learning, acting, and, in many parts of the world, thriving. Each of the shifts we've highlighted can help companies plan and do business better. The power of youth, the primacy of localized content, the resilience of a new kind of bundle, the deepening of developing markets, the potential for new business models: All are taking place against the backdrop of steadily growing industry-wide revenues.

For E&M companies with the right strategies and insights, the opportunities are legion. And the shifts play to the strengths of companies with big market positions, capital they can invest, strong brands, and strength in understanding local tastes and preferences. If they make the right calls, incumbents can position themselves to capitalize on the next phase of change and drive growth.

To do this, they'll need to ensure that their capabilities are both up to the job individually and aligned such that they add up to more than the sum of their parts. Strong brands must be underpinned by the best talent, which must be empowered by low-friction digitized processes that enable them to glean and use deep consumer insight from data. Companies that combine these attributes and establish positions in high-growth markets will be the most likely to succeed. ✚

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Resources

Edward H. Baker, "The Surprising Endurance of the Boob Tube," *s+b*, Sept. 9, 2015: Author Michael Wolff's argument about why television maintains its audience.

Christopher A.H. Vollmer and Matt Egol, "Five Rules for Strategic Partnerships in a Digital World," *s+b*, Dec. 22, 2014: For leading companies in E&M, the future depends on the capabilities and insights they can tap by working with others.

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INDIA'S TRI

PLAY

What do feature phones, regional newspapers, and smartphones have in common? They're all vehicles for the country's remarkable move to digital broadband.

by Suvarchala Narayanan

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Also contributing to this article were Smita Jha, director and leader of the entertainment and media practice at PwC India, and Munnish Puri, managing director of India Financial Advisors and Indian Film Advisors.

All statistics not otherwise attributed are adapted from the PwC Global Entertainment and Media Outlook 2016–2020 (www.pwc.com/outlook).

The tiny commuter kiosk at the train station in Andheri, a working-class suburb of Mumbai, is a hub of activity most afternoons. The proprietor, Shyam, sells dozens of prepaid mobile phone recharges each day, and he comes highly recommended for another service. "Bhaiya, ready hai?" (Brother, is it ready?) asks a 14-year-old boy. The kiosk owner nods and pulls out an SD memory card from an aluminum box. The card contains some Hollywood and Bollywood films, a playlist full of popular songs, and some episodes of *Aap ki Adalat,* a popular TV show featuring hardball interviews with leading public figures.

The boy hands over Rs150 (about US$2.25), and happily inserts the card into his mobile device. That mobile, known widely as a "feature phone," doesn't have a global brand name like Apple or Samsung. And it's not as versatile as a smartphone. But it shows videos, and, unlike the shared TV in the boy's home, it belongs entirely to him.

Although this sale would be labeled piracy in many quarters, Shyam sees himself as performing a necessary service for the young people living in his community — just a few members of a vast and underserved market that could be called *infotainment followers,* after the new media they prefer. A year or two from now, many of them may replace their feature phones with smartphones, especially if the much-anticipated high-speed 4G mobile Internet service is launched throughout India. In the meantime, they depend on their 2G connections and memory cards.

About 30 miles away, a group of young creative professionals — writers, filmmakers, and a chef — are having brunch at one of Mumbai's many inter-

Previous pages: Illustration by Karolin Schnoor

national cafes. They are representative of today's full-fledged smartphone-based media market. Over shaksouka (a poached-egg dish from North African Jewish cuisine) and masala tea, their conversation flows freely from the Panama Papers to the new *Captain America* film to the local motion picture investment scene. Everyone at the table is well informed. But when asked if they read newspapers, only one says yes. "I always read news at breakfast — but only peruse the headlines," she says.

This group is representative of India's global sophisticates. In media terms, they are *digital self-aggregators*; they get their information through Twitter, Facebook, and WhatsApp, following links to particular stories on the *Times of India,* NDTV, or *New York Times* websites. A few of them regularly scan aggregator apps like Flipboard, Inshorts, or Google News. What they consider "news" is highly varied, is easily shareable, and has an extremely short life span. And they're reading just about all of it on their mobile phones, connected wherever possible to high-speed Internet service from urban providers.

Meanwhile, rural communities throughout India constitute the largest and fastest-growing media market of all: *regional print readers.* India is one of the few parts of the world where newspapers enjoy rapid circulation growth. With free delivery, and a business model driven by advertising, newspapers cost only 5 to 10 cents per copy. For people who are largely first- or second-generation literate, the print newspaper is still a mark of status and a newly discovered window on the world. Families buy several papers daily and read them together at breakfast. Commuters read them on trains and buses, and discuss the contents during lunch and tea breaks.

In this world, Hindi and English remain the two most popular newspaper languages — Hindi is ahead by far — but regional papers published in vernacular languages such as Malayalam, Tamil, Marathi, Bengali, Telugu, and Gujarati are growing at a faster pace. In total, consumer print revenue from newspapers and magazines in all languages rose by an estimated 3 percent in 2015, and regional publications' revenues are expected to grow 12 to 14 percent annually for the next several years. At the same time, broadcast television remains popular, and the smartphone is increasingly prevalent. Some observers expect the heyday of English-language print in India to last only a few more years.

These three vignettes are typical of the way the India media market is evolving. While newspapers and magazines are thriving, especially in India's villages and in their non-English editions, hundreds of millions of people are moving to the smartphone as their main source of information and entertainment.

Like other emerging economies, India is condensing this evolution — which took more than a century in the West — into just a few years. The leap to digital, if it continues on its current trajectory, will divide the country's media, in effect, into three business models, each targeting a different audience: infotainment followers on feature phones, digital self-aggregators on smartphones in the cities, and newspaper readers in villages and small towns. All of these audiences watch broadcast television, but they are moving to digital media for news and entertainment — just at different speeds. Marketing, advertising, and media companies that want to win in emerging economies may find it useful to understand the differences.

As Sandeep Amar, CEO of India.com Media, puts it: "The truly big opportunity right now lies in mobile, video, and vernacular languages." The opportunities are huge, because not only are the audiences growing rapidly, but they're also poised for change. To succeed, each media company needs to decide which segments it can reach, and then carve out a business model for reaching those target segments, especially in new digital forms. (See "Vineet Jain on Leading India's Media into the Future," page 154.)

The Growth Trajectory

A confluence of factors have led to India's current media transition point. The first is accelerated access to technology. In December 2015, the Telecom Regulatory Authority of India announced that the country had more than 1 billion mobile phone subscriptions — a number second only to China's. India is also the third-largest smartphone market, after China and the U.S., with 239 million smartphone users. It is expected to overtake the United States in 2016.

The growth of mobile broadband is being promoted heavily by one of India's most influential companies. At the April 2016 media business conference hosted by the Federation of Indian Chambers of Commerce and Industry (a major industry group), Reliance Industries chairman Mukesh Ambani referred

HUNDREDS OF MILLIONS OF PEOPLE ARE MOVING TO THE SMARTPHONE AS THEIR MAIN SOURCE OF INFORMATION AND ENTERTAINMENT.

to Jio, Reliance's new $22 billion telecom venture, as "one of the largest transformational greenfield digital initiatives anywhere in the world." His description of Jio was widely noted. It would be, he said, "a 4G broadband service, slated to provide 70 percent of India's population with speeds 50 to 80 percent faster than the currently available Internet, with data prices well below current rates."

The government is also promoting accelerated access to digital technology. Its Rs1.13 trillion ($17 billion) iDigital India initiative will provide biometrically based digital identification for all citizens. It is also dramatically increasing connectivity, particularly in rural areas. Digital India has promised to install broadband in 250,000 villages by 2017, free Wi-Fi in public schools and universities, and public Wi-Fi hot spots in all major Indian cities by 2019. In addition, the government is developing electronic healthcare, education, infrastructure, and banking services, all of which are already drawing people online.

India's media habits are changing as a result. In her annual report on the Internet economy, Mary Meeker, partner at Kleiner Perkins Caufield & Byers, estimated that in 2016, 65 percent of all Internet traffic in India will take place on mobile phones. "The mobile is no longer the elitist screen, or the 'second screen,' as some used to refer to it," says Paritosh Joshi, CEO of India TV (a Hindi news channel with 90 million subscribers). "It is the most personal, ubiquitous, democratized screen, and the majority of India is on it. We are a mobile-first country."

Yet India's tremendous growth in mobile content consumption has not come at the expense of print. That's in part because of a second key factor in the

nation's digital transition point: increasing literacy, and the way it has expanded the audience for print media. The country has a literacy rate of 71 percent, up from 12 percent in the 1940s, and boasts one of the highest literacy growth rates, about 9 percent per year. Moreover, compared with the rest of the world, Indian residents pay very little for newspapers. Fifty years ago, newspapers had government subsidies; today, advertising revenues allow publishers to keep the price as low as about Rs3 (5 cents) per copy. This has made the newspaper into an aspirational commodity for newly literate low-income readers.

Siddharth Varadarajan, founder of thewire.in (a news site) and former editor of the *Hindu* (a leading English-language newspaper in South India), says, "Indian newspapers are terrified of raising their prices. They believe that the phenomenal growth we have seen is because the papers are really cheap."

A third major factor, India's high-growth economy, has helped increase advertising revenues throughout the industry. India currently has the most vibrant economy of the BRIC nations. Millions of people in middle-tier cities and small towns are eagerly entering the consumer economy and building their personal wealth. In April 2016, the International Monetary Fund projected India's GDP growth at 7.5 percent annually, which is higher than China's. The entertainment and media industry directly benefits from the economy's high growth; for example, entertainment and media advertising revenues grew more than 10 percent year-over-year in 2015, and are forecast to maintain a compound annual growth rate of 8.6 percent to 2020. As one might expect in a newly industrializing economy, the categories with the largest ad spending are consumer packaged goods (known as fast-moving consumer goods), retail, and e-commerce.

"India is the fastest-growing ad market among all the major markets of the world," declares C.V.L. Srinivas, group chief executive of Southeast Asia for Group M, a global media investment group. He adds, "2015 was the best year for ad spend growth we've had in the last five years. While digital will remain the fastest-growing platform, India is one of the few large markets where all traditional media platforms will show positive growth."

Only one category of print publication appears to be headed for decline: English-language newspapers. Although they continue to post strong circula-

"INDIA IS THE FASTEST-GROWING AD MARKET AMONG ALL THE MAJOR MARKETS OF THE WORLD."

tion and revenue numbers, their readers tend to be younger, more educated, and more urban than the readers of other newspapers — and thus they are expected to migrate more quickly to digital content.

This finding reflects a fourth major factor: India's enormous youth population with its digitally oriented culture. Not surprisingly, millennials are forsaking the print newspapers that were the staple of their parents' generation. "More of our audiences [are] consuming content on their mobile phones," says Pankaj Mishra, the former technology editor of the *Economic Times,* who left to cofound Factor Daily, a technology-oriented digital media startup. "We realized we had to move with them."

India's Media Ecologies

The audience for each of India's media subsectors is larger than the total population of many countries. Each sector is thus attracting its own unique group of entertainment and media providers — its own interrelated media ecology, consisting of the creators, the publishers and channel owners (on the Web and elsewhere), the advertisers and marketers, and those who track results.

Consider, for example, the digital self-aggregators. Like the habitués of that Mumbai restaurant, they are globally oriented, open to new ideas, and highly partial to peer curation over traditional news and entertainment channels. They use Twitter; Facebook; and DailyHunt, an Indian news aggregator app with editions in 10 languages, which have a total of 6.5 million monthly active users.

YOUTH KI AWAAZ, A CROWDSOURCED NEWS AND OPINION STARTUP WITH THE SLOGAN "PUBLIC OPINION IS THE NEW SUPERPOWER," HAS 2 MILLION MONTHLY VISITORS.

"We've been very clear from the beginning that we cater to this group," says Samir Patil, founder of Scroll, a digital news startup, which he describes as a "destination site for thinking India." He adds, "We did not lower the quality bar to chase audiences. We trusted instead that our audience would find us." Indeed, Scroll grew to a million readers in its first four months. Patil attributes that success to its social media–style ambiance. Almost 80 percent of its traffic comes from Facebook and Twitter.

Many other startups are trying to reach this market, some with venture capital. Youth Ki Awaaz, a crowdsourced news and opinion site with the slogan "Public opinion is the new superpower," has 35,000 contributors and 2 million monthly visitors; it is funded by Quintillion Media, a digital content venture founded by Raghav Bahl, founder and former managing director of Network18, and his wife, Ritu Kapur. Another site aimed at young people, ScoopWhoop, raised $4 million from Kalaari Capital, which it intends to invest in ScoopWhoop Talkies, a video production unit. Inshorts, which limits the news stories it publishes to 60 words, is the fourth-most-popular Indian news app and has raised $24 million in funding from Tiger Global.

When designed to foster community (for example, when anonymity is discouraged and people post comments with their real identity), these digital efforts have social network–like qualities that actually raise the level of discourse. "There's a human psychology effect," says Patil, "where readers will share stories that make them look good."

The infotainment followers are very different. On their feature phones, they

tend to follow sites that keep their articles and videos short and full of hooks. Most of these media sites offer a combination of popular headlines; film information; and sports, lifestyle, auto, and market news.

India's traditional media houses, which display a deep knowledge of their varied audience, have tapped into this market with digital offerings. For example, Indiatimes.com, the most successful English news website, belongs to the Times Group, the publishers of the *Times of India,* the world's largest-selling English daily. The site has 19 million unique visitors per month. NDTV's English and Hindi sites as well as Zee's India.com are among the largest digital crowd pullers in this market. Anant Goenka, head of new media at another major newspaper, the *Indian Express* (*IE*), celebrates the paper's digital experience by saying, "I'm very happy with the reach and revenue of the last two years."

Many publishers are focused on the regional print readers, who generally favor languages other than English. The Times Group is expanding to 12 regional-language editions. The *Hindustan Times,* the *Hindu,* and the *IE* are making similar transitions. As in the U.K., a person's choice of newspaper often reflects his or her political stance, religion, and profession as much as geographic location. For example, *Hindustan,* the flagship Hindi-language newspaper published by the *Hindustan Times,* has grown 11 percent per year in recent years, compared with 4 to 5 percent for its English-language equivalent.

Although the size of this media market is often ignored by those outside the country, India's media leaders are keenly aware of it. India TV CEO Joshi calls the English-speaking audience "a vanishingly small minority" in comparison. "Take the example of just my channel," he says, referring to one of India's most popular Hindi-language news channels. "It draws a viewership of around 80 million per week," compared with 1 million for all the English news channels in India combined. That's just one of several major channels in Hindi, which in turn is just one language; Tamil and Telugu channels each have tens of millions more viewers.

One trend has accelerated growth for all three audience categories: the increased popularity of video, especially when streamed or downloaded from the Internet. Indian investors are scouting actively for video content companies. Betting on this trend are startups like Nyusu, a self-funded venture. The self-

proclaimed "one-minute, multi-lingual, video news app for Android phones" provides short videos in six regional languages, featuring opinion journalism.

Another hopeful enterprise is Ping Digital Broadcast, launched by Govindraj Ethiraj, the founder and former editor-in-chief of Bloomberg UTV. He explains that the motive behind Ping was "questioning whether we wanted to cater to the audiences of yesterday and today, or to create for the audiences of tomorrow." Ping offers infotainment categories such as food, music, gaming, fashion, and technology. For more serious topics, Ethiraj also founded Boom Live, an independent digital journalism initiative focused on what he calls "impact docu-news." One of his most popular video series, *Explained in 90 Seconds,* condenses complex issues like the European migrant crisis into very brief primers. "Our next step is to do it in 30 seconds," he says.

These emerging video enterprises are betting, of course, that the smartphone and broadband continue to take market share. It's a reasonable expectation; an International Data Corporation report taps India as one of the fastest-growing smartphone markets in the Asia-Pacific region, with sales of 4G devices outpacing those of their 3G counterparts, and smartphones expected to move from their current 40 percent market share to 50 percent or more by the end of 2016. If projections like these are correct, then in many villages, video will not arrive through today's broadcast channels. People in India, even while watching large-screen TVs, will get their news and information through the Internet.

The Strategic Response

What do these trends mean for the business model of a major media company? To start with, the advantage is still with print over digital when it comes to advertising revenues. Close to 40 percent of 2015 advertising spending in India went to print publications, and less than a tenth of ad spending was on Internet advertising. (The rest went to various forms of broadcast.) Although Internet advertising spending grew by 24.2 percent in 2015, compared with 5.3 percent for print and 13.5 percent for broadcast television, the total amount of Internet advertising remains much smaller — about Rs32 billion ($499 million), compared with Rs163 billion ($2.5 billion) for print and Rs204 billion ($3.2 billion) for television. Print, in particular, is regarded in India as a prestige advertising play:

"PURE NEWS OFFERINGS WON'T BE ENOUGH TO SUSTAIN A BUSINESS. THE MODEL OF THE FUTURE WILL BE A COMBINATION OF CONTENT, COMMUNITY, AND PERSONAL SERVICES."

It is the medium where brands are built, especially in consumer-oriented sectors such as food, personal care products, and real estate.

But as Scroll's Samir Patil pointed out in a 2015 white paper, these spending levels don't reflect usage habits. "Indians with Internet access spent over half their media engagement time online," he wrote. If digital advertising spending were proportional to the time spent on each platform, advertising spend on the Internet would rise to Rs192 billion (about $3 billion), or six times current levels.

One problem, of course, is the ad-subsidized model for print — and the widely held view that subscribers will not pay much for information. Digital subscription vehicles, such as paywalls, are not treated with serious consideration by a majority of publishers, for fear that their markets will erode. "When I began this job four years ago," says *IE*'s Goenka, "I believed that we would eventually institute a paywall. *IE* was creating the kind of content that was worth paying for. I quickly backtracked from that. That thinking doesn't work here."

Moreover, advertisers have yet to fully embrace the Internet as a vehicle. The Internet audience is still only one-tenth the size of the television news audience, and Internet-based news is more likely to be aimed at urban digital self-aggregators. The traffic on newspapers and TV is more varied, spread across more geographies, and more oriented to family than individual access.

Vikas Kothari, a venture capitalist at the Mumbai-based private equity firm Lightbox, argues that over time, digital startups — which can easily gather and track usage data — have an advantage over incumbent media companies, especially in countries such as India where they can leapfrog past conventional

practices. "Outsiders have nothing to lose, while incumbents have to disrupt their own business models," he says.

All of these concerns may well vanish, of course, when media companies see the audiences for digital media solidify — especially when millions of people begin to watch massive amounts of video online. Because relatively few Indians have credit cards, billing through mobile carriers will probably be the most successful early payment method. It has already been employed successfully by the Indian music site Saavn and by the content distribution company PK Online, whose audience views about 50 million videos per month. Even where individuals possess credit cards, the government's two-factor authentication rules make online payments a more cumbersome (albeit safer) process. Online micropayments companies such as Yippster, which offer direct carrier billing through a simple SMS, have solved that problem.

Nickhil Jakatdar, CEO of Vuclip, a video-on-demand service, recalls Airtel's one-minute video for Rs1 as an example. "If you ask users to pay each time for each video, they won't do it. But if you offer them a one-time payment plan, like unlimited or 10 videos a day for Rs10, they readily subscribe."

Some publishers believe the subscription-based monetization and advertising models may be helped by a multiservice approach. "Pure news offerings won't be enough to sustain a business," says India.com's Amar. "Even content by itself is not enough. I see the model of the future being a combination of content, community, and personal assistance services." Some news websites in India now include curated city guides and local referrals, whereas others include partnerships with global content providers such as the Huffington Post (for Times Internet Ltd.), Quartz (for Scroll), and the *Wall Street Journal* (for livemint.com, a *Hindustan Times* property). These allow Indian media companies to provide their global news–hungry audiences with diversified international content, while enabling U.S. and European news media companies to tap into India's promising markets. They already know, from traffic on their own websites, that they have sizable potential Indian readership.

The stakes are high for media and entertainment companies in India. Overall, total entertainment and media revenue is expected to reach about Rs2.7 trillion (about $41.1 billion) by 2020, rising from Rs1.6 trillion ($25.1 billion) in

2015. Much of this will be drawn from advertisers, which tap into the consumer demand of a giant emerging middle class.

If you are a media enterprise leader — within India or looking in from another country — the three audiences of India give you a solid starting place. You may have entertainment or media tailor-made for the vast infotainment-craving population on their feature phones and smartphones. Perhaps you have niche mobile news content that caters to the sophisticated urbanites. Or your future growth may lie with the vernacular print audiences in India's smaller cities and villages. Each of these markets will require a different approach to advertising, subscriptions, and monetization.

In the end, however, you cannot let this broad segmentation blind you to the one big factor all three groups have in common: They are becoming mobile-first audiences. India, along with other developing economies, will soon have millions of connected, energetic individuals ready for digital media that meets their aspirations. They see themselves living in a world of opportunity. They want to have it all — all the media of the world delivered immediately, accessibly, and inexpensively. They want the one screen that is inexpensive, ubiquitous, and always on. As in the rest of the world, the smartphone is a gateway to news and entertainment that didn't exist just a few years ago, and that continues to evolve at digital speed. ✚

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Resources

Dan Bricklin, "Radical Intimacy and the Smartphone," *s+b,* Apr. 5, 2016: Brief summary of the distance many companies still must travel to adapt to the close connection people have with their mobile devices.

Roger Martin, Sally R. Osberg, and Jennifer Riel, "Social Entrepreneurship by the Billions," *s+b,* Mar. 29, 2016: Looks at Nandan Nilekani's project to provide digital ID numbers throughout India as an example of how to effect large-scale change.

MediaNama website, www.medianama.com: Good source for all things digital in India.

YourStory website, http://yourstory.com: A media platform for startups and entrepreneurship in India.

NextBigWhat website, www.nextbigwhat.com: Covers digital entrepreneurship, with a strong focus on India.

More thought leadership on this topic: strategy-business.com/outlook

Vineet Jain on Leading India's Media into the Future

by Munnish Puri

"History is history. I only care about what's coming next." So says Vineet Jain, the managing director of BCCL, also known as the Times Group. BCCL is India's largest media conglomerate, with revenues of about Rs100 billion (about US$1.5 billion) per year and with more than 13,000 employees. It publishes the *Times of India*, the world's largest-selling English-language daily (reaching more than 7.6 million readers), and the *Economic Times*, the second-largest-circulation English-language business newspaper (the *Wall Street Journal* is the largest). It also owns 40 FM radio stations, 15 online radio stations, 15 magazines, a number of popular television channels (including Times Now, ET Now, Movies Now, and Zoom TV), and live-event businesses such as the Miss India Pageant and the Filmfare Awards (the "Oscars of India").

BCCL traces its history to 1838, when its first newspaper, the *Bombay Times and Journal of Commerce*, was founded; Jain's family has owned and managed it since 1948. Despite this size and longevity, BCCL is also one of the most entrepreneurial and rapidly changing media businesses in the world.

Under the leadership of Jain and his older brother, vice chairman Samir Jain, BCCL has introduced many innovations in advertising and digital technology, including matrimonial and real estate portals; a smartphone app called Alive, which links scanned print images to downloaded videos; partnerships with the Huffington Post, Airbnb, and Uber; and Brand Capital, which develops and funds marketing efforts in India for startups. BCCL also owns Times Internet Ltd., one of the largest digital media providers in Asia. With entertainment and media industries facing massive disruption everywhere, we met Jain in his Mumbai office to ask about his strategy for the digital age.

The insights here about media in emerging economies are relevant to many other media companies around the world as they navigate major shifts in technology and audience demand.

Photograph courtesy of Vineet Jain

S+B: What do you see as the greatest challenges facing BCCL, and how are you responding to them?

JAIN: The growth of digital has altered the nature of media, and has challenged norms of what it should be. We are fortunate in India to have visibility into global trends, which allows us to proactively address them. We continue to innovate in print and television media, which drives their growth in circulation, viewership, and revenues. And we're aggressively building a digital media business that over time could become larger than our more mature businesses.

S+B: You were an early strong believer in Internet-based publications, back in the early 2000s. What did you see?

JAIN: The newspapers in the West were dying. I felt that the same fate would befall India; maybe not for 10 years or more, but eventually. Therefore, we would have to establish a big Internet company. We invested at the beginning. Also, the digital medium is interactive, and the newspaper is a one-way, passive medium. Interactive media always wins over passive media.

We believe that Times Internet, our digital arm, will one day be a larger business than BCCL is now. Today, it reaches over 171 million users, who spend billions of minutes a month across a number of our products. At the same time, we continue to focus on providing value to consumers across all media — print, television, radio, and others.

S+B: How are the dynamics of news and journalism being altered by mobile technology?

JAIN: Mobile technology, in particular, is rapidly changing the way the news is consumed as well as produced. Capturing news is more "real time" than ever before, and increasingly, anyone with a smartphone can capture the latest events. We now give all our journalists smartphones to video-capture events live. We are also shifting our focus from long-form content to shorter, smarter pieces. Our ability to be pointed, fast, and crisp has improved substantially.

S+B: India has a vibrant but fragmented audience. There are millions of people with very different social, economic, and ideological characteristics.

How do you address the needs of such vastly different segments?

JAIN: Our company was traditionally centered around the elite Indian consumer. The *Times of India* and *Economic Times* are a core part of their daily habit. But over the last 10 to 15 years, our entertainment products, such as Zoom Entertainment Network, Radio Mirchi, and Gaana [a music streaming service], and our non-English print brands, such as *NavBharat Times* and *Vijay Karnataka*, have widened our user engagement bases. We expect that the majority of our audience growth during the next few years, across media, will come as we expand further into the heartland of India. We feel we also have a significant opportunity with the Indian population residing overseas.

S+B: Will advertising continue to be the dominant revenue model for Indian media companies, or do you foresee other revenue sources taking its place?

JAIN: Advertising is still underrepresented in India. Only about 0.35 percent of GDP is spent on advertising, compared with 1.5 to 2.0 percent in the rest of the world. We still see room for significant growth.

Online, our increased presence in performance advertising and classifieds is opening up a larger advertiser segment than ever before. Increasingly, across media, brands are looking for native solutions that are less about interrupting the consumer and more about embedding a message or brand into his or her conversation. Internationally, there is a huge opportunity to build a commercially viable model with the Indian audience at the core. This gets amplified when you consider the age dividend that India enjoys — its high proportion of young people. We are sure that the overseas young diaspora will become a valued audience over time.

S+B: What is BCCL's approach to new technologies, like wearable devices and the Internet of Things?

JAIN: I constantly think about what is coming next. If you don't disrupt your own business, someone else will disrupt it. We thus continue to experiment and innovate, leveraging our technology capabilities and our understanding of the consumer. For instance, Alive is our experiment with augmented reality.

These technologies need an effective infrastructure in place, including great

connectivity, to provide the immersive experiences that will delight consumers. Unless media outlets can think about capturing consumer mind share with great product and content experiences, they risk losing their audience's attention.

S+B: You have opened a Brand Capital office in Silicon Valley. What is going on there?

JAIN: When we look at digital, there are so many international technology companies that haven't come to India yet. It could take them another five or 10 years to do so. We want to reach them much earlier; we think they would find markets and opportunities here.

We are beginning to act as venture capitalists. We invest in small technology companies, and we also barter advertising in our media, in exchange for a small stake in these companies. We aim to invest at an early stage.

S+B: What is your view of social media?

JAIN: Traditional media houses and newsrooms have to embrace social media. You can't fight this technology. In fact, it generates a large part of digital traffic. You have to understand Facebook consumers, and follow the conversations they are having, because their reading habits are very different [from those of traditional consumers]. I tell our journalists to get on Twitter and Facebook, because then they experience the gap between what they think is a good story and what people are reading.

The newspaper of tomorrow has to be much more than printed text. When we first launched our television news channels, I was already thinking of digital convergence. I knew that the *Times of India* would require video content, and that we would end up sharing our content among newspapers, radio, television, and the digital medium.

We are moving in the direction of a common newsroom, where we constantly update our news and we don't wait for the big print story that gets published first. Sometimes, we will have to release something that is short and quick and exciting with one photograph attached. It may be superficial, but that is what works.

We are moving from pure news toward entertainment, short-form content, and fun videos. The definition of news has changed completely.

S+B: Millennials [people age 16–36] make up a significant percentage of the Indian audience. What kind of content speaks to them?

JAIN: Millennials want to consume content from wherever they are, especially on social media. They want to read what their friends are sharing, not what an editor chose to put on the front page. They prefer short-form to long-form, as far as news is concerned.

For a 16-year-old urban middle-class kid, the preferred medium of consumption of news and entertainment may not be of a physical newspaper or a television. He or she most likely consumes it over the Internet and on mobile.

S+B: Even though time spent on digital media by young people is far greater than time spent on print and TV, we haven't seen a correspondingly large shift in advertising dollars. Why is that?

JAIN: The traditional media outlets offer reach, which is not easy for any advertiser to ignore. This will not change for a long time, even though digital advertising may be more measurable. For large-format businesses (consumer products, apparel, financial services), reach will always be relevant. Although digital advertising is growing faster, we expect it will take a long time before we can ignore traditional media altogether.

S+B: On your Twitter profile, you mention "driving change" as your motto. What are the core values that influence your own decisions and thinking?

JAIN: I am a great supporter of personal freedom and liberty. I think the government and legislature should stay out of people's lives as much as possible — whether it's a matter of food, religion, or sexual orientation. Political leaders should instead focus on development. They should lay down modern, reasonable, and clear-cut rules, and then give business and industry a free hand to grow and create jobs.

The government should also be fair and transparent in its dealings. For a decade I've maintained that the arbitrary and opaque allocation of natural resources — whether coal or broadcasting spectrum — is the single biggest cause of corruption in India. We should move toward e-auctions that can stand up to audits and scrutiny. The *Times of India* has been at the forefront of this campaign, and I'm happy to say

that the government has really worked to clean up this process. This was a campaign of national importance, and went to the very root of good governance.

In general, I'm driven by what I think is right or just, even if it means being politically incorrect. And that inevitably means driving change, especially in this industry and this country. I believe a leader should push himself or herself to get out of his or her comfort zone and take calculated risks. We should be ready to challenge the status quo, innovate constantly, and disrupt our own company's business model. To be in business in the media industry is very exciting right now. Every day is a new day, especially in digital media. I am continuously learning.

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is the managing director of Indian Film Advisors (Only Content Matters) and Indian Financial Advisors (Only Trust Matters). He was the chief operating officer of BCCL's Times Infotainment Media from 2004 to 2009, where he managed the businesses of filmed entertainment, live events, and out-of-home advertising.


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FAN FAVORITES

BY ERIN REILLY

In order to build engagement and loyalty in a climate of intense competition and distraction, media companies have to understand their customers, viewers, and readers as fans.

IN 2014, I spent a lot of time around soccer fans. I regularly hung out at the sports bars frequented by Los Angeles's official Real Madrid supporters club. My friends constantly shared with me, via email and social media, soccer-related websites, articles, and videos highlighting soccer fans and their love of the sport — and I clicked on them. I posted on soccer blogs, and rang up a bunch of credit card purchases in Brazil in July, during the World Cup. If my phone, the sites I visited, and the merchants I patronized had been collecting all the data associated with the places I went, the people I spoke to, and even the purchases I made, an analyst could easily have concluded that I was an ardent soccer fan (or, as people outside the U.S. would say, a football fan). But I'm not; at least, I wasn't. At the time, I was studying sports fans as part of a research project with Havas Sports and Entertainment, to understand their passions and how they engage with brands — especially the brands that sponsor players, teams, and events in hopes of giving sports fans the experiences that they want. In doing so, I wound up becoming a case study in my own project.

Illustration by Dan Page

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My data trail marked me as a soccer fan, and continues to do so to this day. As I go about my business online, I am continually served automatically generated soccer-related recommendations and ads.

My experience is, of course, not unique. The widespread use of mobile devices has shifted the way we think about, understand, and participate in the world. Sometimes by permission (but often without our awareness), we continually funnel our locations, habits, desires, and selves into a pool of knowledge that every company wants to drink from in order to better understand and serve us. Each of us increasingly leaves behind trails of data that become crucial in shaping our digital identity.

Marketers, creatives, and nearly everyone else in the entertainment and media ecosystem are doing everything in their power to acquire and understand that data. They want to create relationships with their consumers, so that they remain loyal audience members, fans, and customers who really love their shows, their teams, and their brands.

In theory, new technological advances such as big data and machine learning, combined with more direct access to audience sentiment, behaviors, and preferences via social media and over-the-top delivery channels, give the entertainment and media industry unprecedented insight into what the audience actually wants. But as a professional in the television industry put it, "We're drowning in data and starving for insights." Just as my data trail didn't trace an accurate picture of my true interest in soccer, no data set can quantify all that consumers are as humans. At USC's Annenberg Innovation Lab, our research

has led us to an approach that blends data collection with a deep understanding of the social and cultural context in which the data is created. This can be a powerful practice for helping researchers understand the behavior of fans — fans of sports, brands, celebrities, and shows.

A Model for Understanding Fans

Marketers and creatives often see audiences and customers as passive assemblies of listeners or spectators. But we believe it's more useful to view them as active participants. The best analogy may be fans. Broadly characterized, fans have a continued connection with the property they are passionate about. Some are willing to declare their affinity through engagement, some have an eagerness to learn more about their passion, and some want to connect with others who share their interests. Fans are emotionally linked to the object of their passion, and experience their passion through their own subjective lenses. We all start out as audience members. But sometimes, when the combination of factors aligns in just the right way, we become engaged as fans.

For businesses, the key to building this engagement and solidifying the relationship is understanding the different types of fan motivations in different contexts, and learning how to turn the data gathered about them into actionable insights. Even if Jane Smith and her best friend are fans of the same show, the same team, or the same brand, they're likely passionate for different reasons. For example, some viewers may watch the ABC melodrama *Scandal* because they're fashionistas and can't wait to see the newest wardrobe of star Kerry Washington; others may do so because they're obsessed with politics and want to see how the Donald Trump–like character will behave. And those differences mean fans will respond in varied ways to different situations and content.

Although traditional demographics may give us basic information about who fans are and where they're located, current methods of understanding and measuring engagement are missing the answers to two essential questions: (1) *Why* is a fan motivated? and (2) *What* triggers the fan's behavior? Our Innovation Lab research group is developing a new model called Leveraging Engagement, which can be used as a framework when designing media strategy.

Fan Motivators

In his paper "Television 2.0: Reconceptualizing TV as an Engagement Medium" (2007), digital strategist Ivan Askwith offered an initial framework for thinking about viewer engagement. Here, we build on that insight by identifying certain motivators of fan engagement, which describe the various ways fans approach their passion and the goals that drive their behavior. The Leveraging Engagement model is an inexhaustible, shifting set of motivations — as we explore new genres of media, from e-sports to music sharing, new motivations emerge (*see Exhibit 1*). Here are a few examples of the motivators we've seen in different fandoms:

In sports, some fans engage through *identification*, strongly associating themselves with a passion and defining themselves as fans. Being a sports fan connects some fans to the place they call home; for others, their fandom is important because they believe the team they support says something about who they are. Anyone who has ever asked a resident of New York whether he or she is a Yankees or Mets fan can instantly appreciate the power of identification.

In unscripted entertainment where fans engage with a celebrity host, *advocacy* shines through as a motivator. *Advocacy* involves championing causes on behalf of one's passion and taking positions on issues of importance to the fandom, as fans rally to support the celebrity's causes or the positive impact they have on the community. For example, when comedian Jon Stewart held a March to Restore Sanity and/or Fear in Washington in 2010, more than 200,000 people showed up.

In music, the majority of music festival fans engage through *social connection*, or integrating oneself in a fandom in order to create or deepen relationships with other fans. For fans motivated this way, being around others who love the same music and enjoy singing along or dancing makes the experience.

In superhero story universes, the logic of *mastery* is manifested via a pronounced interest in learning and understanding detailed information and stories about one's passion. Some fans might want to know everything there is to know about Batman's history, whereas others might focus on certain details such as a specific period in time or a deep understanding of the relationship between Batman and Superman.

Fan Mind-Sets

Motivators act as lenses through which we can examine fans' behaviors and desires to engage with a specific type of content, people, or brands. Very few, if any, fans exhibit only one of the motivators at any given time in their engagement. Instead, fans are usually engaging through mixtures of these motivators, and common mixtures are recognizable as recurring *fan mind-sets.*

For example, a common fan mind-set among Americans interested in music is the "Vocalist." As the name implies, Vocalists frequently listen to music and sing along, most often in the car. Their mood drives their choice of song and genre. Vocalists typically look for new music to listen to and enjoy learning about music and musicians, and will still gladly purchase an album or other products artists might offer. However, they don't go out of their way to attend concerts or festivals, even though they are more likely than most music fans to play and create music. The Vocalist mind-set is a combination of *play, identification,* and *creation,* but a Vocalist is not motivated by *social connection* or *advocacy.*

Fans operating with the "Mixologist" mind-set listen to music just as frequently as Vocalists; in contrast, however, their passion is tied closely to friends, family, and other fans who are eager to discuss and share their knowledge about music and musicians. It is the feeling of being connected to a community of fans that matters most, regardless of whether it's in person at the Bonnaroo music festival or online via Phish fan sites. The Mixologist mind-set is a combination of *social connection, advocacy,* and *exploration.*

In our research, we've seen similar mind-sets emerge in both scripted and unscripted entertainment. There are fans of expansive story universes, such

Exhibit 1: **Motivators: What Drives Fan Behavior**

Entertainment: enjoying the overall experience and atmosphere surrounding one's passion
Social Connection: integrating oneself in a fandom in order to create or deepen relationships with other fans
Mastery: consistently learning and understanding detailed information and stories about one's passion
Immersion: losing oneself in the parallel universe surrounding one's passion by shifting one's focus from real life
Identification: strongly associating oneself with a passion and defining oneself as a fan
Pride: reflecting one's fandom in outward appearance and public behavior
Advocacy: championing one's passion and taking positions on issues of importance to the fandom
Play: participating (virtually or in real life) in activities related to one's passion
Creation: expressing interest in how the original subject was made, or making original content/media related to one's passion
Exploration: seeking to discover new points of interest related to one's passion or to be in the know about what's new and on the cutting edge related to the passion
Collection: striving to own a complete set of some specific objects or other items related to one's passion

Source: Erin Reilly

EVEN IF JANE SMITH AND HER BEST FRIEND ARE FANS OF THE SAME SHOW, THE SAME TEAM, OR THE SAME BRAND, THEY'RE LIKELY PASSIONATE FOR DIFFERENT REASONS.

as *Star Wars,* who are just as obsessed as soccer "Connoisseurs," eager to master everything there is to know about the history, characters, locations, and plot twists within that universe, and to share their knowledge with others. However, even if fans have the same motivators, their particular fan mind-sets (or the combination of motivators they're exhibiting at any one moment) may lead them to express their passion via unique behaviors.

Understanding Triggers

Although most fans will hold just one of these fan mind-sets most of the time, they may shift to other mind-sets according to changes in their unique situational triggers. These triggers, which may take the form of tangible objects or discrete actions, can be based on a number of factors, including geographical and virtual location, level of knowledge, strength of social networks, and emotions. If media producers can understand the objects and actions that inspire certain fan mind-sets, they will be better able to create content and activities that can help these fans engage more deeply with a given team, story, or brand.

Let's return for a moment to my experience as a soccer fan. One of the soccer fan mind-sets that emerged in our "Fans, Passions, Brands" study was that of the "Follower." Followers are not likely to be aligned with any of the motivators we've identified except *entertainment*, and the most fleeting form of *social connection*, sparked largely by a desire to strengthen personal connections with friends and family. Followers enjoy watching, especially during

close games or exciting finishes, but they are not deeply invested in being fans. The Follower mind-set is often held by the mothers and wives of more avid soccer fans. Followers could also be the fans who are turned off by some of the over-the-top elements of sports fandom, such as violence, excessive cheering, and poor sportsmanship. They typically don't care much about understanding details and don't possess strong opinions about the sport.

Even a year after my entry into soccer fandom, I identified myself as a Follower. But when my context changed, triggers altered my engagement and my identity. During my trip to Brazil for the World Cup, I socialized with devoted fans and attended large gatherings that shifted me from being a Follower to being a "Mascot." Mascots are loud, high-energy, high-emotion, fun-loving fans. They get wild when matches get exciting. And they have a great time being fans. They love stories about the sport, but don't pay much attention to statistics and tactics. Most importantly, Mascots are often partial to a specific team or nationality. When I went to Brazil, my favorite T-shirt featured Cristiano Ronaldo, the Portuguese striker with movie-star looks who plays for Real Madrid. But I watched the highly fraught game between Portugal and the United States — which ended in a last-second match-tying goal — in a crowded bar surrounded by screaming U.S. fans who were waving flags and chanting "U-S-A! U-S-A! U-S-A!" And when I became caught up in the moment, my behavior changed. Being united with fellow Americans, thoroughly entertained, I found that my new motivators were *identification* and *pride.* There was no way I was going to take off my USA sweatshirt to reveal the Ronaldo jersey underneath. I was right in there with everyone else, chanting loudly and feeling the pain of being robbed of our victory at the last second. In that moment, I was a Mascot of the U.S. team, and I still follow it today.

Enter on Your Own Terms

The challenge of working with the concept of fandom is the absence of a hierarchical ranking into which we can slot various fan groups. The entertainment and media industry widely believes that 80 percent of its revenue comes from the 20 percent of its audience who are frequently referred to as "superfans." Some might not consider Followers to be true fans; in contrast, Connoisseurs could

WHEN WE LOOK AT FANS THROUGH THE LENS OF MOTIVATIONS AND TRIGGERS, WE DISCOVER MULTIPLE POINTS OF ENTRY INTO A FAN COMMUNITY, WITH MULTIPLE VERSIONS OF MEANINGFUL ENGAGEMENT.

be classified as superfans. But this sort of taxonomy papers over the opportunities that each mind-set offers in an engagement strategy. And when we look at fans through the lens of our two core questions of motivations and triggers, we discover multiple points of entry into a fan community, with multiple versions of meaningful engagement.

The model displayed in Exhibit 2 (next page) offers insight into the pathways of potential mind-set shifts for soccer fans. As shown by one of the orange bidirectional arrows, "Patriots" (dutiful fans of their favorite team often connecting home and family to their passion) can transition into "Explorers" when they start to get excited about playing actual soccer, fantasy soccer, or soccer-related games.

Now, take a look at one of the blue bidirectional arrows. "Observers" don't usually become Mascots without "leveling up" socially into the Follower mind-set first, but they can when the party atmosphere is most intense (at big international tournaments, for example). Moving in the other direction, most Mascots have too much single-team focus (rooted in *identification* and *advocacy*) to step back into a role as an Observer, but their loyalty isn't as strong as that of Patriots, so they just might make that move if their team is doing badly for a long stretch of time.

When we move away from using terminology such as *segmentation* or using profiles that rigidly relegate fans to a specific group, and instead turn toward terms such as *motivators, mind-sets,* and *situational triggers,* we have a framework that encourages agility, evolution, and relevance to each person. We recognize

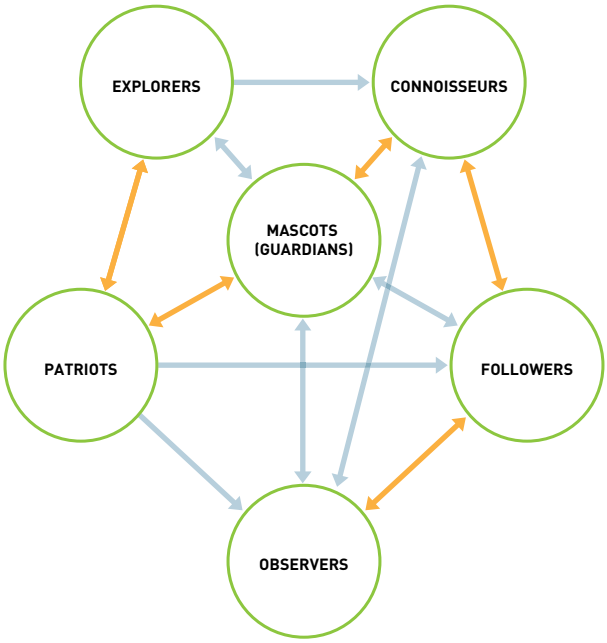
the importance and complexity of each fan (and each potential customer), no matter how he or she chooses to engage.

Understanding Data

As fans exercise greater autonomy with respect to their media choices, industry leaders are seeking new, more refined ways to engage the majority of the audience, all the way down to niche communities. And the data is certainly there to assist in these efforts. The Internet and communications technology can help keep track of what fans are willing to purchase. Sentiment analysis has proven to be a useful tool in gaining the pulse of a specific time or situation, but cognitive analytics will help you use data to understand motivations and triggers in a way that supports effective decision making. In our research, we identified four steps to help you better understand your fans.

1. Ask the right questions. Keep in mind exactly what question you want answered, and be ready to return often to that question and reflect on whether it's still the right one. If you make the mistake of collecting too much information, then you'll be in the same situation as so many others who are "drowning in data and starving for insights."

Exhibit 2: **Soccer Fan Mind-Sets**
Orange arrows indicate more likely mind-set shifts.



Source: Erin Reilly

2. Standardize data collection. Relevant data sets are often owned or managed by multiple teams within a company or even external partners. When we studied a celebrity-driven unscripted entertainment property, we examined data sets from sources such as the show's website, the celebrity host's website, Facebook, and survey data. The lack of standardization across these platforms made it difficult to identify relationships and find deeper connections.

3. Expand your horizons. Relying only on proprietary data isn't using

the power of the Internet — or the power of businesses similar to your own that are trying to reach the same audience. In both our music and entertainment studies, we distinguished between social media posts that were "authored by the brand" and those "not authored by the brand." The majority of the "authored by the brand" and celebrity endorsement "conversations" happened on Twitter and Facebook. The content shared offered minimal conversation or discussion. The motivators fans mainly engaged through were a combination of *entertainment* (for example, celebrities posting images and text such as "On set. Behind the scenes. This set is amazing!") and *social connection* (with celebrities again posting text and images such as "Circled back with some old friends"). And the conversations were not particularly rich. By contrast, most of the conversation surrounding the "not authored by the brand" category happened on sites such as Reddit and Tumblr, which offered posts of greater depth and nuance. For example, a post on Reddit shares a potential theory of the story unfolding on a television series and asks for thoughts and feedback from the community. As a result, motivators such as *creation*, *advocacy*, and *mastery* emerged more frequently.

4. Foster interdisciplinary teams and mixed methods. It's important for a research/consumer insights team to consist of both qualitative and quantitative experts, working together to develop the right set of questions to answer. Volumetric analysis, which is most prevalent in analytics today, allows researchers to identify specific performance metrics, such as the amount of time spent viewing content, comments, shares, and likes. Sentiment analysis has been widely used to address the signal-to-noise ratio inherent in volumetric analysis and provide a

WE HAVE TO LEARN TO VIEW A STADIUM FILLED WITH 100,000 SOCCER FANS OR AN AUDIENCE OF 7 MILLION TELEVISION VIEWERS AS A LARGE GROUP OF INDIVIDUALS.

quick way to assess the attitude of a conversation by identifying the text as positive, negative, or neutral. Advanced approaches to cognitive analytics using both natural language processing and image recognition can help provide insights into motivations, behaviors, and situational triggers for engaging with content, people, or brands. The more your team is well-rounded in its ability to harness and analyze data, the more likely it is to grasp the patterns that are not always immediately evident.

All this work is not easy. The overriding challenge is to introduce the human element into the study of mass behavior. We have to learn to view a stadium filled with 100,000 soccer fans, or an audience of 7 million television viewers, or a collection of 900,000 Twitter followers as a large group of individuals — each with his or her own motivations, cultural context, and way of relating to others. But the effort is worth it. Putting the human touch and time into developing models will grant us the ability to model data and thus find new insights on fans' mind-sets, tastes, proclivities, and interests. Offering a nuanced view to fans will help you better understand and respect what a fan values and how you, in return, can value the fan. +

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Thought Leader Interview: Sir Martin Sorrell

Outlook 2016–20

WPP's CEO explains how the global agency is deploying its resources to connect effectively with clients and consumers across industry and geographic borders.

BY DEBORAH BOTHUN AND DANIEL GROSS

Photograph by Phil Adams

Sir Martin Sorrell is one of the most enduring leaders in an industry that is famously transitory and focused on the shrinking human attention span: advertising and marketing services. As CEO of WPP, he presides over a parent company stocked with more than 160 operating companies. WPP's assets include iconic advertising agencies such as J. Walter Thompson, Ogilvy & Mather, Grey, and Young & Rubicam; media agencies such as MediaCom, Mindshare, and MEC; its data management arm Kantar (which includes Millward Brown and TNS); digital firms Wunderman, VML, Possible, and AKQA; public relations titans Burston-Marstellar and H+K Strategies; and public affairs outfits such as the Glover Park Group and Penn Schoen Berland — not to mention many other wholly owned operating businesses, associates, and investments. WPP is a global empire with 2015 billings of £47.6 billion (US$67.5 billion) and revenue of £12.2 billion ($17.4 billion). The company employs 190,000 people spread across 3,000 offices in 112 countries. As was said of the old British Empire, the sun never sets on WPP. Its operations touch every part of the global media industry, and, increasingly, other industries as well: technology, software, retail. And, unlike many others in the media business, WPP has managed to post steady growth in profits. Its earnings per share were up more than 10 percent in 2015.

The consistent growth and solidity of this company belie the churning waters in which it operates. The term *disruption* has been so overused as to have almost become a cliché. But it is difficult to think of industries that are being disrupted more than advertising, marketing, branding, and communications, the sandboxes in which WPP plays. Consider the ability of DVRs and other technologies to block and screen ads; the growth of time shifting; the introduction of new measurement tools; and the headlong rush of consumers to access media on tiny mobile screens (and then make purchases there). *Native content* — a phrase unheard of five years ago — has become de rigueur. Sand Hill Road in Palo Alto, ground zero of the venture-backed technology revolution, is now rivaling Madison Avenue as the geographic center of the advertising industry. As publishers give way to platforms, technology companies move into the ad business, clients develop their own content, and audience attention grows more elusive, advertising companies must develop ways to work, invest, and think collaboratively.

Sorrell sits at the center of this maelstrom. An air of calm pervades WPP's headquarters, in a townhouse in the Mayfair area of London, whose reception area more closely resembles an economics department at a university than a glitzy 21st-century multinational. (A shelf displays the many Cannes Lions awards the company has won in recent years.) In an unadorned conference room, Sorrell sat down with Deborah Bothun and Daniel Gross and discussed the necessity of coming together more effectively.

BOTHUN: At the PwC Global Entertainment and Media Outlook, we try to look ahead to see what the media industry revenue trends will look like over a five-year period, which is difficult. What will your business look like in five years?

SORRELL: In a sense there's violent change, and in a sense there isn't. The direction remains the same. We'll be a more integrated business. We'll be a more fast-growth-market business, although those fast-growth markets are not as fast as they used to be.

BOTHUN: Will you still be an advertising agency? Because you recently said WPP isn't in the advertising business.

SORRELL: Already, half our business is media and data. And we'll be a more digital business and a more data-driven business. But I don't see any massive changes in direction from where we've been going for the last five, 10, or 15 years. Digital will be 40 to 45 percent; that's inevitable. Data will probably be the same, maybe a bit greater. But the big engine of WPP is the $73 billion of media that we buy each year. Our billings are bigger than Google's. If you add it up, especially the data and the media, three-quarters of our business comes from stuff that Don Draper wouldn't have recognized 30 years ago. We probably wouldn't have recognized it ourselves 15 years ago. It's always very difficult to figure out what will happen going forward because the nature of our competition is changing.

> "Three-quarters of our business comes from stuff that Don Draper wouldn't have recognized."

BOTHUN: You've got your clients flirting with trying to do some of their own work, with native content.

SORRELL: There's a limit, though. I find it very difficult to believe that clients can do in-house programmatic advertising, for example, over the long term. When they've got low growth, very little pricing power, low inflation, and a focus on costs, I can't see clients spending a lot of time or money building their in-house programmatic advertising capabilities. And most of the good people in that area don't want to work on just one client, they want to work on a multiplicity of clients. You also have to keep up with the technology.

We buy $73 billion in media a year, and the largest single client we have does $6.5 billion. So we're about 11 times bigger than our largest client. And we can get the benefits of economies of scale. Now, it's true that our digital billings are only, say, about $23 billion out of the $73 billion. But we can get very, very great economies of scale, particularly in the highly fragmented online space.

BOTHUN: Let's talk about segments. There's a big focus on reaching youth today.

SORRELL: It's a bit troubling as to why, given the fact that the older segments are growing faster and they're wealthy. But that's a subject that's been with us for 20 or 30 years.

BOTHUN: In the 54 countries where the Global Entertainment and Media Outlook measures media, there is a pretty direct correlation between growth in entertainment and media spending and the proportion of the population under 35.

SORRELL: A direct correlation? I think that's understandable. I think younger people are more interested in music and entertainment and so on. But these are very fragmented audiences.

BOTHUN: So if you were giving advice to a 22-year-old who wants to be in the advertising, media, and marketing business, what would you tell her to do? Get a degree in data analytics? Become an IT specialist?

SORRELL: The answer to that question is really linked to the change in how we present. We used to present a strategic plan, and then out of that came a big cre-

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ative idea, and then came the media plan. Today, we'd probably start with a strategic plan based on heavy data input. We look at the behavior of the centennials (people born in 1997 or later) or the millennials. So, Snapchat versus Facebook. We do the analysis on them and the older demographics, and then we come up with an idea. It could be a single big idea or one that is segmented by media. And in a way, the medium has become more important than the message, in the sense that the nature of the medium determines what the message is. We may do one thing for a small screen like this [points to his iPhone], and, for a big screen like that [pointing to a colleague's tablet], we may have to do something different creatively or contextually. So when I'm playing a video game, instead of seeing an ad that is completely irrelevant to me, I see an offer for the latest edition of the Ford F-150 because they know I've recently done a search for pickup trucks.

Creative is still obviously very important. But the nature of the creative has changed. That's why we're not in the advertising business anymore; we're in the media, data, and digital business, predominantly. That's 75 percent of our business.

That doesn't mean that David Ogilvy's big idea or Stanley Reese's big idea or Ray Rubicam's big idea doesn't matter. But what it means is the other aspects have become very much more important. It's not just the 30-second, 60-second TV spot. So we need a creative who is prepared to employ data, to use technology.

GROSS: What type of stresses and pressures does that put on an organization and on senior executives who are not data scientists?

SORRELL: It means the skills needed are very different from the ones Don Draper had. There are also skills that you probably still need today. People in our business get very irritated when I say this, but it's a bit like King Canute and the waves, isn't it? You can't stop the tides. People are looking back with rose-tinted spectacles to a different era.

But to your question, you have to change the engines while the plane is flying. And that's difficult for anybody who has a legacy business. The disruptors have it very easy, because they're revolutionaries and can tear things down. And because the world economy isn't growing quickly, you have to focus on costs. And you have CEOs who last for six or seven years, CFOs for five or six years, and CMOs for only two years. You put those three things together, and that means it's a very tough environment.

GROSS: Given that tough environment, what do you do?

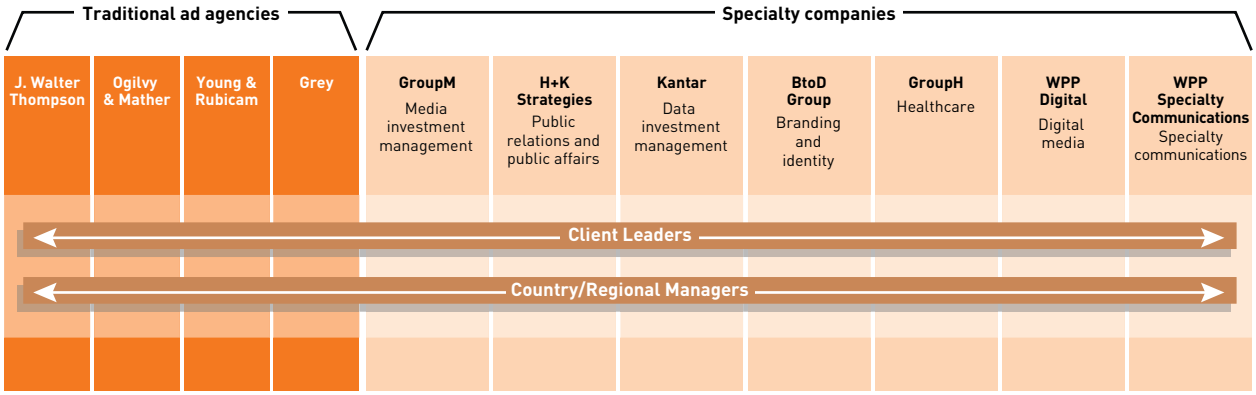
SORRELL: Three things. One, you need to move your traditional business quickly into the digital space. The second is to get your digital brands — we have five or six big digital brands like Wunderman and Possible and AKQA and VML — to move even faster within the digital space. The third is [to address] cannibalization. If you don't eat your own children, somebody else will. But the people in those traditional businesses, irrespective of whether they know what's going on digitally or beta-wise or media-wise, are emotionally tied to the business. So it's very difficult to change.

BOTHUN: One of the big points you emphasize is that firms like yours have to work with clients in new ways. You've become known for talking about "horizontality" in the ad business, meaning that people in different units and with different competencies should work together through client teams and country and regional managers. You've gone from 10 cross-group client teams in 2010 to 45 last year. How far can you take that?

SORRELL: Not far enough. The ultimate way you get to horizontality is to have one brand. That would be impossible, in my view, because the parent company would get confused with the operating company. However, we are increasingly organized by client and by country.

Exhibit: **Horizontal Approach**

By working together across vertically organized businesses, WPP can bring all its capabilities to bear on serving a single client or addressing a single geographic market.



Source: WPP

BOTHUN: Does horizontality also mean that you go to market by industry sector?

SORRELL: Yes. I'll show you how. We've got verticals that are sectors as well as being brands. [*See exhibit.*] The matrix is brands and function: advertising, digital, data, branding and identity, public relations, and so on. But under advertising we've got four brands: JWT, Ogilvy, Y&R, and Grey. I can't pull out somebody from here to put them in charge of all these things, because client conflicts immediately come out of that. So we have client leaders who work and manage horizontally, drawing from different units. We also have country and regional managers. Everybody looks at this image and says, gosh, that's a mess, which it is. But deliberately so, because we're just getting economies of scale.

BOTHUN: How do you incentivize people who are in five or six different groups, working for one client?

SORRELL: If they're working for the client, we're increasingly incentivizing them on the results of that client. That could be the client's revenue growth, or the client's profit, or the client's happiness and satisfaction. The biggest issue for us is how do you get everybody to think about the group as a whole? So all these people in that vertical have to think about that. And at the top of that organization it's even worse, because they are prouder. There's a sort of law of cooperation: The deeper you go down inside a company, the more cooperative people are.

Also, the better the people, the more difficult they are. Average people are easy to deal with; good people are difficult to deal with.

BOTHUN: What are you doing at WPP to develop your people?
SORRELL: We've got the WPP Fellowship, which is awarded to selected new hires at various points — entry, first degree, second degree, art school degree, and everything else. We have developed MBA-type training programs. Interestingly, the three countries where we've founded schools are China, in Shanghai; India, in Mumbai; and South Africa, in Cape Town. We find more flexibility and willingness among municipalities or institutions to invest in Shanghai and Mumbai and Cape Town than we do in London or New York or Paris, which is a shame.

BOTHUN: One of the things companies are struggling with is the fact that the talent in the two generations that are currently from age 21 to, say, 35 is becoming so fragmented. It seems like many sectors, especially technology, are looking for the same types of people that you would look for.
SORRELL: The investment banks probably have lost ground — and the tech companies have gained ground. The consultancy companies, yourselves included, probably remain the same. I think because we're seen as being technology-related, WPP has a relative advantage. The fact that digital is 40 percent of our business has given us an advantage. It's more sexy for youngsters.

BOTHUN: But you still have quite a bit of turnover. In fact, the turnover has been increasing in the last few years.
SORRELL: Our turnover is 20 to 25 percent — 20 percent in bad times and 25 in good times. That's too high. (At the senior levels, among the top 2,000 of our people, it might be 3 to 5 percent.) And in some markets, it can be as high as a third. What our leaders have to understand is that managing a strong growth business in a strong growth market means you're going to get high turnover. You can't stop that. The young Chinese men and women want to move fast, and compensation is important. And if you have a competitor.… One of the problems in our industry is that some companies grow by stealing people.

BOTHUN: At some point, do you say that this turnover is too expensive, and you have got to change your talent model?

SORRELL: At the moment, I think the cost of trying to change is so great that it's not worth it. Our turnover rate should probably be 10 to 15 percent overall. So, could we solve that issue, if it is an issue, by increasing our salaries by 10 percent? No. Could we solve it by increasing our incentive pools by X amount? No.

BOTHUN: Over the last few years in particular, you have bought a lot of companies that are responding to the big disruptions in the industry. How do you use these acquisitions to support your strategy?

SORRELL: Most of the acquisitions, if not all, we grafted onto one of our 11 verticals. I can't remember the last acquisition that was what I would call a free-floater, increasing the horizontal span. We usually have five-year earn-outs. So over a five-year period, we learn a lot about the clients and the people, which is sufficient in our mind to make sure that everything is hunky-dory. Some of those acquisitions get grafted onto the legacy businesses. Some get grafted onto the digital businesses. And some are pure cannibalization businesses. The fact that somebody competes with you, or competes with a service that you have, or threatens to disintermediate you, doesn't mean that you should ignore them. What you should be doing is creating your own innovation or investing in it. If we have been successful, which we have, in keeping alive (because everybody said we were going to get killed by Google, and we haven't been killed yet), it is because we have done that.

The advertising and marketing services market is over a trillion dollars, $500 billion old stuff and $500 billion new stuff, and the market has continued to grow in the 30 years we've been in existence. So we try to keep our head above water by trying to find, in a world growing at 3.5 to 4 percent in nominal terms, the growth buckets.

GROSS: Where are those growth buckets?

SORRELL: This year, the growth buckets are still going to be the G2 — China and the United States. They will drive incremental growth in the world markets. In the eurozone, it will be the United Kingdom. In India, [prime minister

Narendra] Modi has got some challenges. But he's done a brilliant job, just like [president Mauricio] Macri has with Argentina.

BOTHUN: One of the things you've talked about is the fragility of an economy that isn't growing that rapidly to begin with. Between terrorism, the immigration challenges, and the economic challenges, what are you most concerned about?
SORRELL: Well, you know I'm a raging bull on China. People forget that even if it is growing at only 3 or 4 percent per year, China is the world's biggest incremental source of growth. I mean, 3 or 4 percent of $11 trillion is equivalent to a little bit more than 2 percent on $16 trillion [about the size of the U.S. economy]. If China were to go south? That would be a problem. Brazil is not as critical, but it is still important. The Brexit is a big, big, serious threat. And within Brexit, Grexit, because people have forgotten about Greece. When we were in Greece last November for Stream, our big digital conference, we said that in six months' time, Greece will come back as an issue.

> "I'm a raging bull on China. People forget that China is the world's biggest incremental source of growth."

GROSS: You spoke before about how some industries have it easier, in the sense that they know exactly who their competitors are. So you see a startup over here, it's got a huge valuation. How do you assess whether this company is going to compete with you; is it a company you want to cooperate with or invest in, or is it someone you can ignore?
SORRELL: You have to assess whether you think they're going to be a frenemy: a friend and an enemy. You can ignore them, but sometimes you ignore them at your peril. I think the answer is, you just have to accept that this is going to be a contradictory world, that in some aspects of your operation, you might be having a constructive relationship, and in some aspects of your operation, you have a destructive one.

BOTHUN: Like the relationship between WPP and Google in some respects.
SORRELL: Oh, Google's a frenemy. The world is not segmented anymore. I mean,

what is the Internet, at the end of the day? It's a big disruptor of traditional business models and business approaches. And every legacy business and even the new businesses are going to be disintermediated. Who would have thought that the automobile business would have Uber, which has a value of $60 billion, as a competitor? Or that 3D printing could challenge manufacturing? I saw a 3D-printed car, full size. Two-seater. Really pretty, for $12,000, and it was produced in 10 hours (without the engine, bucket seats, and wheels).

BOTHUN: So do you have proactive discussions with other CEOs in these frenemy organizations where you say, "Let's just face reality, we're your customer, and we're your competitor"?

SORRELL: Yes. Absolutely. All the time. There then may be grounds for cooperation. So take Sapient, which was acquired by Publicis in 2015. When you buy a company outright, you take the risk of buying the business, which has on it, excluded from its P&L, the stock option costs of keeping the people. And the moment you buy it out, the people fly with it. So it makes no sense [to choose that transaction]. Instead of buying Sapient for $4 billion, in 2013 we invested about $80 million in Globant [an Argentina-based company that specializes in software for digital marketing]. It has now gone public, and we own about 20 percent of it, worth about $250 million. There are lots of ways to skin a cat.

BOTHUN: I want to finish up with mobile, which certainly looks like the next frontier in which people in the ad industry have to learn how to work together in new ways. Facebook now gets 80 percent of its ad revenue from mobile. How do you manage your clients' explosive growth in that area?

SORRELL: If you look at the industry stats, mobile advertising has not penetrated as rapidly as it should be. So there's more to do there. The industry hasn't figured out how to deal with the small screen yet. +

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MEET THE NEXT GENERATION OF **BUSINESS THOUGHT LEADERS**

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Thought Leader Interview: Carolyn Everson

Outlook 2016–20

Facebook's top marketing executive describes the social network's ambitious efforts to forge enduring and meaningful relationships — with employees, industry partners, and everyone else on Earth.

BY DEBORAH BOTHUN AND EMMANUELLE RIVET

Photograph courtesy of Facebook

Connecting at scale: the ability to create meaningful, lasting, mutually beneficial relationships with a large number of consumers, users, and employees. This business imperative is one of the keys to success and profitability in the entertainment and media world today. Few companies are forging the depth and scale of connections that Facebook is. Far more than providing a platform for sharing status updates and photos, the 12-year-old company has emerged as a conduit for communicating through images (Instagram, 400 million users) and messaging (WhatsApp, 1 billion users). Facebook's core platform, where 1.6 billion people around the world come together every month, has emerged into a vital distribution channel for journalism and a crucial marketing venue for businesses large and small. And CEO Mark Zuckerberg continually pushes the company to replicate and enhance the Facebook experience in new realms: mobile, live video, and virtual reality.

Carolyn Everson, vice president, global marketing solutions, says connecting at scale is at once a significant competitive advantage, a responsibility, and a standard to live up to. A graduate of Villanova with a Harvard MBA, Everson gained experience in consulting, media (Zagat, Primedia, Viacom), and technology (Microsoft) before joining Facebook in 2011. Her current job has put her at the center of a continuing revolution in sharing, connectivity, and media consumption and production. At Facebook's New York office, Everson spoke with Deborah Bothun and Emmanuelle Rivet of PwC about the unique position Facebook occupies in entertainment and media, the way its ambitious initiatives serve the company mission of connecting at scale, the commitment to help employees lead whole lives, and the need to come up with better ways to measure how advertisers and marketers connect with their target audiences.

BOTHUN: Facebook has shown an impressive ability to pivot, organize, and plan — even in an environment that shifts with remarkable speed. Given the pace of change in the world, and in your industry, how do you plan on executing on your strategy three to five years from now?

EVERSON: We start almost any strategy discussion with our mission. The mission is to make the world more open and connected. We believe connectivity is a human right, just as much as food, shelter, and water.

The framework that Mark [Zuckerberg] speaks about is increments of time: one to three years, three to five years, five to 10 years. The one to three [increment] focuses on our existing platforms and improving them. That's where the majority of our resources are still dedicated. How do we continue to improve the experience of Facebook or Instagram, every time somebody [uses] them?

The three-to-five-year horizon is about getting some of the other platforms to scale, and then figuring out a monetization strategy for those that are at scale. (WhatsApp is already at 1 billion users.) The five-to-10-year period concentrates on our long-range bets, which are about increased connectivity. Although many people are connected, we have to realize that two-thirds of the world population is unconnected, and that part of the world will fall further behind, educationally and economically, if it remains unconnected.

> "Telecoms are offering free services with the belief that people will become paid subscribers. And that is playing out well."

BOTHUN: What's the approach for the long-range bets?

EVERSON: We have an umbrella strategy called Internet.org, which has lots of components. There's Free Basics, which gives people an on-ramp to the Internet at no cost. In countries where the poverty line is US$1.90 per day, many people have to decide between feeding their family and paying for data. They're always going to choose feeding their family. We want to make Free Basics available to the billions of people who are not connected. About 19 million people have taken advantage of it. We're finding that within 30 days, many of those who can afford to do so are actually converting to paid data plans, once they see the power of the Internet.

BOTHUN: How do you market that?

EVERSON: We partner with the local telecommunications companies. Telecoms are offering free services with the belief that people will become paid subscribers. And that is playing out well. They're getting access to very

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basic services, often on 2G connections [see "India's Triple Play," by Suvarchala Narayanan, page 140]. The next billion people who come online will probably do so mostly on feature phones in these markets — simpler phones with very, very low-speed connections.

We're also investing in alternative ways of providing connectivity that are less expensive. We're testing an unmanned aircraft named Aquila, the idea being that it can fly between 60,000 and 90,000 feet above Earth and can beam connectivity down about 11 miles away, and to other unmanned aircraft. We plan to launch a satellite in sub-Saharan Africa as well this year.

BOTHUN: But even though this is a long-range bet, you're already working on it.

EVERSON: Right. It's not like we're sitting here saying, "We're going to start that in five years." It is a question of resource allocation and time frames. These things could take decades. But we're making a significant bet on artificial intelligence [AI], and really trying to figure out if machines can both learn and make decisions the way humans do, to help facilitate efficiency and allow humans to do higher-order tasks.

RIVET: Is AI just being used to organize content?

EVERSON: We just announced, for example, that we now have, using artificial intelligence, the ability to help blind people on Facebook. Worldwide, more than 39 million people are blind and more than 246 million have a severe

visual impairment. When someone who is visually impaired is on Facebook, AI reads out the compositions of photos, like "picture of Carolyn with two other people, and the sun is shining, and it's a beach." With Messenger, we're working on M, a virtual assistant. It's early days, but we are trying to train M to answer basic inquiries and do things like make reservations, order flowers, give you information. I was in Houston for the NCAA tournament, and I asked M for information about the Space Center, and it sent me a whole summary. There are more than 50 million businesses on Facebook, and we have more than 3 million advertisers that are businesses. We could help those businesses answer basic customer service inquiries with M. And then there's Oculus [the virtual reality unit], which offers a different way to experience connectivity. But it all ladders to the mission. So we are not a company of disparate bets going all over the place.

RIVET: Yes. I want to talk a little bit about Oculus. Where does it fit?

EVERSON: Oculus is in more of the five-to-10-year bucket [right now]. But the "bucket" framework isn't ironclad. (Originally, for example, Instagram wasn't in the one-to-three-year bucket, but it developed more rapidly.) The biggest hurdle to Oculus becoming a scaled solution in the market is going to be cost. It's still pricey. And the second biggest is that it requires a very powerful PC to run it. But as with any technology, over time those things will evolve.

BOTHUN: Are you looking at enterprise uses for that as well?

EVERSON: I would say that there is probably an application for Oculus in almost every industry that you can think of. Gaming is the one that's obvious and happening most actively right now. The entertainment industry is very focused on Oculus and what kind of experiences they could bring to it. But we've had inquiries from hospitals and physician groups, trying to understand if surgeons could be trained in a completely new way. It is so realistic. I mean, you literally feel like you're being transported into another world. You could imagine education applications, giving students an opportunity to visit the Louvre without ever traveling to France. We've had a lot of inquiries from retail partners and clients. Oculus is going to be limited only by imagination.

BOTHUN: When we talk about the company's overall strategy, geographic expansion has to be part of it. When you look around the markets where you are not fully penetrated, do you have particular focuses for the one-to-three-year or five-to-10-year windows?

EVERSON: India is clearly an incredibly important priority. About 133 million people a month access Facebook in India, and it will become our largest market soon, when it surpasses the United States. But the population of India is well over a billion. And there are a lot of barriers to connectivity there. We focus mostly on people. We find ways for people to use the platform, and the monetization comes later. Africa is quite important to us. Again, we have north of 120 million people in Africa using Facebook on a monthly basis (with over 80 percent on mobile), but it's a drop in the bucket when you consider the population. And then of course there's China. And from our perspective, we won't be fulfilling our mission unless we figure out a way to connect people in China.

> "The Middle East consumes more video than almost any other market. And so we are making product changes in the region."

BOTHUN: And I'm sure you have thought about and considered whether you can partner with anybody there, and whether that makes any sense.

EVERSON: We are looking at every alternative and every type of strategy. And Mark is deeply committed. He's learned Mandarin, he's on the board of Tsinghua University. But there is really no way to say whether or when that's going to happen.

BOTHUN: It sounds like you have to tailor both connectivity solutions and user experience to different markets — at scale.

EVERSON: Right. We know that the Middle East, for example, consumes more video than almost any other market. And so we are making product changes as a result of both bandwidth challenges and consumer interest in the region. We rolled out Slideshow, which can take a video and consolidate the data usage

involved with it and display it almost like flowing images. That's helping us in those markets such as the Middle East and India where users are relying on 2G or feature phones.

BOTHUN: What about people who want to connect with Facebook as an employer? Let's say I'm a sophomore in college, thinking about my major, and I really want a future with Facebook. Should I earn an engineering degree? Should I get a data and analytics background? Should I make a name for myself at another company before applying?

EVERSON: First, Facebook can't hire enough good engineers, particularly female engineers and engineers from other underrepresented demographic groups. So if I had an interest in engineering and a propensity for that, I would pursue that degree, regardless of whether I'm trying to get a job at Facebook. We as a society can't fill the number of engineering jobs that are open.

At Facebook, if we're not testing for a specific skill, like engineering, we are very much screening you for our values. I would say that the things that we mostly look at have to do with impact. Have you demonstrated a consistent desire? Are you intellectually curious? Are you bold? Are you not afraid of failure? Are you open and collaborative? We need to [concentrate on those characteristics] because we don't have a playbook. We're making it all up as we go.

We take some interns on the business side of Facebook, but it's a small group. You could start off in a small business team, which is mostly in Austin, Texas, if you're in the U.S., or São Paulo in Brazil, without a ton of experience. On the team that I'm responsible for, we prefer to hire people with five to 10 years of experience.

BOTHUN: Which type of experience?

EVERSON: All different. We hire people who have had industry and vertical expertise — travel or consumer products or financial services. We hire people from the advertising agency community and from other technology companies. We hire people who have done consulting. We've hired entrepreneurs who have tried to sell, or maybe have had success at selling, companies. If I had to describe an ideal resume, it would show some consulting experience, some

vertical expertise, and some technology experience. Put that all together, and then the person has to be really comfortable with rapid pace, agility, and things changing all the time.

RIVET: For the type of people you've described, there's a real war for talent. So how do you retain people and keep them engaged, and continue to be a great destination for experienced people and young people?

EVERSON: We do not make counteroffers. Right, wrong, or indifferent, we don't. So that means the ability for us to retain people has to be in place *before* they log off and try to get another offer. Number one is the mission. People who are here and who tend to stay here just deeply believe in the mission, and can't imagine picking up and going somewhere else where the mission seems more trivial, or not as clear.

The environment and the culture of how we operate is another important factor in retaining people. We make a list of all the things that people may have experienced in bigger companies, and then say, "Don't bring any of that in here. Don't bring hierarchy, don't bring bureaucracy, don't cover your rear end on decision making. Don't bring competitiveness with your colleagues."

Live Map shows where Facebook users around the world are streaming live video.
Source: Facebook

The third is giving people a real sense of what the future holds. We're 12 years old. Some might have said, "Gee, after you go public, it's going to be so hard to recruit people, right? Anyone coming in now has missed the window." And the truth of the matter is, by our constant reminder that we're only 1 percent done with the journey, people know they can join Facebook today and feel like they have so much more to do.

BOTHUN: Burnout has become a challenge for all companies, but particularly for technology companies in this 24/7 work environment. How do you combat that?
EVERSON: We're working hard to give people the opportunity to feel that they can have an incredibly successful career at Facebook, but also lead a high-performance life outside. All our jobs are highly demanding. We're trying to avoid burnout. Average employee retention in companies has gone from 10 years to five, and in technology, it's three.

We encourage our team members to declare a vision: to define what's important to them within the company as well as personally. By doing this, we empower people to figure out how to make that [balance] happen. And we hold managers accountable for helping their teams actually live the kind of life they want to lead. As a leader, I have to care about people having an amazing life outside work, just as much as I care about delivering incredible results at Facebook.

BOTHUN: That's a different approach to management and leadership. How does it work in practice?
EVERSON: When I do my one-on-ones every couple of weeks with my team, I'm not just asking them about the business. I start by asking how they are doing in achieving their vision and what barriers they are struggling with. The idea is that once you declare what's important to you, you can prioritize how you spend your day, what you're concentrating on. I'll give you a personal example. I had a great conference that I got invited to that was taking place over several days. But Villanova, my alma mater, was in the NCAA men's basketball championship. And it was very clear to me that this was a once-in-a-lifetime opportunity for me to experience the tournament with my family. I was easily able to make that decision

to go to the game because I had outlined in my vision the importance of creating memories with my family. Someone else's vision may be that he wants to be healthy and lose weight and exercise more. And then when he prioritizes his time, he's clear that if he's not working out as many times a week as he wanted to, he needs to make adjustments. I believe company cultures are going to have to dramatically evolve. It is because, frankly, the technology is such that if we don't modify how we operate in our corporate cultures, people will be working 24/7, and the burnout rates will be terrible.

BOTHUN: Let's switch gears to talk about mobile. Facebook's shift from having essentially no mobile revenues in 2011 to mobile generating 80 percent of its revenues today has been impressive. Was that simply a set of tactical moves? Or the result of an execution of strategy?

EVERSON: The shift that we had to make to mobile was [vital for us to] survive and stay relevant. Mobile was that much of a threat. It was right around the time we went public. More people started using Facebook on their mobile device instead of on their desktop, and suddenly the revenue lines crossed. That was a big wake-up call. Our mobile product at that time was not good. We had made a bet on HTML5 for scaling purposes, which meant that we did not build really good data for iOS or Android apps. And Mark called the company together to do an all-hands meeting, which he typically does several times a year, and declared that we had to be not only "mobile first," which we weren't, but "mobile best." Yes, the story is true that somebody walked into his conference room and showed him a product mock-up on a desktop, and Mark ended the meeting abruptly. Everyone canceled their meetings with him for two weeks after that, because no one had mobile first.

> "The first priority in the shift to mobile was to get the consumer experience right. There was no discussion of monetization initially."

But that change was perfectly in keeping with our strategy. The first priority in the shift to mobile was to get the consumer experience right. There was no discussion about monetization initially. We had to retrain all the engi-

neers. They had to rebuild native apps on iOS and Android, and rise from very poor ratings in the app store to much higher scores. Then, once we understood what the consumer behavior was — at that time, consumers were spending most of their time in our News Feed — we made News Feed the "real estate" for monetization. Next we needed to think about how to get an ad into News Feed that would feel organic or native and be great for the consumer and drive the business result.

BOTHUN: So even though Facebook had an established advertising business for desktop, the connectivity and user experience preceded the monetization.

EVERSON: Yes. We are constantly refining our ad unit offerings within News Feed. Last year, we developed Carousel, which lets people scroll horizontally, and opened new real estate and new capabilities for advertisers. The next big development is Canvas, which is more like a door that opens up [and offers immersion and interactive capabilities]. Now, that doesn't mean the market suddenly decides to start buying this, just because we made it. So there's an ongoing effort to educate and inspire and teach the market how to take advantage of the mobile opportunity. I talk about the shift to mobile day in and day out. Consumers are spending more time on mobile than they are on television these days. Depending on the demographic, they may check their phone 100 to 300 times a day. A business that doesn't think about how to build mobile presence will be irrelevant.

BOTHUN: How do you use all the data you're gathering from this activity to personalize the experience for the user?

EVERSON: We talk a lot about people-based marketing. And the notion there is simply that the smartphone is the most personal device consumers have ever had. Consumers' expectations for marketing are that you show up to be useful, to delight or entertain, or to create some kind of emotion — but you show up for a good reason. So we need to get the most relevant marketing in front of consumers. Because if the consumers don't like what they're seeing, they could spend less time on Facebook or Instagram, and that would be detrimental to the whole business.

So we utilize a lot of data. Sometimes it's just our own data, how consumers are experiencing Facebook, where they spend more time, what stories are of greater interest. I mean, thousands of data points go into the algorithm, to try to serve up the right content. Sometimes it is our data combined with a marketer's data. We have a product called Custom Audiences. Whether you're a credit card company like MasterCard or American Express, or a car company like Toyota or BMW, your customers expect you to know that they are using your products. And that means you have to show up with ads that acknowledge that.

RIVET: Increasingly, it seems that the relevant content consumed and discovered on Facebook will be video.

EVERSON: As much as mobile was a major pivot for this company, Mark says video could even be bigger. We've had a bunch of announcements about Live [which allows users to stream live video]. You can afford every consumer — any business, any celebrity, any athlete, anyone — the opportunity to communicate in the most authentic manner possible. You can show Live to just one person or you can show it publicly to the world. Live frankly surprised us, in both how fast it's growing and how widely it's been adopted. We saw some incredible data about how people are consuming, discovering, and engaging with video content [pulls out a tablet to show map of where people are on Facebook.com/livemap]. Live attracts 10 times the user comments that normal video gets.

BOTHUN: What in general does Facebook see as competitive threats?

EVERSON: The way we answer this question, and I really believe it's a sincere answer, is that our biggest threat is ourselves. If we don't execute, if we become too complacent, then we will be replaced. When you leave our campus, which used to be the headquarters of Sun Microsystems, you can see the old Sun sign. It's a reminder to everyone that if you get complacent, you can wind up in trouble — because Sun was really a successful company at some point. We have things called hard conversations, and we ask people all the time, "What's the last hard conversation you had?" Because our belief is that as companies get bigger, people tend to be less willing to have the hard conversation. And if you look at compa-

nies that fail, it's not like they sat there one day and suddenly said, "Oh, God, our business is gone!" People knew. They were afraid to bring it up, for fear of punishment or insulting somebody or whatever reason.

BOTHUN: Let's talk about metrics for a minute, because that is such a huge issue today. How can the clients who are paying the bills measure the return on investment that they're making?

EVERSON: We think the metrics have to change dramatically. We think the media industry is measuring the wrong things. They're measuring impressions, click-throughs, and video views. And we believe there needs to be a massive shift to value. What I mean by value is actually measuring things that drive business value. Let's say you have a really cheap cost per thousand audience members [CPM]. You're just buying really cheap media. But if it's not driving your business, it doesn't matter. I tell clients all the time, "Don't give us a single dollar unless we're actually driving your business." In a simplistic way, and I'm really oversimplifying, "driving your business" means we're driving actual sales, product off the shelf, cars off the lot, e-commerce, whatever it is, or we are driving long-term brand metrics that will eventually tie back to sales. If you're not doing those two things — driving sales and driving metrics that lead to sales — and measuring them, I really think you're doing the wrong thing.

> "We think the media industry is measuring the wrong things. And we believe there needs to be a massive shift to value."

I think this shift is going to take years. The systems that tell us what we buy and sell and how the whole marketing industry and ecosystem works are all in the dark ages. And we think that all media needs to be held accountable.

BOTHUN: I want to end by asking you about something that doesn't have to do with measuring profits but is essential to the company's culture: philanthropy. How does philanthropy fit into the company's mission and its people strategy?

EVERSON: Mark's belief is that we need to deliver more social good in the world than the benefits that we've received from the markets. What we have done in the last few years, I think, is start to realize the power of what Facebook can do in the world for social good. So we don't have a foundation that writes checks. Our strategy, instead, is: How can we let NGOs, nonprofits, and so on use the benefit of the platform to potentially raise money? That's one pillar of it. Another is the way we connect to employees and their interests outside Facebook. Every month, Facebook's 13,000 employees are given an allotment of ad credits that they can use toward any organization they like. That's really empowering. And we do hacks with nonprofits. A member of my team in Canada is really passionate about Alzheimer's and dementia. He wrote in his vision two years ago that he was going to host the world's largest dementia hack. And he rallied the right resources in the company, the right external interests, and hosted the world's largest dementia hack, at the end of 2015. [See http://hackernest.com/DementiaHack/.]

So you've got everything from employees using ad credits and employees thinking boldly at an individual level to those at the global level thinking about how we can turn the power of having more than a billion people a day on our platform into social good in some way, shape, or form. +

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Share and Share Alike

by Lydia DePillis

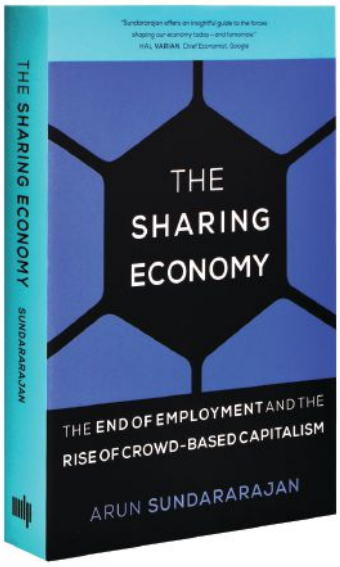
The Sharing Economy: The End of Employment and the Rise of Crowd-Based Capitalism,
by Arun Sundararajan, MIT Press, 2016

Arun Sundararajan, a professor at New York University's Stern School of Business, prefers the term *crowd-based capitalism* to describe the phenomenon encapsulated by rapidly growing commercial platforms such as Uber. But, like the rest of us, he also uses the term *sharing economy,* because doing so "maximizes the number of people who seem to get what I'm talking about," he writes.

The confusion over terms — other people speak of the "gig economy" or the "on-demand economy" — is understandable. After all, sharing economy arrangements have cropped up in a wide variety of industries, including transportation and housing. The structure of such enterprises varies widely as well. Some sharing economy ventures truly involve sharing — facilitating an exchange of services with no money changing hands, as is the case with the travel platform Couchsurfing. Others look like fairly traditional marketplaces in which buyers and sellers meet and cut deals over networks such as Etsy. Providers on some platforms can become microentrepreneurs, free to conduct

Illustration by Noma Bar

commerce on their own terms; others can look an awful lot like employees.



This smartphone-enabled, venture capital–fueled phenomenon cries out for a biography, a taxonomy, and an impact analysis. In *The Sharing Economy*, Sundararajan supplies all of those things. While much of the book will be familiar to someone who follows events in this world — he spends a good bit of time explaining how these platforms actually work — it's a useful and fundamentally optimistic attempt to explain where the sharing economy came from, and where it's going.

Sundararajan believes that these new developments are, on the whole, a force for good in the world. Perhaps for that reason, he overlooks some of the less-rosy economic forces behind their rise, and brushes off those who argue that platforms such as TaskRabbit are basically traditional businesses attempting to skirt the rules by which conventional industries are bound. At the same time, Sundararajan is not so naive as to think that such new businesses ought not to be regulated — and he offers a few thoughts on what the new regime should look like.

To a degree, the sharing economy is a back-to-the-future move, Sundararajan explains. In the pre-industrial economy, most people ran their own businesses or had gigs, either as smallholders eking out an existence from the land or as urban grunts doing odd jobs. The 20th century brought a disruptive force: large corporations that employed tens and hundreds of thousands of people, and distributed safety net benefits.

But as we evolve from managerial capitalism to crowd-based capitalism, today's small-time entrepreneurs — and the massive companies that facilitate them — begin to have huge advantages over their predecessors. Widely available GPS technology, connected to smartphones, allows for the seamless delivery of goods, services, and payments. Universally visible online profiles allow people with no formal credentials to build credibility through earning endorsements for services rendered.

And yet these changes raise big questions about how government and society can ensure that consumers are protected and workers are treated well when the closest thing they have to an employer — the platform upon which they find customers — denies that it's an employer at all.

It's clear where Sundararajan's sympathies lie. The text is peppered with tales of sharing economy conferences attended, panels conducted, and test rides taken, and he largely shares the perspective of those who have pioneered and invested in this emerging form of commerce. He argues, convincingly, that on-demand platforms could have many salutary effects. For example, in his influential book *Capital in the 21st Century* (Belknap Press, 2014), economist Thomas Piketty lamented the fact that the return on investments in physical assets is rising faster than the economy overall. "With a little additional infrastructure," Sundararajan writes, "Piketty's 'renters' can begin to experience the other side of the coin by making money through investing or owning rather than laboring."

That's possible. But Sundararajan — a user and beneficiary of the sharing economy — overlooks some of the less appealing factors behind its rise. For example, he neglects to mention the pervasive wage stagnation that has pushed people (many of them with full-time jobs) to augment their income with microtasks. He also presumes that employees automatically have less flexibility than contractors, which isn't always the case. Full-time employees (like professors!) can often have exceedingly flexible work arrangements.

Sundararajan buys into the notion that because the sharing economy creates fundamentally different forms of work, the old rules and regulations are obsolete. "There is little value in trying to retrofit old regulatory regimes into the new models," he writes. What might make sense for ensuring compliance by a large institutional hotel or restaurant chain, he thinks, could push the person earning some extra money on VRBO out of business.

Sundararajan writes persuasively that networked platform companies will actually have an easier time self-regulating in the public interest than their traditional counterparts because a provider's future business prospects depend on the reputation he or she has built with customers. His answer to the question of how to regulate employment, however, is less satisfying. Facing the prospect of

a social safety net shredded by the growth of mini-jobs that don't require employers to contribute to workers' long-term financial security, Sundararajan posits that many platforms want to offer employment-like benefits — as long as they don't come with employment-like obligations.

To that end, Sundararajan cosigned a letter with platform companies that are subject to traditional regulatory frameworks, calling for a "safe harbor" from employment law for platform companies while they figure out their business models. "How would one relax those constraints in a manner that allows us to examine what the market will provide naturally, and what we need the government to step in and make happen?" he writes.

He suggests that platforms could be asked to contribute to portable accounts for retirement, healthcare, and unemployment on a prorated basis to replace the formal commitments that traditional companies have made with their employees. Over the longer term, that concept could evolve into a system of providing basic incomes for all members of society as a way of compensating for the declining quality and quantity of employment throughout the economy. Such measures sound good in theory. In the meantime, and in the short term, letting sharing economy companies off the hook could also let their workers fall through the cracks.

If sharing economy companies are let off the hook, their workers could fall through the cracks.

The sharing economy industry has made great strides in constructing systems and platforms that are appealing to consumers. Its next great challenge will be to allow workers to share in the benefits more fully. +

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How to Become a Talent Magnet

by Theodore Kinni

Superbosses: How Exceptional Leaders Master the Flow of Talent,
by Sydney Finkelstein, Portfolio Penguin, 2016

A decade or so ago, Sydney Finkelstein discovered an interesting fact about Alice Waters, the legendary chef at Chez Panisse in Berkeley, Calif., who played a pivotal role in launching the farm-to-table movement. "Industry insiders will tell you that Waters is also known for something else: spawning the country's best culinary talent," explains Finkelstein, Steven Roth Professor of Management at the Tuck School of Business at Dartmouth University. A host of James Beard Award winners — including the late Judy Rodgers of Zuni Café, California cuisine originator Jeremiah Tower, and chef and consultant Joyce Goldstein — worked for Waters early in their careers.

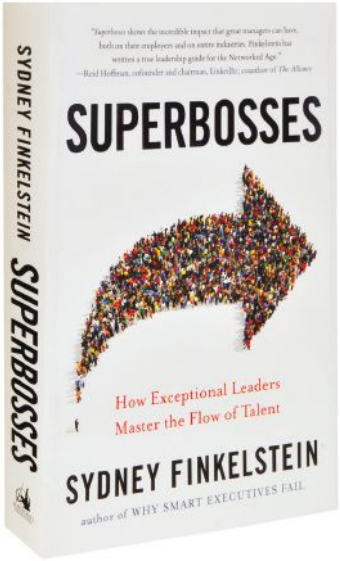
Intrigued at the outsized effect Waters has had on the top talent in her industry, Finkelstein wondered if there were leaders who had played a similar role in other sectors. He found them in fashion (Ralph Lauren), finance (hedge fund magnate Julian Robertson), professional football (San Francisco 49ers coach Bill Walsh), media (*Philadelphia Inquirer* editor Gene Roberts), politics (Hillary Clinton), and technology (Oracle founder Larry Ellison), to name a handful. And he's written *Superbosses,* an intriguing and insightful book about them.

The first thing superbosses do is hire the right people. They look for exceptionally smart, creative, and flexible people.

Even though superbosses can have wildly varying leadership styles, writes Finkelstein, they conform to a recognizable pattern in their approach to people management: They "identify, motivate, coach, and leverage others [in ways that] are remarkably consistent, highly unconventional, and unmistakably powerful."

The first thing they do is hire the right people. Finkelstein writes that su-

perbosses go above and beyond the best hiring practices to find people who "get it." They look for exceptionally smart, creative, and flexible people. They find them by taking an active hand in hiring — grabbing good people when the opportunity presents itself, spending time with candidates, conducting unusual interviews, and taking chances on promising people with unorthodox backgrounds. The first chef Alice Waters hired for Chez Panisse was a graduate student in philosophy with no culinary experience; Bill Walsh hired a high school coach for his NFL staff. Sure, superbosses take some hiring risks, but when such a risk doesn't pay off, Finkelstein tells us, they are quick to fire.



Next, those people are put to work. Superbosses expect perfection — and when they get it from someone, they pile on more challenges. Anneke Seley started working for Larry Ellison as a receptionist and went on to manage customer relations and launch Oracle's inside sales department. Though superbosses give employees lots of responsibility, they also make sure their people have a clear, compelling vision to guide them, and they provide plenty of frank feedback. Superbosses are unusually accessible, often working side by side with employees as a master would with an apprentice — Ellison himself taught Seley the SQL programming language. And they build teams of talented people — cultlike cohorts of high performers who support one another and drive results.

The superboss approach is powerful because it creates a virtuous circle. If you're a superboss, you hire the best people and empower them to do their best work. Some percentage of these people flourish under your tutelage and become successes in their own right. You gain a reputation for launching great careers, and the best and the brightest want to work for you. You become a talent magnet. Given the careers that superboss Lorne Michaels of *Saturday Night Live* has had a hand in launching — from Eddie Murphy to Tina Fey — is it any surprise that he has his pick of comedic talent?

Another result of the superboss approach, to which Finkelstein devotes a chapter, is the network effect that is created by following the superboss playbook

over the long term. If you are a superboss, many of the talented people you develop and nurture are going to move on. They are going to start their own businesses; they are going to be offered great jobs in other companies. If you maintain close, supportive relationships with these people after they leave, they become valued members of your professional network. They become suppliers and customers. They refer new talent to you. They also provide you with investment opportunities. Witness how, after closing Tiger Management, Julian Robertson provided the seed money that enabled some of his most talented managers to start their own hedge funds; in 2015, reports Finkelstein, Robertson's so-called Tiger Seeds were managing US$32 billion in assets. Being a superboss pays dividends long after your protégés outgrow you.

Now, any endorsement of *Superbosses* — and I certainly endorse it for its enthusiastic advocacy of a hands-on approach to talent by top leaders — should include a couple of provisos. First, we need to recognize that Finkelstein's contention that superbosses outperform other bosses is supported by anecdotal evidence only. Second, there's no telling how much of the success that the leaders featured in the book have enjoyed is attributable to their distinct approach to talent. Third, we need to acknowledge that being a superboss is not all there is to being a boss. Almost a half century ago, Peter Drucker wrote that leaders had three principal tasks: to achieve the purpose and mission of the organization; to make work and workers productive; and to manage the organization's social impacts and responsibilities. A winning way with talent is not all that's needed to successfully undertake these tasks.

These reservations aside, there is no question that this is an era when talent is increasingly essential to the success of organizations. That alone makes *Superbosses* a useful and profitable addition to your leadership library. +

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Nurturing Nature

by David K. Hurst

The Secret of Our Success: How Culture Is Driving Human Evolution, Domesticating Our Species, and Making Us Smarter,

by Joseph Henrich, Princeton University Press, 2016

What's the secret of our evolutionary and ecological success? Not only is *Homo sapiens* the most advanced species on Earth, but the species is capable of surviving and thriving in a wide range of environments. The orthodox answer is that we are a species in which a process of genetic evolution over millions of years — random mutations and selection — has produced large brains that make us smarter than other animals. We also have more cooperative instincts, which make us the most social of creatures.

But although the evolutionary process that produced life on Earth has lasted billions of years, it is only the last 10,000 to 100,000 years (depending on who you listen to) that have produced an explosion of creativity and innovation. This quantum leap came when genetic evolution slowed or even stopped, and cultural evolution took over. Culture sits upon a foundation of genetics and biology but is separate from it.

Joseph Henrich wants to upend this conventional narrative. A professor of evolutionary biology at Harvard University, he also holds the Canada Research Chair in Culture, Cognition and Coevolution at the University of British Columbia. In *The Secret of Our Success*, he contends that cultural evolution, which intertwines with genetic and biological changes, is a much larger, longer-acting, and more central component of our development than most people think. He casts a wide net for evidence: a detailed reexamination of the historical record, mathematical models, computer simulations, and laboratory experiments with both humans and primates.

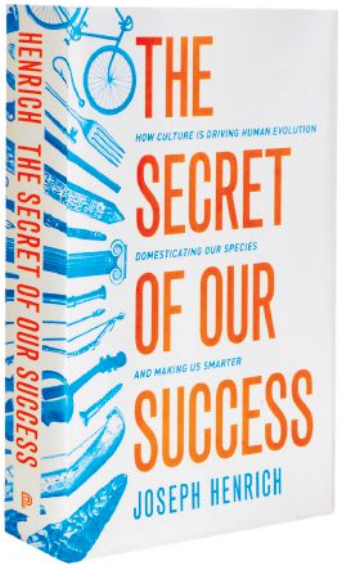
And it is clear he is on to something. Many aspects of our physiology are

baffling unless you understand them as responses to cultural factors. Human digestive systems are very different from those of other primates. We have tiny mouths, weak jaws, and small stomachs. Our bodies don't detoxify wild foods well. This setup works only in situations where parts of the digestive function have been "externalized" to a culture of food preparation. In other words, slicing, dicing, crushing, and cooking allowed us to, in effect, outsource digestion and focus on our core competency — building large brains to become a new kind of domesticated animal that specialized in living together in large groups and learning from one another.

There is evidence that this process began more than 3 million years ago, and accelerated a million years later as our evolutionary ancestors transitioned from *Australopithecus* to the first species of the *Homo* genus, *Homo erectus*. At this time we find indications of substantial food processing and tools that could cut grass and saw wood. As our ancestors' brains grew larger to specialize in the acquisition, organization, and transmission of culture, the progress was not always smooth or accumulative. Innovations can be lost, especially when groups become isolated from one another. At times our ancestors appeared to be "dancing on the threshold" of what the author calls an evolutionary Rubicon — a barrier crossed only by outlaws or outliers, whose crossing changes everything.

As our ancestors' brains grew larger to specialize in the acquisition and transmission of culture, the progress was not always smooth.

At a certain point in history, human culture started to exert its own selection pressures on the evolutionary process. For instance, blue eyes are common only in a region around the Baltic Sea in Europe. Why? Well, the author writes, 6,000 to 10,000 years ago, a group of cereal crops proved adaptable to the region. High consumption of cereals can lead to a vitamin D deficiency unless the body can synthesize the vitamin from sunlight. In the high latitudes, this favors a light skin. And the complex process that suppresses melanin in the skin also does so in the iris of the eye. In other words, a step forward in cultural evolution — figuring out how to grow grains in a particular climate — led to biological and genetic changes.



Culture can affect our preferences, helping us select partners as well as goods of all kinds. In taste tests, novice wine drinkers typically say they prefer cheaper wines — and brain scans indicate the enjoyment is real. It is only after people take courses in wine appreciation that their pleasure centers start showing greater response to the more expensive vintages. When we move into novel environments, culture can make the difference between life and death. Henrich illustrates this feature with fascinating tales from the "Lost European Explorer Files." We learn, for example, how all 129 members of the 19th-century Franklin expedition, who hailed from Great Britain, perished in the Arctic, despite being in a region where humans had lived for 30,000 years or more. The explorers were equipped with big modern brains and the latest technology but lacked the fine-grained, situation-specific cultural knowledge that enabled the local Inuit to thrive.

For a culture to make continual progress, it needs to employ widespread experimentation and develop a method of selecting which tools and processes to keep and which ones to discard. People pay attention to whoever seems competent, successful, or prestigious. Henrich argues that at the same time, people are wary of manipulators and may look for what he calls credibility-enhancing displays (CREDs), actions that a person would be unlikely to perform if he or she did not believe his or her stated beliefs. And when it is unclear which of these displays are responsible for their success, people will copy *all* of them. The result is that great expertise in one area may generalize into others and, in the age of the Internet, some people may become famous for being famous. (It turns out there may be an evolutionary argument for the existence of the Kardashians.)

The implications of this new, continuing narrative for the way we think about people, societies, and even companies are both subtle and significant. The hidden hand of culture is as powerful as that of any market, and evidence shows synergies, not trade-offs, between profitability and social concerns. It

seems that humans are bad at intentionally designing effective institutions and organizations. They would be better advised to mimic evolution and develop "variation and selection" systems, dumping the losers from the portfolio and keeping the winners, without ever losing touch with culture and context. Perhaps such dynamics are the secret of success for both capitalism and democracy. But nothing lasts forever. We should bear in mind, as Henrich remarks in a slightly cryptic aside, "over time, history suggests that all prosocial institutions age and eventually collapse at the hands of self-interest, unless they are renewed by the dynamics of intergroup competition." That too sounds like a new take on an old story. +

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Hamilton's Place

by Daniel Gross

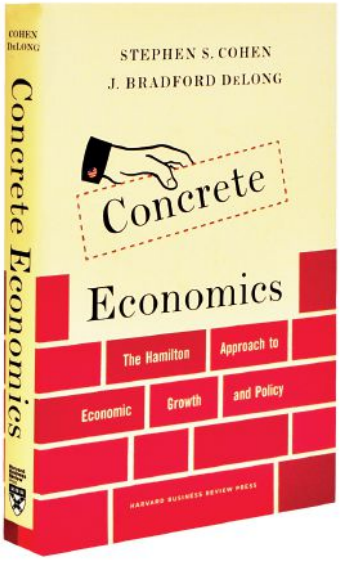
Concrete Economics: The Hamilton Approach to Economic Growth and Policy,
by Stephen S. Cohen and J. Bradford DeLong,
Harvard Business Review Press, 2016

Alexander Hamilton is having a moment. The fantastic Broadway musical *Hamilton* (go see it, if you can afford a ticket on the secondary market) has restored the oft-forgotten founding father and architect of America's economic infrastructure to his rightful place at the center of our national narrative. Now a short, intriguing book, just published by Stephen S. Cohen and J. Bradford DeLong— scholars at the University of California at Berkeley — highlights another overlooked aspect of Hamilton's legacy.

Early in this country's history, the authors of *Concrete Economics* argue, Hamilton established a precedent of designing a pragmatic approach to economic development. This pragmatic approach is one that was followed to great effect, the authors argue convincingly, for nearly 200 years. And it is one, they argue somewhat less definitively, that has been abandoned in the past 40 years — which helps account for some of America's less-than-satisfying economic performance.

The authors aren't talking about ideology in the traditional left/right, libertarian/socialist sense. Rather, they view ideology (dealing in abstractions, knowing things before they happen) as being in opposition to pragmatism (focusing on achieving specific concrete goals). "What we do know is that since the days of Hamilton, it is a fact that America's successful economic policy has been pragmatic, not ideological," they write. "It has been concrete, not abstract."

Cruising quickly through two centuries of American economic history, the authors argue that the controversial template Hamilton laid out in the late 18th century — "pushing policies to promote industry, commerce, and banking" —



worked quite well and endured. The early lattice of tariffs, infrastructure spending, and public investments enabled America's Industrial Revolution, and persisted through the 19th and 20th centuries. Despite sharp political disagreements over economic issues, including Andrew Jackson's hostility toward the Bank of the United States and the fierce debates over the interventions of the New Deal, the policy pendulum has in fact swung back and forth in a relatively narrow band. Successive waves of changes — Teddy Roosevelt's reforms, the New Deal's "pragmatic experimentalism" aimed at fixing the housing and finance systems, and Eisenhower's programs of funding interstate highways and government research — added layers to Hamilton's original platform. And it was all about getting things done. "There were no questions of theory or ideology to wrestle with," the authors write.

So what has changed in the last 40 years? Two things. First, other countries, especially the rising powers in Asia, adopted America's Hamiltonian efforts: promoting rapid economic growth through developing manufacturing, using trade barriers to protect domestic industries, and investing in productivity-enhancing infrastructure. "It is not wrong to say that the East Asian development model was invented in the United States," Cohen and DeLong write.

Second, the U.S. response to this development was less than practical. Cohen and DeLong argue that American businesspeople, intellectuals, and policymakers believed (this is the ideology part) that it was fine to move manufacturing jobs to Asia and elsewhere because the U.S. could easily develop new, high-value industries. And they further believed that three principal sectors — finance, real estate, and healthcare, all of which were propelled in part by government policy — would provide the necessary growth. And although these industries have created a large number of jobs, Cohen and DeLong argue that they haven't been the same catalysts for growth and high-income jobs and new industries that the building of railroads or highways was in previous generations. Worse, finance and real estate are prone to bubbles and busts.

Cohen and DeLong provide a valuable lesson to people who run organizations of any type: public, private, for-profit, nonprofit. Ideologies can be very useful in founding a university or developing a theory. To make things happen in the real world, however, you have to be relentlessly pragmatic. It's not enough to set up an intellectual frame for understanding how things should develop. You have to put plans in place aimed at achieving specific goals and outcomes — and then reassess them quickly if they don't work out.

In many ways, the original system that Hamilton laid down, however creaky it has become, continues to work.

But I also think the authors are a little too down on America. In many ways, the original system that Hamilton laid down, however creaky it has become through successive additions over the years, continues to work. Sure, the U.S. has failed to replace all the manufacturing jobs it has lost. But the narrative doesn't really account for the many highly pragmatic Hamiltonian developments of the past few decades. Think about all the new companies and industries that have been able to develop scale and scope very quickly owing to the ready availability of financing, key government investments, and light regulation. The renewable energy industry has grown by leaps and bounds thanks to a network of incentives and research support. Fracking, which has liberated huge reserves of natural gas and oil from the ground, was made possible in part by the highly pragmatic approach taken by government and industry. The Internet — and all the U.S.-based global businesses that were ultimately built on it — grew out of a Defense Department program.

The U.S. may be 240 years old. But, as the song from *Hamilton* goes, in some crucial ways, it is still young, scrappy, and hungry. +

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Nice Guys Finish First

When hiring CEOs, companies appear to focus on interpersonal skills while overlooking the candidate's capacity to get the job done.

BY MATT PALMQUIST

Nice guys finish last, the old sports adage goes. But according to a new study, nice guys finish first in the race up the corporate ladder. And yes, it's usually guys who emerge victorious. Hiring committees tend to disproportionately value candidates' interpersonal qualities, the authors found, and elevate far fewer similarly credentialed women than men to the CEO role.

The authors analyzed a proprietary database containing comprehensive assessments of more than 2,600 candidates for top management positions at both public and private firms, ranging from well-funded startups to companies that take in more than US$1 billion in annual revenue.

The evaluations, collected between 2000 and 2013, were based on four-hour interviews that resulted in a 20- to 40-page report on each candidate. These reports traced the candidates' actions and behavior through their childhood, college years, and professional careers. Along with demographic information, each final report contained a detailed breakdown of how the candidate rated on 30 personal and professional characteristics. Investors, boards, and HR executives use the database to evaluate potential hires for top management positions, including CEO, CFO, and COO.

Illustration by Elwood Smith

The authors found that candidates' traits could be grouped according to four overarching categories: talent for management, ability to execute tasks, charisma, and strategic and creative thinking.

Candidates who were immediately hired for the open CEO positions tended to score higher across the board, the authors found, compared with their colleagues who were vying for lower executive slots.

Scoring high on the four factors also predicted a candidate's future career advancement. Candidates for positions other than CEO who scored higher across the board were more likely to become CEOs down the road, the authors found. This finding indicates that certain executive traits and talents can both be detected and remain constant throughout an individual's professional development.

But although men and women didn't have huge scoring differences, the authors found that women who were rated similarly to men were about 28 percent less likely to be appointed CEO, underscoring how wide the gender gap remains at the upper echelons of companies.

In another interesting finding, the authors determined that people hired as CEOs scored much higher than other candidates on their interpersonal qualities — willingness to listen, readiness to be part of the team, and receptiveness to criticism, for example — and lower on execution skills, which include efficiency, proactive leadership, and persistence. But that suggests personality can outweigh credentials, metrics, and a track record. Search committees should endeavor not to place too much value on charisma. They should focus on a candidate's ability to get things done and keep subordinates on task. +

Source: "Are CEOs Different? Characteristics of Top Managers," by Steven N. Kaplan and Morten Sorensen, Columbia Business School Research Paper No. 16-27, Feb. 2016

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