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Knowing When to Reinvent

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by Mark Bertolini, David Duncan, and Andrew Waldeck

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KNOWING WHEN TO REINVENT

Detecting marketplace "fault lines" is the key to building the case for preemptive change.

BY MARK BERTOLINI, DAVID DUNCAN, AND ANDREW WALDECK

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No business survives over the long term without reinventing itself.

But knowing when to undertake deliberate strategic transformation—when to change a company's core products or business model—may be the hardest decision a leader faces. This kind of change requires overcoming big obstacles: Employees feel threatened, customers can become confused, investors don't like unproven strategies. And the risk of failure is high—research conducted by two of us suggests that although more than 80% of executives at large enterprises recognize the need for transformation, only about a third are confident that they can get the job done in five to 10 years. The decision to reinvent is even more difficult when company performance is strong and Wall Street is happy; it's tempting to take a wait-and-see approach unless evidence clearly shows that industry disruption is imminent. But by then it may be too late, as demonstrated all too well by cautionary cases from Borders and Blockbuster to Compaq and Kodak.

So how can a leader know that it's time to transform a company? We have identified five interrelated "fault lines" that suggest the ground beneath a company is more unstable than it may appear. Executives who can detect these fault lines have early warning of industry upheaval and can prepare and adapt. Just as important, our fault line framework can help executives build a case for change and garner stakeholders' support. Finally, by identifying gaps between an organization's current state and where it needs to be to thrive in the future, the framework can inform the vision of how the company must transform, which can be refined once the change is under way.

Given the magnitude of disruption required to compel a company to reinvent itself, our fault lines focus on fundamentals: whether a business is serving the right set of customers and using the right performance metrics, whether it is positioned properly in its ecosystem and is deploying the right business model, and whether its employees and partners have the necessary capabilities.

To illustrate how to detect the fault lines, we rely principally on our experience at the health care company Aetna, where one of us (Mark Bertolini) is the CEO and the others have worked as strategic consultants. We also draw on cases from Nestlé, Netflix, Xerox, and Adobe, all of which undertook strategic transformations in the past 15 years. Accompanying the discussion of each fault line is a set of diagnostic questions designed to help leaders recognize impending upheaval while there's still time to respond.

Detecting the Fault Lines at Aetna

In 2010, when Bertolini became CEO, Aetna had 22 million medical policyholders, making it the third-largest player in the highly conservative health insurance business. The *Fortune* 100 company appeared to be in a strong position: It had grown even during the 2008–2009 recession, when millions of people lost their jobs and their employer-provided health insurance, and it was prospering in the wake of the 2010 U.S. Affordable Care Act, which imposed significant industry reforms. By the end of Bertolini's first year at the helm, Aetna had achieved a 38% surge in year-on-year net income; it seemed impervious to disruption.

Yet during a pivotal series of board meetings early in his term, Bertolini began making a case for transforming the company into something beyond a traditional health insurer. He was driven in part by personal experiences—he had suffered a near-fatal ski accident, and his son had been diagnosed with a rare form of cancer—that left him deeply critical of the existing health care system. But he backed up his intuition by telling the board of certain fault lines that indicated a changing future: Despite its profitability, the business of health insurance in its current form would soon disappear, to be replaced by a whole new way of making money that focused on servicing health care's consumers and providers. If Aetna pursued only small changes, Bertolini argued, it risked either slow decline or disruption from new entrants—but if it transformed to take

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Idea in Brief

THE PROBLEM
No business survives over the long term without reinventing itself. But knowing when it is time to transform is difficult.

THE SOLUTION
Five interrelated "fault lines" can indicate that the ground beneath a company is unstable. Executives who are able to detect those fault lines have early warning of impending industry upheaval and are better able to prepare and adapt.

THE PRINCIPLES
The fault lines focus on the fundamentals: whether the business serves the right customers, uses the right performance metrics, is positioned properly in its industry, deploys the right business model, and has employees and partners who possess the required capabilities.

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advantage of new opportunities, it could double its revenue by 2020.

As of this writing the transformation program at Aetna is far from complete, and—like that of any ambitious initiative—its success is not guaranteed. Our intention in what follows is not to discuss the specifics of Aetna's program but to explore each fault line in turn and to explain how the fault line framework helped Bertolini and the Aetna board make the existential choice to reinvent the company just when its profits were soaring.

1 CUSTOMER NEEDS. For most of its 160-year history, Aetna's customers were mainly large organizations—corporations, governments, universities, and other employers. Typically one person or a small department in each chose the health plan or plans for the entire organization. Thus, one of Aetna's core competencies was selling plans to those intermediaries, rather than to the ultimate consumers.

This turned out to be a major fault line. Benefits managers and policy brokers look for ways to demonstrate value to their organizations—which had come to mean offering employees something "new." The process inevitably gave rise to policy features that few members used in a given year but that generated higher and higher premiums. It also resulted in one-size-fits-all plans, with individuals unable to choose the coverage that was best for them.

Bertolini recognized that the needs of his primary customers—benefits managers—were not as urgent as the needs of the insured. Indeed, catering to those middlemen was backfiring. Employers and consumers alike were starting to actively shop for health care services, and they were growing increasingly sensitive to price. The Affordable Care Act had drawn public attention to the enormous cost of health care in the United States and its impact on the global competitiveness of U.S. firms. Employers had begun to shift health care costs to their employees, offering plans with high deductibles and out-of-pocket expenses at the point of care. And just as they were beginning to shoulder those expenses, consumers were becoming empowered by access to medical information through technologies such as Google and WebMD. It all added up to an awakening in which consumers sought more control over the design and cost of their health plans.

To remain a major player, Bertolini realized, Aetna would have to develop products and services that directly targeted the affordability needs of end consumers. This was the heart of the powerful case for transformation. It required a strategic shift over time from being strictly a B2B company to becoming a B2C company as well—one that could help consumers make informed decisions about their health and their health plans. Because of its narrow focus on its traditional customers, Aetna had become disconnected from the most urgent needs of its true customers—such as the ability of individuals to buy the right health plans for their situations and the ability of hospitals, clinics, and other providers to offer higher-quality, lower-cost care.

Aetna is not the only company to recognize a fault line between the needs of today's customers and those of tomorrow's. A similar awareness drove Nestlé's decision to change direction in the early 2000s. In 1997 the Switzerland-based multinational was the world's largest food company, with 70% of its revenue coming from its core segments of beverages, milk products, and chocolate and confections. Yet CEO Peter Brabeck-Letmathe was concerned about the sustainability of the company's core strategy at a time when consumer behaviors were rapidly changing. As people embraced more-healthful food

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and lifestyle choices, he and his team came to believe that Nestlé was in danger of underserving future customers. As he described it to shareholders, partners, employees, and other stakeholders, the company "made the strategic decision to transform itself from a successful food and beverages company into an R&D- and marketing-driven nutrition, health, and wellness group." That meant identifying specific health and wellness needs and developing products and brands to meet them. Fifteen years later Nestlé's traditional core segments account for just 47% of revenue, while the powerful new focus on the future consumer has allowed the company to continue growing.

When an industry reaches an inflection point, old ways of measuring success can lead to a sharp decline—or failure.

DIAGNOSTIC

To discover if you have a customer fault line, talk to 10 customers in each of three categories: your most profitable customers, your least profitable ones, and those you don't currently serve. Don't ask for feedback about your company; instead, try to discover the functional, social, and emotional needs each group seeks to have fulfilled, along with the frustrations they feel when doing so. The following questions can help guide you:

- What are the top unmet needs of each group of customers? Do they vary across different types of customers (in Aetna's case, benefits managers, hospitals, and individual consumers)?
- Do customers we don't currently serve have emerging unmet needs? If so, does that signal an opportunity that a new competitor could seize?
- Are our customers loyal to our product, or are they captive for lack of other options? Would they defect if they could?
- If we are a B2B company, do the needs of our business customers conflict with those of end consumers?
- Could emerging technology simplify how end users' needs are met?

2 **PERFORMANCE METRICS.** When an industry reaches an inflection point, old metrics can prove deceptive—and are sometimes dangerous. Once-reliable ways of measuring success can lead to a sharp decline or even failure, although your short-term results may be healthy.

Aetna's main performance metric had long been the degree of choice in policies offered to employers and institutions. Benefits managers sought the largest physician and hospital networks possible within a given cost range, so as to minimize complaints from employees that the doctors and facilities they wanted weren't covered. In this context, "innovation" meant giving consumers a wider range of providers and giving companies broader options for structuring benefits.

When Aetna recognized that its most important customer might soon be changing, it naturally saw that its way of measuring the value of its products and services would also need to change. Bertolini's personal experience navigating health care confirmed his suspicion that Aetna's primary performance indicators were not adequately connected to the needs of end users. Although the system offered lots of choice, it was impersonal, convoluted, and costly. No one coordinated individual patient care to monitor quality and eliminate unnecessary tests and visits.

As costs kept rising and premium hikes kept getting passed on to employees, Aetna realized that the industry needed to start measuring value as a function of three factors, adopting what one nonprofit advocacy group termed "the triple aim": improving the experience of care, improving the health of populations, and reducing costs. That was

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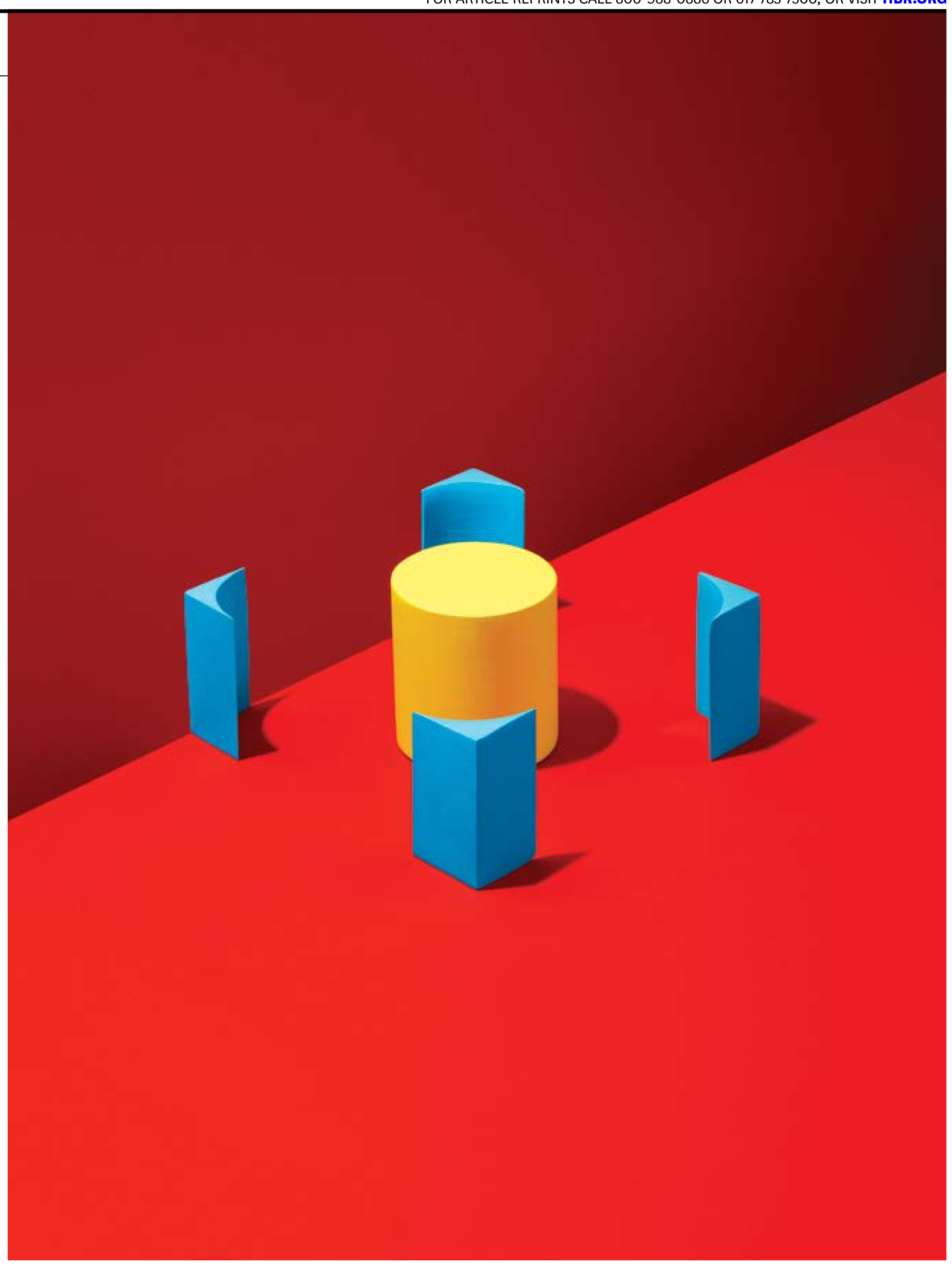

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the definition of value that would matter most to future customers.

The shift toward delivering on the triple aim required new ways of measuring the business. For decades Aetna had focused on acquiring new members to build its customer base and lower its risk exposure, but in the new world of health care, *retaining* customers would be more important. With more consistency in the customers they served, providers could better prevent illness through holistic programs and better manage care by coordinating services over time and across various clinical settings. Metrics such as customer acquisition targets needed to be superseded by customer retention targets to give investments in prevention and wellness time to pay off for both employers and providers.

To confirm that the triple aim should be its new North Star, Bertolini turned Aetna into a laboratory. He made a variety of wellness programs available in-house to Aetna's 50,000 employees, including fitness centers, healthful meals, and alternative healing methods such as yoga, meditation, mindfulness training, and massage therapy. He believed that this would reduce the company's overall health care costs and lead to a happier, healthier workforce. Subsequent surveys revealed a 28% decrease in employees' stress levels, a 20% improvement in sleep quality, and a 19% reduction in pain. Health care costs dropped and productivity increased. These types of metrics were one way Aetna would start to measure success with its B2B customers—and they would increasingly form the primary basis of competition in the industry.

Other companies have similarly recognized that traditional metrics were leading them astray. By 2008 the Silicon Valley software giant Adobe—the

FINDING STABLE GROUND

When leaders spot fault lines early, they can preempt disruption. Here's how five companies adapted to impending upheaval.

FAULT LINE	Customer Needs	Performance Metrics	Industry Position	Business Model	Talent and Capabilities
COMPANY	Nestlé	Adobe	Xerox	Netflix	Aetna
CONTEXT	In 1997 Nestlé was the world's largest food company. But consumers wanted more-healthful options.	In 2008 Adobe measured success by how many software packages it licensed, but its customers cared more about web traffic and revenue.	In 2001 the office equipment industry was under siege from Asian competitors and intermediary group-purchasing organizations.	In the late 2000s streaming content threatened to make Netflix's mail-order DVD rental service obsolete.	In 2010 Aetna identified talent as its biggest risk—not just finding people with the right skills but also cultivating employees with the courage to step into something new and uncertain.
STRATEGIC SHIFT	Nestlé transformed itself into an R&D- and marketing-driven nutrition, health, and wellness company.	Adobe switched its primary metric of success to subscriptions and renewals for its new cloud-based services.	Xerox lessened its dependence on office hardware and began offering business process outsourcing services.	Netflix changed emphasis, and by 2013 it became the world's leading streaming-content company.	Aetna launched an internal start-up in Denver and Silicon Valley—places where it could find employees with the skills and attitude to disrupt its traditional business.

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Just because your current business model is widely used and profitable doesn't mean it will serve you well in the future.

creator of Photoshop and Illustrator—had become the world's second-largest desktop-applications company, after Microsoft. But following a series of blue-sky strategy sessions, CEO Shantanu Narayen and his senior team concluded that the company needed to move beyond desktop software and even beyond its core mission of serving creative professionals developing content.

During its first 25 years Adobe measured success by how many copies of software packages it licensed. But its customers wanted results such as increased web traffic and revenue, not just beautiful documents. Recognizing the disconnect, Narayen decided to divide the company's products into two sets of cloud services. Adobe's core group, digital media, offered 19 programs in a set called Creative Cloud, available for $50 a month with a one-year contract. A new group, digital marketing, offered eight categories of programs and apps packaged together as a subscription service called Marketing Cloud.

After making the change, Adobe needed a way to tell whether it was working. The key metric became monthly and annual subscriptions—sign-ups and renewals—rather than package sales, and it showed that both business units were delivering the desired results. The company had successfully shifted from focusing on products to building long-term relationships—a change inspired by identifying a fault line.

DIAGNOSTIC

To ensure that you are using the correct performance measurements, hold a cross-functional internal working session in which you examine whether your metrics are consistent with the things your customers value most. Don't be afraid to challenge the logic underlying each metric. Use these questions to guide your analysis:

- Do we understand what our customers really value? How well does the performance of our product or service match the customer's definition of value?
- Will the customers of tomorrow define quality differently from the way today's customers do?
- How closely do our customer satisfaction and financial metrics correlate? Are our customer satisfaction scores as strong as our financial indicators?
- Are we measuring units and volumes, or outcomes? If outcomes, are we measuring ones that matter to our customers, or ones that matter to us?
- Do our products or services have more features or complexity than most of our customers value?
- Is there a new metric that aligns with the needs of future customers?

3 **INDUSTRY POSITION.** Companies that start out serving niches often expand to encompass more and more tasks. If others are moving into your space at lower cost, it could signal the third fault line. In other words, watch out for players that are beginning to do what you do.

Aetna faced disruption in its core business on two fronts. The first was from public and private health exchanges, which were central to the Affordable Care Act. These digital marketplaces allowed benefits consultants and other third parties to redefine how employers and employees shopped for health insurance—including what products would be listed on websites and how information would be displayed. Benefits consultancies such as Towers Watson and Aon Hewitt had become multibillion-dollar businesses by helping employers and employees navigate health care's complexities. Now they were building simple exchanges for consumers that directly pitted one health insurer against another. Having once

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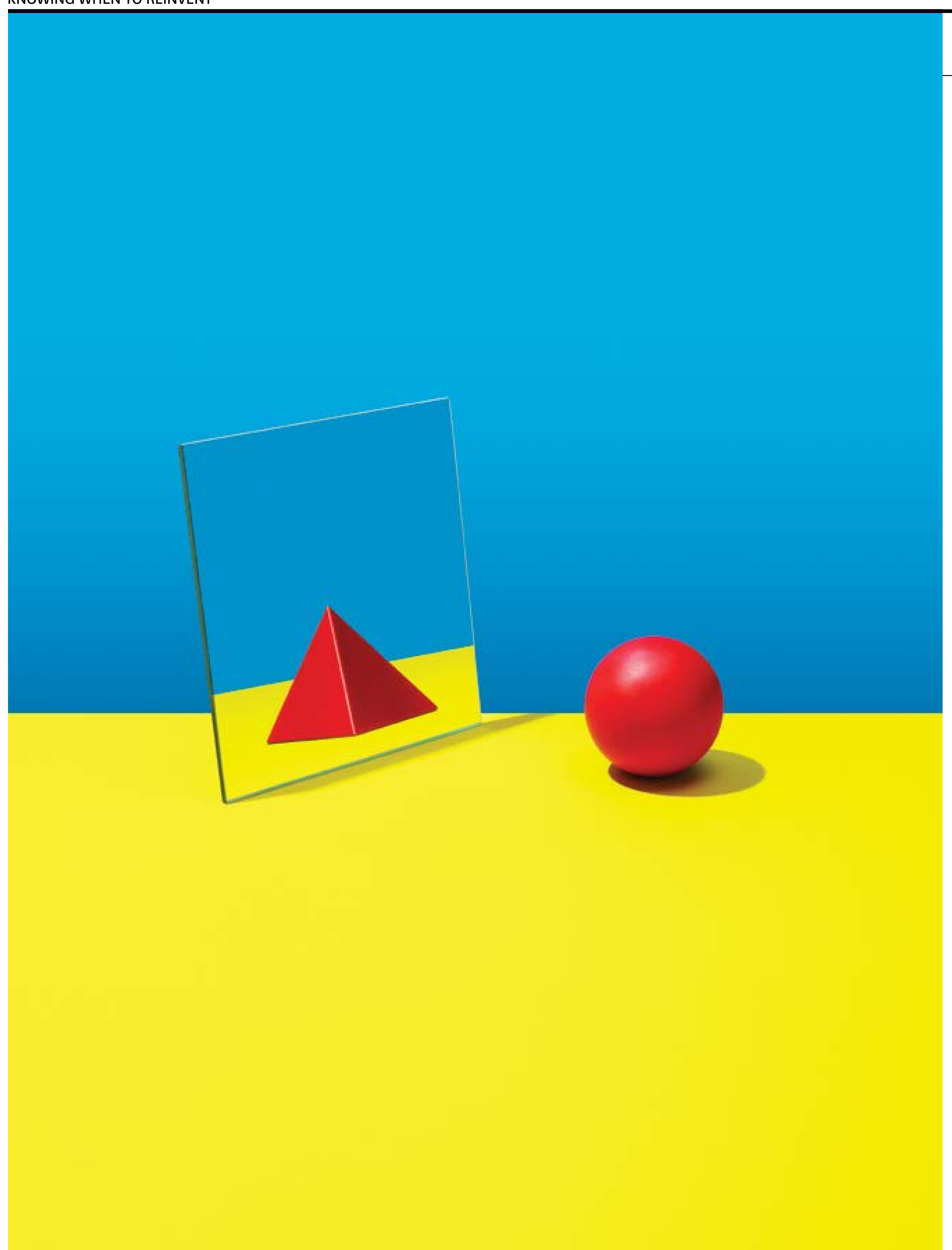

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been advisers to Aetna's customers, they suddenly became direct competitors to Aetna.

Second, starting in about 2013 Aetna faced disruption from hospital groups and other providers that began taking on one of its historical responsibilities: assuming the financial risk of caring for defined populations of patients. That increased the danger that Aetna and other insurers would be disintermediated and that their raison d'être—matching demand for health care services with supply—would disappear over time.

In a similar way, Xerox found its role in its industry's ecosystem under siege. By the late 1990s Asian competitors including Canon and Ricoh had drastically commoditized the market for copiers and printers. At the same time, big corporate customers had begun to outsource the purchasing and servicing of the machines to small third-party contractors who were focused on saving them money—and that meant attacking Xerox's margins. In 2001 the new CEO, Anne Mulcahy, and her leadership team decided to launch a transformation effort to lessen the company's dependence on manufacturing and concentrate instead on offering business process outsourcing services. Xerox would not only manage machines but take over entire corporate functions, ranging from technical support to corporate accounting to customer-relationship management. By assuming a new place in the corporate services ecosystem, it found a new way to grow. Within 15 years the company's core business had declined, while Xerox Business Services accounted for nearly 60% of revenue.

DIAGNOSTIC

To determine whether your position in your industry's ecosystem is risky, scan the periphery—analyzing start-ups, adjacent competitors, and historical partners and suppliers that have the potential to fill existing and emerging customer needs. To make the exercise more tangible, draw up a list of 10 companies that are viable competitors. Consider the following questions:

- Are regulatory, technological, or other external developments lowering barriers to entry to our industry or changing how our current customers consume our products?
- Are external forces diminishing the value of our role in the industry?
- Is a disruptive technology emerging that could significantly change the cost-value equation in a major part of our industry?
- Are our customers starting to bring our services in-house or to outsource them to someone else?
- Is our industry expanding to include new kinds of competitors? Is there consolidation among major players—signaling that it's becoming harder to make money in the traditional way?

4 BUSINESS MODEL. Successful companies are often lulled into complacency by how well their business models have been—and indeed still are—working. But just because your current model is widely used and profitable doesn't mean it will serve you well in the future.

For Aetna, strong financial performance at a time when health care costs were escalating meant that its business model was serving the company but no longer working well for employers or end consumers. The model involved setting policy rates to exceed the cost of claims. This practice—keeping a tight lid on claims while premiums skyrocketed—was at the heart of the frustration directed at health insurers in 2010.

Recognition of the first three fault lines led Aetna to seek new ways to generate profits. The company identified two major business-model initiatives. First, it launched a consumer unit at its Hartford, Connecticut, headquarters to start shifting its core business from a B2B to a B2C model. This meant creating direct-to-consumer advertising along with digital distribution systems for new consumer-centric products to be piloted in 2016. Because of out-of-pocket expenses and premium sharing, consumers were already footing the bill for 40% of their health care costs, with employers covering the rest. Anticipating that consumers would soon pay for more than 50%, Aetna decided to create a private-exchange marketplace—something that would provide an experience analogous to shopping on Amazon.

The second initiative was directed at providers. Correctly predicting that hospitals and clinics would become increasingly interested in taking on the financial risk of managing the health of groups of patients, Aetna decided that it needed to offer new technology along with traditional actuarial and other risk-management services to health care providers.

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This led to the formation of a new business unit, Healthagen, based not in Hartford but in Denver and Silicon Valley. Its mission was to help providers manage costs and risks while improving the overall health of large populations. Bertolini saw the initiative as a way to become the big data engine—the "Intel Inside"—of the new provider networks.

Making a case for preemptive change is always challenging, but it's even more difficult when the journey will be long-term.

In seeking new business-model initiatives, Aetna was hardly alone. Netflix provides a classic example of how a corporation must assess whether it needs to move beyond its core business model—and how tricky the timing can be. In 1997, when Reed Hastings started the company, he designed the business model to leapfrog physical stores such as Blockbuster by providing DVDs through a mail-order subscription service. Despite overwhelming early success, he understood that another upheaval was on the horizon—the shift to streaming content.

The streaming business initially looked unattractive because of constraints in bandwidth, consumer resistance, and Hollywood's recalcitrance about signing new kinds of deals. But Hastings chose to embrace the transformation. As he himself acknowledged, at first it seemed that he had moved too quickly. In 2011, when Netflix announced that it was spinning off its mail-order DVD business to focus on streaming, hundreds of thousands of customers canceled. Hastings acknowledged the disaster and reversed course, retaining the DVD service and treating the two businesses as equals.

Yet Hastings's speed soon appeared prescient: As Netflix accelerated its transformation to a streaming company and a purveyor of original content, revenue grew, doubling in just three years. Detecting and acting on the fault line too early had almost surely been better than waiting for the business case to become entirely clear.

DIAGNOSTIC

To see if you're sitting on a business-model fault line, map your current business model and assess how well it is primed to compete against emerging rivals and to deliver against new performance metrics. (For a discussion of mapping, see "Reinventing Your Business Model," by Mark W. Johnson, Clayton M. Christensen, and Henning Kagermann, HBR, December 2008.) Ask yourself:

- Is at least one emerging competitor in our industry following a different business model—even if at the moment that model looks financially unattractive?
- Is the way we make money aligned with how value is created for customers? Are customers balking at price increases or added fees?
- How durable are the key components of our existing business model—things like the customer value proposition, resources and processes, and the profit formula? Are any at risk of being undercut by external forces or new competitors?
- Will the strategic assumptions that underlie our existing model—assumptions about risk, differentiation, and growth—hold true as our industry changes?

5 **TALENT AND CAPABILITIES.** It is a best practice for executives to continuously assess what skills, competencies, and organizational structures will be required to succeed in the future. When that future is marked by fault lines, the chance of misalignment is high. We find that the fifth fault line is often different from the others in that it may become apparent only after you have detected the first four. And yet the sense that your human resources are not well configured for the future can

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be the decisive indication that your organization is off track.

After pondering Aetna's future and identifying multiple fault lines, Bertolini came to believe that the company's single biggest risk lay in talent—not just in finding new people with the right skills but also in cultivating employees with the courage to step into something new and uncertain. That's why Aetna located its technology-focused Healthagen venture in Denver and Silicon Valley rather than in Hartford. In those places it could more easily staff the initiative with employees who were experts not at creating insurance policies but at developing software to manage, deliver, and track patient health. Voicing his belief that Healthagen would be key to Aetna's transformation, Bertolini said publicly that the initiative "will destroy the insurance industry as we know it."

Nestlé, Adobe, and Xerox went through a similar process, recognizing that they would need new talent to overcome the forces about to shake their industries. At Nestlé, the focus on consumer nutrition and wellness required capabilities in areas as diverse as consumer ethnography, microbiome research, and health economics. So the company boosted R&D spending, opened the Nestlé Nutrition Institute, and began working with a wide network of universities and hiring hundreds of postdoc scientists. Adobe needed to beef up capabilities in the new field of digital marketing in order to deliver on the promise of its Marketing Cloud. And Xerox had to hire thousands of specialists across more than a dozen industries for its business-services venture. In each case the need for new talent and organizational structures was so great that the company decided to make strategic acquisitions a major part of the transformation plan.

DIAGNOSTIC

The following questions can help uncover a fault line in your current capabilities and organizational structure:

- Will we be fulfilling customer needs that require new skills to be brought on board?
- Do we have enough emerging leaders who are excited by the prospect of transformation?
- Have our company and industry struggled to attract tech-savvy talent?
- Do the leaders of our business view talent as their responsibility, or is it relegated to HR?

Synthesizing the Shifts into a New Strategy

The fault line framework augured major disruption for Aetna. But it also suggested how the company might succeed in the future. And because it provided early warning, Bertolini was in a strong position to innovate. Aetna had more than enough capital to invest in the future. More important, in 2010 it and other insurance companies were the only industry players with both the actuarial expertise and the data needed to make money by keeping entire populations healthier at lower cost, which was the key to abandoning the increasingly unpopular health care model that focused on reimbursing often expensive treatments for the unwell. This opened up opportunities to occupy new places in the industry over time.

Making a case for preemptive change is challenging under any circumstances, but it's even more difficult when the journey will be long-term. Reed Hastings may have stumbled when first communicating his vision of transformation at Netflix. But, like the leaders of Nestlé, Adobe, and Xerox, he learned that it takes years to fully communicate such a vision. Their campaigns are still going on today.

For Aetna, assessing the fault lines and synthesizing them into a single worldview yielded the clear outlines of a new strategy. Yet only recently has the bulk of the health care sector caught on. In mid-2015 Aetna announced that it would acquire rival health insurer Humana in a $37 billion deal that would keep it among the big three players in its sector. The acquisition would extend Aetna's traditional footprint. But it was also "a way to accelerate our transformation to a consumer-centric health care company," Bertolini told investors.

Although the process of transformation may be long, the fault line framework can give organizations the clarity to overcome the inevitable speed bumps and roadblocks along the way. It can help leaders frame the challenge, build confidence among senior leaders, and align stakeholders with the case for change—and do so years before the situation becomes so dire that there's not enough time or capital to execute a new plan.

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