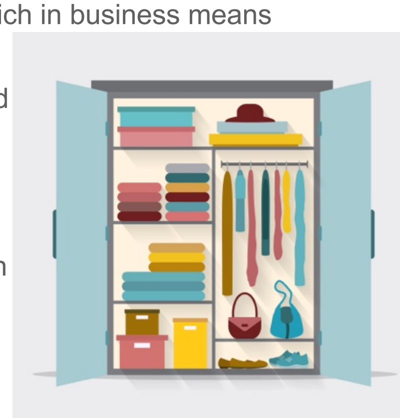
September 2016 – On Renewal and the Necessity of Disengagement

RITA GUNTHER | MCGRATH
Author. Speaker. Consultant.

Dear Colleagues,

Despite the fact that New Year's Day is actually the start of a new calendar year, to me, the arrival of September has always felt like the time for many new beginnings to take place. Often, the first step of starting something new is to decide what you're going to stop doing in order to free up time, capacity and energy.

This got me thinking about the process of disengagement, which in business means shrinking or exiting entirely from declining or flat-growth businesses. This is analogous to cleaning out your closets and getting rid of the accumulated 'stuff' that you no longer need. This simply makes business sense, as researchers with McKinsey documented years ago. Nonetheless, coming to grips with the need to divest or pull back from a business often happens too late, long after a great deal of value has been destroyed.



The long slow forced divestment in retail

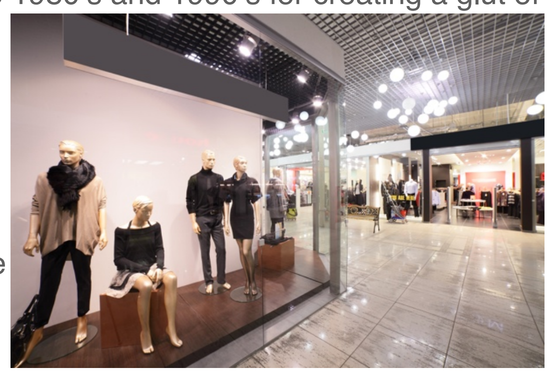
The current retail landscape is a textbook example of how painful a long, slow disengagement and a lack of willingness to change business models can be. Macy's, for instance, despite aggressive competition from companies like Amazon, continues to lose sales in their retail stores, even as their on-line presence expands. They recently announced that they will close 100 of their department stores, with widely admired CEO Terry Lundgren arguing that 'we're going to get out in front of this'.

The big threat to stores such as Macy's is not so much on-line competition (as for many people, buying clothing and other personal goods still is best done in-person). It is, instead, the rapidly growing deep discounters, such as T.J. Maxx and Marshalls, who are not shy about claiming to offer similar goods at rock-bottom prices. As I have long argued, in a world of transient advantage, you always have to watch out for other players rewriting the rules that underpin your business.

Dead malls & ghostly leftovers: victims of the hourglass economy

As Macy's and other middle-of-the-road retailers, such as J.C. Penney and Sears go, so go the malls that once housed them. In the mall business, as in so much of society these days, we are seeing the hourglass economy playing out. This phenomenon, which I've been watching for a while, means that spending growth is taking place at the top of our income distribution and at the bottom. Spending in the middle is disappearing, and taking with them those retailers aimed at the middle market. The result is that the shopping locations that used to serve those customers are closing. Indeed, researchers found that only 80% of America's malls are 'healthy,' down from 96% just ten short years ago.

Many blame the massive growth of malls in the 1980's and 1990's for creating a glut of space that needed to be filled. While the high-end malls are benefitting from serving free-spending and well heeled shoppers, an increasing number of also-ran malls are simply not a draw. These malls, however, are not without some admirers – indeed the very active website deadmalls.com has all the information anyone could want about the phenomenon.



On a brighter note: Dayton-Hudson department stores become Target

Is it inevitable that when the rules change, a company should follow the example of the now-defunct Sports Authority and have a 'going out of business' sale? Not necessarily.

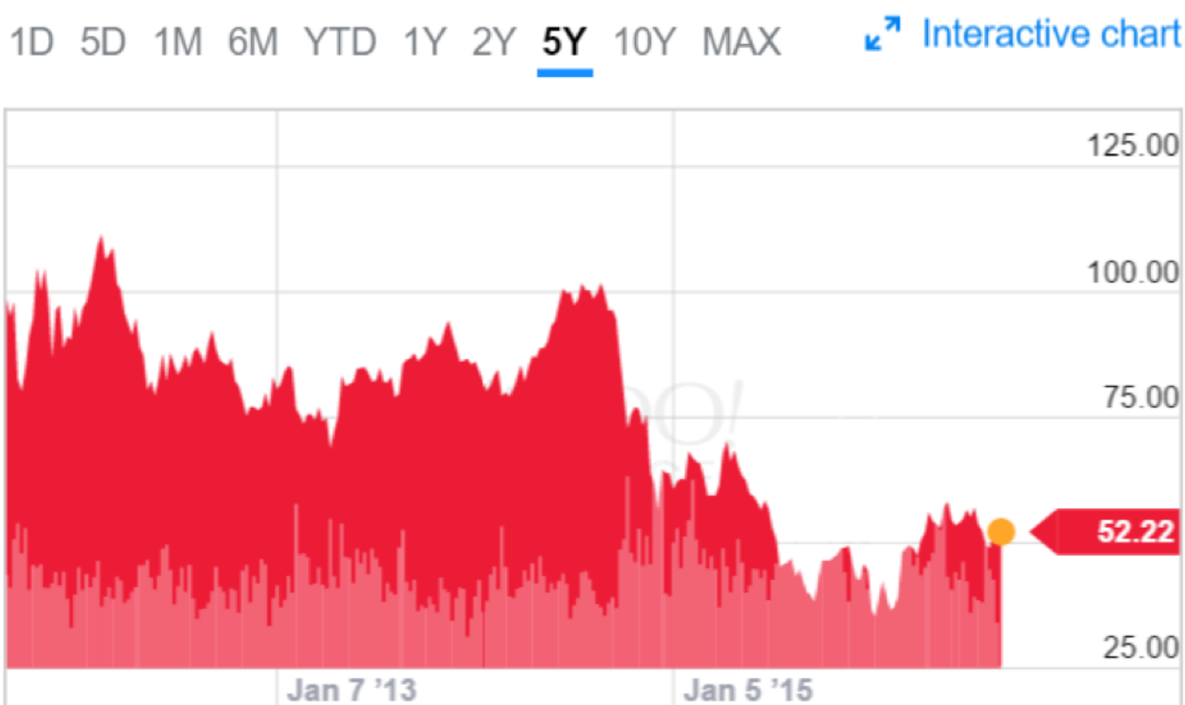
An interesting case, of a transition from a traditional department store to a fast-growth new format, is behind the rise of Target. The company had its roots in a traditional department store, Dayton's, that eventually became Dayton-Hudson and eventually Marshall Field's. In 1960, its leadership saw an opportunity in offering value-conscious customers a good shopping experience. To protect the then-respected department store brand, the new venture was branded separately, with its iconic bulls-eye imagery and the notion of hitting the target of convenience, price and customer experience. By the mid-70's, the Target stores were out-selling the department store part of the company. By 2000, Dayton-Hudson officially changed its name to reflect the reality of its now-central business. The company sold their department store brands, now called Marshall Field's and Mervyn's, in 2004, completing an extraordinary retail transformation.

Stock buybacks are simply a disengagement by another name

Stock buybacks have been the subject of much discussion of late, with critics arguing that they are simply a mechanism for rewarding investors and executives without leading to better or more fair wages or re-investment in the company's future health. Indeed, companies are using share repurchases and dividends extensively to satisfy the investing community. The reality is that such repayments to investors can undermine a company's growth over the long term, as a recent study comparing Cracker Barrel, which pays a modest dividend with another restaurant chain that spent ten times as much. Cracker Barrel, concluded the researcher, was investing for growth while the other company was basically divesting resources.

Another little-mentioned aspect of share repurchases are that this signifies that a company's management has no good, new, growth ideas that they would like to fund. Unlike the telecomm giant Verizon, who does make those option-oriented investments, they are basically signaling disengagement from their future. And for any long-term investor, that should be a warning sign, not something to be rewarded for the short-term.

A case that illustrates this principle is that of the oil and gas producer, Apache Corp. In 2013, the company announced, with great fanfare, that it planned to divest $4 billion in underperforming assets. So that made sense, given the importance of disengagement. But, woops – did they plan to invest in exciting new opportunities with all the cash that was freed up? Nope. Instead, they announced that their cash flow was going to go instead to retiring debt and buying back shares. Investors were pleased and the stock dutifully went up. But this happy state was not to last. If you have a look at the 5-year history of Apache's stock from a 2016 vantage point, it is painful to see.



So yes, the rosy glow of 2013 did improve the company's prospects for a while, but its current stock price is about half of its 2012 value of $111.57 a share.

Latest HBR digital article: Escaping the tangle of growth

To Reduce Complexity in Your Company, Start with Pen and Paper

---

Upcoming Events

Technology and the Future of Labour

Sponsored by Aftenposten - September 19 – Oslo, Norway

Leading Transformation: A CEO Summit 2016 - in Berlin on September 20th.

Co-Presenting with Clayton Christensen - Innosight

SHIFT**: Accelerating Corporate and Venture Partnerships - October 28th in New York**

SHIFT is a one-day meeting designed to facilitate information between corporates on best practices across both direct and LP investment models.

The Entrepreneurial Society - Moving Beyond a Society of Employees

November 18, 2016

The 8th Global Peter Drucker Forum – Check out the event program

My Plenary Session **- Time to Change the Practice of Management?**

Speakers:

- Tim Brown, CEO & president, IDEO
- Sara Armbruster, VP of Strategy, Research and New Business Innovation, Steelcase Inc.
- Julian Birkinshaw, Professor of Strategy and Entrepreneurship and Director of the Deloitte Institute at the London Business School.
- Rosemarie Ryan, Co-Founder and co-CEO, co:collective

How much of what managers "know" about managing is outdated, still based in the realities of past industrial eras? This panel brings together management practitioners from a variety of companies – products, services, large, small, incumbent, and challenger – to find the common themes in how the practice of management must adapt to the twenty-first century. Some things will not change – like Peter Drucker's famous assertion that "the purpose of a business is to create and keep a customer." Yet - are management ideas, concepts and tools moving into the direction of a VUCA world where the customer is king?

October also marks another run of my well attended Columbia Executive Program, **Leading Strategic Growth and Change**, which begins on October 17.

In the News

- Amazon's 30-hour work week could be just the ticket to increasing its diversity.
- Why Boards need to do a better job of promoting innovation.
- End of Competitive Advantage recommended for late-summer reading.
- An interview with my colleagues over at CapGemini about what digital transformation means.
- What does Verizon want with Yahoo! A LOT!
- Yahoo lost it's way and Verizon bought it anyway.

More links to recent press mentions can be found on the Press section of my website.

So what's next for retail?

It's hard to say. Customers have been taught that many of their basic needs can be met with the click of a mouse. Increasingly, they are also spending on experiences, not things. So, to make money on physical space, you're going to have to provide a pretty compelling reason for people to get off the couch and go somewhere. Some companies that rely on people using their physical spaces are thriving, because they offer a clever way to meet an unmet need. An example might be Hana Haus in Palo Alto that is capitalizing on the emerging trend of freelancers and entrepreneurs enjoying co-working space. Another is PeerSpace, that is kind of an AirBnb for commercial office space, connecting workers with underutilized spaces. The key to these company's rapid growth, is, as it always is, addressing the customer's core 'jobs to be done'.

Have a great start to your autumn,
Rita

Password for the "Tools" Section of My Website

To access the tools part of the web site (downloadable diagnostics, quizzes, spreadsheets and other cool stuff) go to the RitaMcGrath.com website and use the password - **mcgr8th!** *(the exclamation point is part of the password).*

If this newsletter has been forwarded to you and you want your own copy - please sign up for your own copy at the top of my website.