CHAPTER 7

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# FOREVER FRUGAL

*Necessity is the mother of reinvention.*

**—what Plato should have said**

Excerpted from THE REINVENTORS: HOW EXTRAORDINARY COMPANIES PURSUE RADICAL CONTINUOUS CHANGE. Published by Portfolio/Penguin.

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In 1975 a small start-up airline was bleeding cash profusely. The company's first president and his VP of operations realized their new company was between a rock and a hard place. "Do we accept defeat or do we find a way to cut our expenses by twenty-five percent overnight?" they wondered.

At the time the airline had four aircrafts flying around three hundred flights a week. If they cut flights or destinations it would mean disappointing their new customers; if they ordered layoffs it would mean breaking promises to new employees. So the pair searched for another solution.

"If we could find a way to make three planes accomplish the work of four we could sell off one plane and still keep our commitments to both our customers and employees," the president, Lamar Muse, suggested. At the time, each of the airline's flights averaged fifty minutes in the air and twenty-five minutes at the gate unloading, cleaning, refueling, and loading again. When Muse crunched the numbers he found that "if we could cut our turnaround time by sixty percent [from twenty-five minutes to ten] we could keep our current schedule and even add nine more flights." The president

asked his VP, "Do you think our teams could make these quick turns?"

"We can and we will," Bill Franklin, the ops VP, replied.

Over the next two days the ops team reinvented the ground operations while the chief dispatcher and Muse rearranged all the schedules. All the supervisors and employees pitched in, coming up with a plan to create greater cooperation and coordination from all twelve different job functions, which would have a critical impact on airplane turn times. Getting everyone from flight crew to baggage handlers to do whatever was necessary to meet a ten-minute quick turn goal was something other airlines had thought about but had decided was impossible.

By the end of the weekend, crew routings and assignments were rescheduled and everyone was on the same page. After several days of successful ten-minute turns of three aircraft, everyone was able to breathe a sigh of relief. They sold the fourth airplane and stopped the bleeding. The airline's cash crisis was averted, and profits soared from the increased productivity.

That's the real story about how a small, upstart airline reinvented itself, got a new lease on life, and prepared itself to fly high and become America's largest airline (in terms of domestic passengers). You now know them as Southwest Airlines.

Since those early days Southwest has reached the top of everyone's list of inspiring and innovative organizations. The airline is a global icon of high quality, superior customer satisfaction, unparalleled productivity, and total teamwork in an industry infamous for finger-pointing management and "it's not my job" employee attitudes that leave scores of customers dissatisfied and disloyal. Without a doubt founder Herb Kelleher's passion for building a people-focused culture was crucial to the airline's success, but imagine for a moment that back in 1975, instead

of facing a cash crisis Southwest had deep pockets filled with venture capital. Its leaders may have never discovered the innovative solution to quickly turning airplanes based on coordination and cooperation among every job function, from pilot to gate personnel. The company could easily be a footnote in aviation history, like People Express, Skybus, and scores of others. "Not enough" money was certainly the catalyst, the mother of Southwest Airlines' first reinvention.

When companies haphazardly throw money at what they perceive their problems, challenges, and opportunities to be, the *real* answers that could solve the *real* problems or allow them to embrace radical change and take advantage of the real opportunities are seldom found.

Other U.S. airlines became outraged at the success enjoyed by Southwest, but rather than embracing radical change and dealing with an outdated hub-and-spoke flight system, obsolete labor agreements, and horrible morale as a result of the shabby way they treated their workers, they either threw money at lawsuits trying to squeeze Southwest (as did American Airlines) or tried to beat them at their own game with copycat subsidiary airlines such as United Airlines' discount carrier, Ted; US Airways' MetroJet; and Delta Air Lines' aborted Delta Express and Song. At the end of the day, none of their frivolous lawsuits stopped Southwest and none of their copycat tactics prevailed, as Southwest grew its number of total daily flights to nearly four thousand.

As a former CEO of United Airlines recently confessed to me, "The profits reported by airlines aren't all that great, but airlines have terrific cash flows, and great cash flows allow you to cover up and bury a lot of mistakes or problems."

The lesson is clear: Having too much money or too many resources can actually get in the way of successful reinvention.

## THE DOWNSIDE OF DEEP POCKETS

Do you remember Boo.com? Boo was the dot-com dream of two photogenic twentysomethings, Ernst Malmsten and Kajsa Leander (he a poetry critic; she a fashion model). Malmsten and Leander saw themselves as experts of "world cool, world chic." Their big idea was to create a cutting-edge Web site and reinvent the high-fashion shopping experience with Planet Boo, a 3-D gateway to a virtual world of hip and trendy international sportswear labels for fashionistas and their followers here on planet Earth.

Bernard Arnault, the chairman of LVMH, Europe's largest luxury goods group; Alessandro Benetton, the Harvard-educated son of Benetton's chairman, Luciano Benetton; and Bain Capital and J.P. Morgan must have loved what they heard in the pair's venture pitch. Planet Boo was given deep pockets stuffed with almost two hundred million dollars of other people's money.

Leander, Malmsten, and their crew spent all that and a few dollars more in just eighteen months. Here's a short list of what they reportedly bought:

- $70 million in software and servers
- $42 million in advertising
- $200,000 to rent apartments for Leander and Malmsten, plus $100,000 each to redecorate their pads
- $600,000 to PR firm Hill and Knowlton
- $200,000 per month in travel expenses
- $5,000 a day in stylists' charges to perfect the look of Planet Boo's mascot, Miss Boo.

- $1,000,000 to design their magazine
- 400 people doing the work of 80

For all that spending, Boo's investors got a total of only a half million hits (videos of giggling babies routinely get more hits on YouTube in just a few days), two million dollars in sales, and at final liquidation (months after the buying spree) a pathetic $962,000 for all the assets and goodwill. Boo indeed!

Companies with long histories of successfully embracing change and reinvention have a shared disdain for waste and indulgence, which probably comes from the fact that during their formative years they had to count on ingenuity instead of cash to maintain momentum and keep on creating better tomorrows for all the stakeholders.

## THE UPSIDE OF NOT ENOUGH MONEY

Arrow Electronics is the quintessential example of what I've learned in thousands of interviews with successful entrepreneurs: "If you want to accomplish great things, what you need is a problem and not quite enough money." Arrow was once a very small business and is now a twenty-two-billion-dollar worldwide company that has constantly embraced radical reinvention and succeeded without a lot of cash.

The company began as a retailer with a single location. Realizing that their best opportunities existed in wholesale distribution, the leaders proved themselves adept time and again at letting go and discarding companies and business units that no longer fit the strategic direction of the firm. Arrow's reinvention efforts have been doubled under its current CEO, who promised that going forward the company

will be involved in "everything that has an electrical part or component."

"Ours is a company that grew despite never having quite enough money," says Arrow CEO and chairman Mike Long. "Things were so tight that for many years we wouldn't allow our general managers to hand out payroll checks until after five p.m. on Fridays so that our employees wouldn't cash them until Monday, when we'd hopefully have money in the bank to cover them all.

"If you can do the things that customers need done but that are giving them fits, and you scale that, you'll be very successful. We know that if it's complex we can make money at it."

## THE EARLY DAYS

Almost one hundred years ago, as radio broadcasting was first sweeping the nation, a huge market developed for new and used radios, places to get radios repaired, and stores that sold vacuum tubes, spare parts, and tuners to those early radio geeks who preferred to tinker and fix things themselves. Very quickly, many major U.S. cities had an area of their downtown that came to be referred to as Radio Row (much like Auto Rows today), lined with stores selling radio-related merchandise.

No Radio Row was as famous as the one on Manhattan's Lower West Side, on the site of the former World Trade Center, where hundreds of stores stood side by side selling their wares. The stores were so jammed with merchandise that pictures taken at the time reveal huge bins of parts spilling into the streets and scores of customers doing an early version of Dumpster diving, their bums in the air, rummaging deep in the bins for their needed parts.

In 1935 Maurice Goldberg opened Arrow Electronics as a small retail store on Manhattan's Radio Row. By the late 1960s Goldberg had two stores, an electronics distribution business, and a spot on the American Stock Exchange. Three men, Duke Glenn, Roger Green, and John Waddell, who'd become good friends while attending Harvard Business School, acquired a majority interest in the company, sensing a real opportunity in electronics distribution.

Among the skills Glenn, Green, and Waddell developed while studying at Harvard was how to leverage a balance sheet and rapidly grow a company using stock and very little cash to acquire other firms.

In a model not unlike that of Smithfield Foods, they'd find a company that they believed fit their long-term vision of electronics distribution and buy it using the shares of Arrow as currency. Then, they'd reduce the new company's operating expenses by eliminating any functions that could be centralized, while simultaneously doing whatever it took to grow sales, which resulted in improved growth for the entire company. Without coming up for air, they'd take their story of growth to Wall Street, leverage up, ID their next target company, and do it all over again.

During their first twelve years of leadership the three partners took the company into electronics distribution, licensed consumer electronics, audio speakers, and a dramatic expansion of their retail presence. The scrappy company earned a spot on the NYSE and became one of the top five electronics distributors in the nation.

In December 1980, tragedy struck when the top thirteen officers of the firm, including Glenn and Green, were meeting at Stouffer's Inn, in Westchester, New York.

Arrow's officers were conducting their annual budget-planning meetings at the hotel and on the spur of the moment asked the hotel for the use of a small conference room for an impromptu gathering of

senior officers. Shortly after their meeting began, the entry to the room became engulfed in flames and the panicked group tried escaping through a set of doors leading to another conference room. What they didn't know was that the doors had been dead-bolted on the other side to prevent a decorated Christmas tree from tumbling over in the event someone accidentally opened the doors. All the attendees perished.

The subsequent investigation revealed the fire had been set by a hotel worker who feared he was about to be deported because of his illegal immigration status. He'd believed that if he secretly set the hotel afire and was then seen extinguishing it and saving lives, he would become a hero and not be deported.

Following the fire, John Waddell, the sole surviving partner and senior leader, spent his time assuring investors and reporters that Arrow could and would continue in business. He immediately brought in Stephen Kaufman, a former McKinsey and Company partner, to help rebuild the company's management team.

Kaufman, cut out of the same cloth as Waddell, served as a senior leader and then president and CEO until 2002, during which time the company made more than fifty acquisitions following Waddell's formula of issuing stock to finance the acquisition, keeping all the salespeople, and consolidating warehousing, management, HR, accounting, and finance. Arrow also left the retail business and made its first forays into the Asian and European markets, growing to twelve billion dollars in annual revenues and becoming one of the two largest electronics distribution companies in the world.

In 2003 Kaufman stepped down as CEO and Arrow recruited William Mitchell, a thirty-year veteran of the electronics industry, to serve as its president and CEO. During Mitchell's reign he focused the company's attention on Asia and continued an aggressive program of acquisitions. The company continued growing its revenues and became one of the two hundred largest companies in the U.S.

From the depths of the Great Depression through wave after wave of roll-up consolidation, one fact was constant: Arrow was always strapped for cash, yet it kept growing and growing.

## MIKE LONG: THE QUINTESSENTIAL REINVENTOR

When I'd finished writing the following profile of Mike Long, the CEO of Arrow Electronics, I decided it was too long and that I'd have to shorten the story and cut out any words or paragraphs that didn't specifically highlight a trait of a successful reinventor or teach a vital lesson about embracing change. To make my job easier I highlighted every character trait and lesson learned that has made Mike Long America's quintessential reinventor. In the end I didn't cut out any words.

Mike Long, Arrow's CEO, radiates the authenticity and humility you'd expect of a farm boy from rural Indiana. "Growing up a farm kid our family didn't have much money, but we sure ate well," Long says. At an early age his father told him that there were two things expected of him: working and playing sports. Both pursuits served him well.

As a teenager Long worked for a contractor, digging holes and hauling lumber, and during high school he learned enough carpentry that by the age of eighteen he'd started his own construction business. "It was the construction business and playing football for the University of Wisconsin that got me through school," he says. While most CEOs with a background in athletics cite sports as a key influence in their lives, it was Long's construction experience that taught him how to grow a business without a lot of money.

"I started my construction business without any money at all," Long recalls, "doing small jobs, odds and ends for people I knew who needed things repaired or built. The business did well, and I started getting work from insurance companies to fix homes damaged by weather, neglect, or fire—all the messy stuff that other contractors didn't want to do. The big lesson that taught me," he says, "is that if you're able to take the complex things that people don't want to deal with, get them out of their lives, and solve them, you can make some serious money without having a lot of money.

"When I graduated my dad told me that anybody could be a contractor and that it was time to go out into the real world and use my education and get a job." Long took a job as a buyer at Allen-Bradley Company (now a unit of Rockwell Automation) but quickly realized that being an hourly worker was a dead end and decided to become a salesman for the company. His efforts were rebuffed; he was told he needed an engineering degree to become a salesman for the company.

"After two years of night school studying engineering I decided I didn't want to be an engineer, that I'd mastered the basics, and I went back to the brass and told them I was ready to become a salesman, and again they told me no and said I had to have a full-fledged engineering degree." Long says that before that time it had never occurred to him to look for a job somewhere else; he'd assumed he'd be there for life. Out of frustration he applied for a sales job at Arrow, but the company also told him no, that he wasn't qualified.

Finally a company called Schweber Electronics, a specialist in the distribution of semiconductors and connectors, decided it needed a presence in Milwaukee and hired Long as a salesman to cover the territory. Schweber rented a five-hundred-square-foot office for Long, and he became the salesman, coffeemaker, and cleaner-upper.

"I took the job and ran," he says, "and worked harder than I'd ever worked to build the business, and it took off so fast that the

company decided they needed to put a general manager in to manage the office, and the VP came up and told me they wouldn't give me the job because I was too young. I thought that was a raw deal and I let him know my feelings, and he obviously figured out I might leave, so one night about midnight I got a call at home from him. It was obvious that he'd been out drinking. He said, 'If you can be in Chicago tomorrow for a meeting at six a.m. we'll give you the job.'

"I got up in the middle of the night," Long continues, "drove to Chicago, and was in the parking lot at five a.m. waiting for them. Neither of them showed up until after ten o'clock, and when they did the VP said, 'What are you doing here?' and I told him he'd called me at home the night before and told me that if I could be in Chicago by six the next morning the general manager's job would be mine."

Avery Long, the slightly hungover VP, looked at his boss and asked, "Did I say that?'

The boss nodded and said, "Don't you remember? You called the kid at midnight and offered him the job."

Long says the rest is history. First he became a general manager, then they made him a vice president and eventually a regional vice president, but when Arrow bought the company, Long decided to leave.

"I wanted to move up the ladder," he says. "I wanted more responsibility and figured I didn't have a future with Arrow, seeing as how they'd turned me down for a job years before. So I went to the CEO and said, 'Look, I'm going to leave but I'll stay through the transition, make certain the good people stay, and then you can replace me with an Arrow executive.' "

The CEO asked Long if he'd interviewed with any other companies. He replied that he hadn't and wouldn't consider doing so until he wrapped things up with Arrow. The CEO asked Long to give him thirty days to come up with something that would broaden his

horizons. "All I ask," the CEO said, "is give me the first shot at coming up with something for you."

"On the thirtieth day the CEO called me," says Long, "and told me he wanted to open a different kind of business, a business where the guys who would open it would have to put money into it alongside Arrow and that Arrow would loan the company money to grow the business. What Arrow wanted in return was the right to buy the business if things worked out. That's how Capstone Electronics got started," he says. "I took a mortgage on my house, put all my money into the company, and, as things turned out, the business boomed, Arrow bought it from us, and it was the first time in my life that I made some serious money and was able to pay off my mortgage, one hundred percent of my debts, and still have money in the bank."

Following the purchase of Capstone by Arrow, the company's CEO, Steve Kaufman, asked Long to move to Greenville, South Carolina, and fix a big problem that could potentially bring the company down. Arrow had purchased a computer and printer business and was losing money. Soon after his arrival Long realized that the company they'd acquired was in the wrong business. "The business was growing fast but there wasn't any profit in it," he says, "and I reported back that we could use the business as a foundation to get into another business and then sell off the computer and printer business."

When you spend any time with Mike Long, you quickly realize that one part of his brain is always mindful of the powerful lesson he figured out when he was running his contracting business: Find something that people and companies find complex and painful, come up with a solution to make the pain go away for them, and then figure out how to scale it.

"The writing was on the wall that there weren't ever going to be big margins in building and selling computers and printers," says

Long, "and a partner and I in Greenville figured out that we needed to move the business into something more complex." The pair used the business as a base to get into the server and systems business, which today represents Arrow's North America computer business and does more than eight billion dollars annually. According to their initial plan, they sold the original PC business to a company called Synnex, and it still exists today.

In 2008 Arrow finally named Mike Long as its CEO. He quickly made his vision very clear: "If it has an electrical or electronic component in it we're going to be involved."

Since Long took charge, Arrow has made as many as ten strategic acquisitions in one year. But more impressive than the sheer speed is his reinvention of the integration process, succeeding where other companies fail (seven out of ten times) and making those acquisitions pay off.

For example, in early 2008 Arrow acquired Logix S.A., a midrange IBM IT solutions distributor based in Europe. At the time, founder Laurent Sadoun had Logix on track to do about three hundred million dollars annually. Thirty-six months later Logix is fully integrated, with sales up 500 percent, over a billion and a half dollars a year.

This huge success is due to the reinvented acquisition process. And according to Mike Long the most important changes didn't cost an extra dime.

## "We keep the entrepreneurs 'entrepreneurial.'"

Entrepreneurs like Laurent Sadoun have great qualities. They are highly creative, blessed with awesome gut instincts, are charismatic leaders, and possess the uncanny ability to attract scores of talented

people and great customer relationships. That's because the very best don't do what they do just for money. They have a dream.

All entrepreneurs get strapped for cash. Private equity and other sources of funding will buy into the company. But many don't buy into the dream and end up driving the entrepreneur away. "We don't want to let that entrepreneurial dream disappear when they become part of our twenty-billion-dollar business," Long says.

"We keep the entrepreneur by letting them continue to grow the dream. Like every acquirer, we are buying them because there is something special about them that we believe can go the distance. But unlike so many other acquirers, we encourage them to take their dream the distance. If they are strapped for cash, need help with their balance sheet, need some synergies with other products, we've got their backs.

"Sadoun had his dream, and when we got together, our combined dream ended up bigger than any of us thought originally," Long explains. "We all got on the same page, and Sadoun became the principal architect. He helped us find other related acquisitions, and together we have built a business that does many more things than anyone thought when we first got together. And he's now leading all of it." Growing the dream and keeping entrepreneurs entrepreneurial has been one of the drivers of Arrow's success.

### "We make everyone feel they're a part of it."

Acquirers often behave like conquistadors—throwing their weight around, disrespecting the natives, imposing foreign beliefs, and dealing harshly with anyone who dares to push back. Later these acquiring conquerors are dumbstruck when they are unable to get enough buy-in from the front lines to make their acquisition strategy succeed.

Long is different. "I haven't gone in and said, 'No! Do it this way, do it that way, do it my way.' " He positions Arrow to act like a bank, but with a really *cool* attitude, a bank that understands that the people are the ones who can grow a business fast. "We set targets and help scale the organization to reach an entirely different level. Then we let them execute."

Arrow doesn't allow that kind of "home office knows best" bureaucracy that kills momentum. "The people that run a business really know that business. We execute better because we push activities and decisions down to them," Long explains. "I believe our success is because the people we acquired in the deal all feel they are a part of it."

## "We are ferocious learners."

"I hate to tell you," Long says candidly, "but we don't know where everything will lead.

"When we got into the computer business we had no clue what we were getting into, and our first year in the storage business we lost six million dollars. Some wanted to scale back. But I said, 'Look at all we are learning and if we add some costs in we'll be fine.' Today storage is worth north of one billion dollars and the computer business will approach eight billion dollars for us."

Strategy for both businesses (and the rest of Arrow) again follows Long's simple guiding principle: "If you can do things customers need that are giving them fits, and you scale that, you can be very successful." Learning what gives Arrow's 120,000 customers agita or pain has revealed the road map for leadership in a $150 billion industry. "Learning costs nothing, and learning pays big," Long explains. But at Arrow learning is a journey that will not end.

"I liken our journey to driving on a highway and visiting new cities. Every time you go to a new city you'll learn something, but in order for that to happen, you have to be on the highway. We don't know where every road will take us, but it won't take us anyplace unless we're on the journey."

If you want to embrace constant change and reinvention, you'd be wise to measure yourself against the character traits and life lessons learned by Mike Long and quickly figure out how to make them your own.

Long's assertion that the road to change, reinvention, and growth is determined by learning how to solve a problem that perplexes customers and then using persistence and knowledge to scale the solution would sound very familiar in India, where they even have a name for creative problem solving without a lot of money.

## *JUGAAD*

*Jugaad* started as the Hindi word for an ultracheap vehicle first fashioned by rural Punjabi carpenters. Having nothing but empty pockets and a problem to solve, the local craftsmen took an old diesel irrigation pump, attached it to a wooden frame, and added wheels and the discarded steering system from a broken-down jeep. They called this jalopy "jugaad," roughly translated as "using few resources and a lot of determination to find an innovative solution to a problem."

Since then jugaad has come to symbolize the grassroots genius and entrepreneurial spirit of Indians working to overcome obstacles with creativity, urgency, and never enough money.

The best of jugaad is visible in the work of Ashish Shah's people

at the GE Healthcare laboratory in Bangalore, India, where they've created a handheld EKG that fits into a backpack and costs just one dollar per patient to run a test. It's also in Ananth Krishnan's water purifier, which provides abundant bacteria-free water for only twenty-four dollars per household. Tata Motors' ultra-affordable twenty-two-hundred-dollar car, Godrej & Boyce's seventy-dollar battery-operated fridge, Anurag Gupta's smartphone ATM, and fifteen-year-old Remya Jose's creation, a pedal-powered washing machine that can clean seven pounds of clothes in minutes without electricity, are other great examples.

Indian businesspeople aren't the only ones to practice jugaad (think of the American phrase "Yankee ingenuity" or rural Sweden's principle of *lista*), but as a culture they have embraced this guiding principle with great gusto. Eighty-one percent of Indian businesspeople cite jugaad as the catalyst for their company's success.

Jugaad starts with the needs of a large population, such as safe drinking water, fresh food, the ability to get from point A to B, improved personal hygiene, etc. Next jugaad looks at existing products stripped of all bells and whistles, searching for simplicity. Finally it uses basic science and two-fisted ingenuity to fashion a solution in spite of limitations—little water, no electricity, tiny incomes, distant communities, and limited infrastructure. One can argue persuasively that it was the principle of jugaad that caused Southwest Airlines to come up with the solution of a ten-minute airplane turnaround or Arrow to acquire dozens of companies without much cash.

Ingenuity in product offerings is just the start. Jugaad also looks for waste in processes and business models. For example, thirty-billion-dollar mobile communications company Bharti Airtel Limited was the first cell phone company in the world to outsource everything but its customer relationship operations. It has achieved some of the lowest charges and highest quality (earning a Cisco Gold

Certification) in its industry by persuading partners to rethink their business models as well, getting network providers to charge by the minute and tower owners to allow the company to rent space rather than own it.

In an interview, former CEO of General Electric Jack Welch described his goal of "rethinking products from the customer perspective back to the factory." At the time, most manufacturers had a "move the metal" mentality, which meant that marketing and sales had to figure out how they could get customers to accept products and quantities—whatever the factory produced—even when they were not in their best interests. Welch's idea was to change that mind-set by putting the customers first in strategic planning and getting everything in sync with their circumstances and demands. He wanted executives to look at the supply chain and reverse engineer their strategies.

Executives at Walmart did just as Welch had suggested, disciplining themselves and their suppliers to work on "price-based costing" instead of "cost-based pricing." By ruthlessly rethinking, reengineering, and reinventing every little decision in every link of their supply chain, Sam Walton and his team created innovative new business models that delivered customers a much better deal.

Companies that successfully embrace constant change and reinvention must continually reexamine everything through the eyes of their customers, determine what customers are prepared to pay for a solution, and then figure out if they can earn enough profit to make it worth their while.

Like every good strategy in business, the lessons of jugaad can be misused. Some in India have used the concept to justify a "by hook or by crook" (illegal or unethical) attitude, as long as it gets the job done. That's been a problem with frugal and lean thinking for more than a decade. In the U.S., "Chainsaw" Al Dunlap and others like

him paired lean with mean to suggest that they had a license as true capitalists to break commitments and hearts as long as it drove quarterly profits.

Our research shows that in contrast to these lean and mean managers, true practitioners of lean reinvention are the furthest thing from mean in thought, word, or deed. Many refuse to allow themselves the easy answer of layoffs and heartless leadership. They're tough and demanding, but they run their lean companies with fairness, principle, and integrity.

Mike Long says, "When the days were at their darkest and the economy was plummeting in 2008, we planned to do some layoffs. I was sitting across from one of my executives and said, 'If everybody from the two of us down to our regional level of executives would be willing to take a ten percent pay cut we could save *five hundred* jobs.' I floated the idea in a town hall meeting and didn't get any grimacing or grousing. We just didn't have a mentality that layoffs are good. We came to the conclusion that if we shouldered the cuts at the leadership level, when the economy turned we'd have five hundred people we didn't have to hire, plus we'd have people with the knowledge and passion to help us reach new heights fast. And you know what? They have!"

## BEING FRUGAL SPURS REINVENTION

"Spending on scientific research is at an all-time low," a renowned pundit told his audience. "If one more dollar is cut I fear we'll create an insurmountable innovation gap." We hear a lot of that kind of talk in businesses and in government. We're facing tough times, and any cutbacks are quickly labeled self-defeating. But is that true?

IBM recently celebrated one hundred years in business. It also celebrated another milestone: one hundred billion dollars in worldwide revenues. Life is good at Big Blue—so good that it would be easy to forget that in the early 1990s this same iconic technology giant was nearly bankrupt, routinely dismissed by experts as unimaginative, and in sore need of reinvention. Louis V. Gerstner Jr.'s job as the new CEO was to make the company more imaginative and reinvent the business.

His bold move to cut a billion dollars from the research and development budget shocked everybody. "How long before the superiority of our nation is in danger?" asked one of IBM's most respected physicists. "Gerstner is nothing but a cookie seller who has no business tinkering with a technological treasure."

But the billion-dollar cut was anything but self-defeating tinkering. Many of the research scientists were energized. They cleaned out the cobwebs and refocused their thinking, many spending quality time with customers. The result was scores of innovations that matter. Frugal was a catalyst, not a catastrophe.

There are three big reasons why being frugal helps organizations reinvent:

## Frugal Is a "Whack on the Side of the Head"

"We all need a whack on the side of the head on occasion to shake us out of our routine patterns, to force us to rethink our problems, and to stimulate us to ask the questions that lead to the right answers," explains creativity expert Roger von Oech.

The great architect Frank Lloyd Wright echoed that sentiment when he wrote in *The Natural House*, "The human race built most

nobly when the limitations were the greatest. . . . Limitations seem to have been the best friend of architecture."

## Frugal Makes Us Better Stewards of Other People's Money

The bosses at Boo.com are an extreme example of something Nobel Prize winner Milton Friedman wanted everyone to understand about human nature: *We're not very good when we're spending other people's money.* Friedman created this simple chart:

| Whose money? | You | Someone Else |
|---|---|---|
| Yours | *Very Careful* | *Careful* |
| Someone Else's | *Not so careful* | *Not careful at all* |

He made the point that the average person gets a better deal and the most value when he spends his own money on himself. When that same person buys someone else a gift or when he uses his company expense account for himself, other considerations and trade-offs inevitably get in the way of grinding out the best deal and greatest value. The absolute worst results, Friedman observed, come when someone else spends a third person's money.

You've probably seen this at work. Headquarters decides to spend big bucks and everyone ends up paying dearly. Imagine all the pain they'll be going through at News Corporation now that the MySpace acquisition, which cost the company $580 million, has been sold for $35 million, literally pennies on the dollar.

That's really what went wrong at Boo. They carelessly spent other people's money.

Compare Boo with James Archer's start-up company. Just a few years before Malmsten and Leander started pitching investors, Archer pitched his own brainchild, Multi-Chem. But since Archer was almost forty, had just lost his job, had no big-money connections, and was not at all chic, he could find only one investor—himself. He launched his idea with all the money he could scrape together—fifty thousand dollars mortgaged from his personal IRA.

Archer was aiming every bit as high as Boo had. His dream was to radically reinvent the business of energy production by providing innovative services and highly productive solutions for oil field operations. In this dream he could see a high-tech laboratory for analyzing and inventing, a state-of-the-art chemical and supply warehouse, snazzy business offices, and a big staff of skilled experts burning with the same passion for the company's mission that he possessed. But since Archer had just fifty thousand dollars in his piggy bank, he had to pinch pennies, testing chemicals in his garage and using the front seat of his old pickup truck as his office.

Working seven days a week, he tackled the problems of clients. He discovered new answers, such as a process to de-liquefy gas wells that increased production, impressing the biggest and the best oil field professionals, including Exxon. As he had no deep pockets to fund a slick promotional campaign, Archer relied on word of mouth to help his business grow. It worked. One by one new customers became loyal users and then told others. Soon he had the money to hire a small staff and rent some space for a warehouse and offices.

And Archer's frugal model keeps working. With the motto "If we don't have it, we'll invent it" and a commitment to "helping the customers profit first," today Multi-Chem has ninety-two locations in the world and is set to hit seven hundred million dollars in sales in the next couple of years.

## Frugal Builds Teamwork

There's nothing like being on a winning team to keep a smile on people's faces and build a very collegial environment in which everyone is engaged and on the same page.

As you read in the story at the start of the chapter, not having enough money brought everyone together at Southwest. Twelve different job functions, from flight crews to baggage handlers, all put aside status concerns, job descriptions, and work rules to become a team with a big objective: the ten-minute turn.

With very good reason, another very happy place is the campus of Apple. Last year Apple *grew* its sales by twenty-two billion dollars, which is more than but a handful of companies will ever do in a year. Apple's revenue is now greater than that of Microsoft, the iTunes store does more revenue than the world's biggest music company, and it sells 110,000 iPhones each day. As testament to the passion for change and reinvention that Apple embraces, more than half of the company's revenue comes from products that didn't exist four years ago.

While it would be tempting for a company as spectacularly successful as Apple to be a lavish spender, just the opposite is true. In a typical year it spends $1.7 billion on research and development, compared with Microsoft's nine billion, and it spends one-third of what Microsoft spends on sales and marketing.

You've thought it, I've thought it, every executive and every entrepreneur on the planet has thought it at some point: "If I only had more money, all my problems would disappear."

It's time to realize how wrong we sometimes are. Great companies that embrace radical change and enjoy constant growth find a new path when solving problems and taking advantage of opportunities.

They reject the urge to throw money at their challenges and discipline themselves to do more with less. They practice the Indian path of jugaad and discover there's truth in the adage that all you need to accomplish great things is a problem and not nearly enough money.

## GUIDING PRINCIPLES FOR FRUGAL REINVENTION

### Make Everything Simple

Einstein wanted fellow scientists to worry about being incomprehensible. "If a physical theory cannot be explained to a child," he told them, "then it's probably worthless." I'd love to say the same thing to everyone who thinks up business strategies.

Arrow Electronics is like all modern businesses: It's a complex business, made more complex by its strategy of taking the customers' thorniest problems on its employees' collective shoulders. So CEO Mike Long and his managers have studied how to make simple sense out of complexity. "The more simple you can make it allows your people to get really focused.

"Back when we were rolling up fifty acquisitions and crossing oceans to grow," says Long, "it would have taken us fourteen pages to explain who we are and where we are going. Now we've learned to make it simple. It doesn't cost you anything—it pays."

Don't let anyone make your business proposition too complicated. If it's already complicated, keep simplifying it until you can explain it to a child without his or her eyes glazing over.

## Edit Every "To Do" List

According to the Hackett Group, a global strategic consulting company, the average business tries to manage 372 different objectives during the year. Chances are good that number doesn't surprise you, because you probably live with nearly as many on your plate.

However, Hackett found that leaders at "above average" companies are surprisingly different in this critical measure. They identify an average of just twenty-one priorities instead of 372. Editing the list isn't easy, but the payoff is huge. Time and money get tightly focused on the crucial activities that drive the firm's competitive advantage, and everyone has a clearer idea what to do and no problem deciding who's accountable.

One question I ask each of the thousand CEOs, business owners, entrepreneurs, and senior leaders I speak with each year in preparation for speeches and teaching is, "What's keeping you awake at night, and what are the potential stumbling blocks that might get in the way of your business achieving its full potential?" There are some common answers I frequently hear, but one that's mentioned in almost every conversation is "staying focused," and almost all of them add, "There are so many damn initiatives, plans, programs, decrees, and grand announcements around this place that it's almost impossible to get anything done."

Long believes that "people come to work *wanting* to do their best because that creates enjoyment and fulfillment—they feel like they are making a difference."

So he asked himself a killer question: "What makes the difference between a good hire and a bad one?" The answer, he concluded, is one that's eluded many managers. "A good person knows what they're supposed to do and a bad one isn't sure. I believe the differ-

ence between doing a good job and a bad job is clarity . . . and clarity is leadership's responsibility."

## Celebrate Frugal Reinvention

In a stony terrain in the south of Sweden, the people of Småland have their own special expression for the art of frugal reinvention, the previously mentioned *lista*, a phrase derived from the Swedish word for "cunning" or "craftiness."

Lista is at the heart of IKEA's incredible success. Leaders at IKEA are determined to avoid spending unless it is really necessary. "If I lower the shelf half a meter, I can make do with my old hand-operated pallet truck. It'll save me having to buy a forklift," they reason. You can find stories of lista in every design and leadership decision at IKEA.

Lista was also at the heart of an incredible, first-of-its-kind accomplishment in IKEA's history. It's the story of "nine in eight," in which IKEA North America got nine new stores designed, engineered, and up and running in just eight short months. Never in IKEA's history had any team accomplished this complex chore so fast.

Most astonishingly of all, the team accomplished this feat frugally, using nothing but existing in-house infrastructure and resources—no additional consulting engineers, no new project coordinators, no logistical outsourcers, and zero additional bureaucracy.

That means a staff of people who had never added more than a store every few years (it took twenty-five years to open nine stores in Canada) charged themselves with planning, building, and merchandising over three million square feet of new retail construction, hiring thirty-three hundred new associates and managers, and purchasing a hundred million dollars of the right new inventory. Like

all good stories, this one has a happy ending. "Nine in eight" was a phenomenal success—lista at its very best!

Every company has stories like this, in which employees faced a huge task and meager resources. You read James Archer's story of working magic in his garage laboratory, inventing a process that stunned the deep-pocket researchers at Exxon and made his start-up a world leader. What story can you tell?

## Ask WTGBRFSTM: What's the Good Business Reason for Spending This Money?

One of the best frugal reinventors, Mel Haught, of Pella Corporation, teaches us to love dumb questions—good dumb questions such as "Why do we do it that way?" that really clear away the hidden assumptions.

But the best dumb question ever is one I learned from two other frugal reinventors, Herb and Marion Sandler. The Sandlers built one of the most productive and innovative financial institutions by asking themselves and their managers over and over, "What's the good business reason for spending this money?"

That question made the Sandlers' company, World Savings,* an icon of productivity. The business ran with half the staff of its nearest competitor, with each employee generating 40 percent more revenue

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* I first researched and wrote about World Savings in my 2002 book *Less Is More.* Based on research, I believed then and maintain now that the company was one of the best led and managed businesses that ever existed in the U.S. When they reached their midseventies the Sandlers sold their company to Wachovia, a firm later acquired by Wells Fargo during the real estate meltdown of 2007–2008. Some people in the media attempted to vilify the Sandlers as being part of the real estate meltdown. I believe their forty-two years of stewardship and growth proves otherwise and makes the company they built worthy of study by any serious student of business.

than the industry average of $762,000 per associate, and it delivered double the average profit per employee. By doggedly asking WTG-BRFSTM and demanding a good answer before making any expenditure, the Sandlers and their team achieved 20 percent average compound growth each year for thirty-five consecutive years.

When you examine all you've seen and lived through in business, the magic of asking WTGBRFSTM becomes very clear. How many times have you seen expenditures rationalized because "we did it last year"?

Or how many expenditures have you seen made to put out some fire or respond to what the competition is doing? "When everyone was offering free checking," Marion Sandler recalls, "we considered the costs and asked, 'What's the good business reason for doing this?' and the only way it seemed to work was by feeing the customer to death." That led the leadership to their strategy for attracting new checking customers. "We offered a significant bump [five percent instead of half a percent] in the interest we paid on high balances," she recalls. "It was like someone opened the floodgates!"

Marion pointedly told me in response to my questions about her notorious frugality, "Instead of being surprised at how much we do with so little, I'd honestly like to know how other banks manage to spend so much." I suspect it's because they're afraid to ask WTG-BRFSTM.

## Blow Up Any Bureaucracy

An Englishman named Cyril Parkinson analyzed the British Admiralty in 1955 by charting the number of headquarters administrators versus the number of people commanding and running ships and shipyards of the Royal Navy year by year for a decade and a half. Then he saw a surprising pattern in the results. As the number of

front-line people doing the actual work decreased 31 percent headquarters grew 78 percent. This caused Parkinson to produce a mathematical formula that showed that the most natural action of any official was to breed junior officials. Those junior officials would quickly beget their own subordinates, and so it would continue. The work of one would quickly become too much work for seven.

The incentive for each layer in a bureaucracy was that as any subordinate base grew the lead bureaucrat would be promoted. Parkinson had discovered a people pyramid scheme. He called his conclusion the law of the bureaucracy: "Work expands so as to fill the time available."

Five decades and trillions of wasted dollars later, nobody thinks bureaucracy of any kind is funny.

A.T. Kearney research shows that the best performing companies had five hundred fewer managers per billion dollars in sales than poorer performing organizations. It's not hard to see why that happens.

Years back, executives at U.S. Steel saw the threat from Ken Iverson's newly formed Nucor. Innovators inside the executive group drew up plans for a cheap and cheerful mini-mill of their own to compete. But senior financial officers crunched the numbers and scolded them. "It's cheaper to produce more steel from our existing furnaces. Capital costs are covered and all that remains is the variable costs of each extra ton, so it's lots more profitable to continue producing steel the way we do." Technically correct but shortsighted!

## FOREVER FRUGAL: ACTION PLAN

- Make asking the question "What's the good business reason for spending this money?" part of your culture.

◗ Celebrate wins that embrace the spirit of jugaad, lista, and old-fashioned Yankee ingenuity.

◗ When confronted with a problem or opportunity, gather your key people and brainstorm how to solve the problem or take advantage of the opportunity without using financial resources. You won't always be able to do it, but in many cases you'll end up with a better plan than simply throwing money at something.

◗ Allow your entrepreneurs to be true entrepreneurs; don't kill the dream.

◗ Make yours a culture of problem solving by regularly acknowledging, celebrating, and generously rewarding those who advance your business by identifying the complex problems driving your customers crazy that you can solve.

◗ Consider a pricing model that starts by asking the question "What will the customer pay us for this?" and working backward, instead of taking the position that "this is what it costs us to do it and we'll add our desired margin on top, and that's what customers will have to pay."

◗ Be relentless about simplifying everything without exception.