thinkset

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TOM NEALON LEADS AN $800 MILLION MISSION TO BUILD SWA'S FUTURE

Rebooting Southwest

How a new tech platform overhauled airline operations

Managing Uncertainty
Strategies for getting through the fog

R.I.P. Inc.
Is the corporation obsolete?

Integrated Healthcare
Well-being at all levels

Fall 2017


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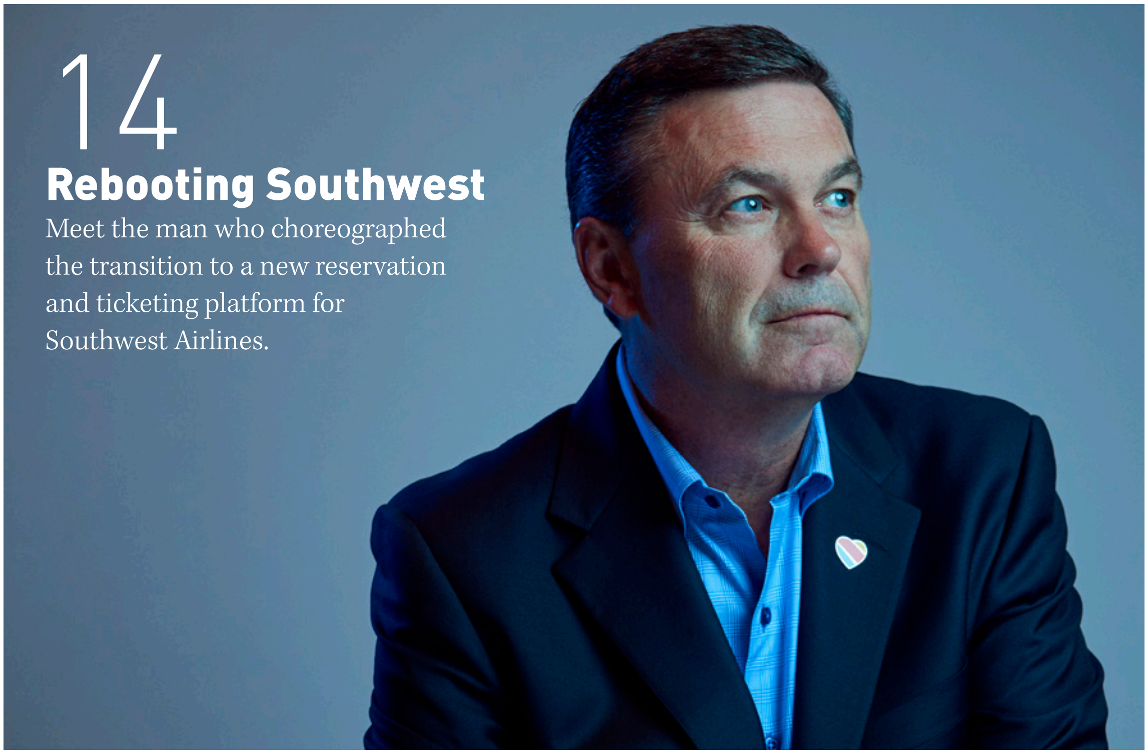
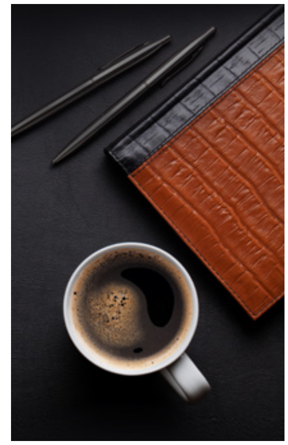
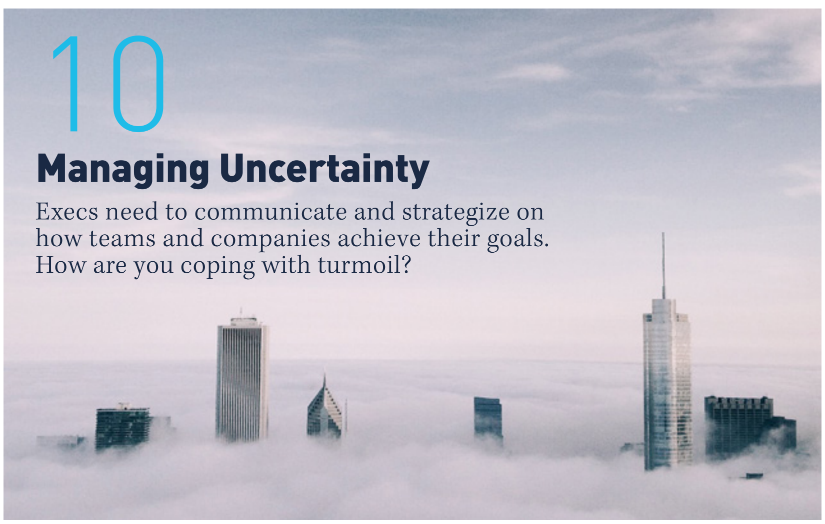






DEPARTMENTS

Leadoff

If the only constant is change, then adaptation and entrepreneurial activity are required.

As individuals, we deal with aging conditions involving eyeglasses and other assistance from people and devices. Companies have advisors, processes and systems to monitor their present and prepare for the future.

We explore some of these challenges in this edition of ***ThinkSet***, diving into both the near-term future of the corporation and ways to transition, whether the change is global, digital or survival.

Some organizations are setting audacious goals or reenvisioning their central mission and value propositions according to their customers. Consider the SkillsPivot program now underway at AT&T Corp. This company looks nothing like it did 140 years ago. Today, thousands of employees need retraining to prepare for a future that includes digital networks, open-source software-based jobs and industry combinations not yet envisioned.

John Donovan, chief strategy officer at AT&T Technology and Operations, indicates that bold collaboration is necessary because gradual or incremental learning cannot happen quickly enough. The company's goal is to move 75% of its business to software by 2020—up from 30% in 2016. Colleges and universities, online courses from Udacity and micro-degree programs for skills-based requirements all have been enlisted to upskill and reskill the company's 280,000 employees.

THE FUTURE ARRIVES WHILE YOU'RE DISTRACTED WITH TODAY

Whether you're the boss or a frontline employee, your job is changing. ***ThinkSet*** looks at ways people and companies find new approaches to help prepare for a faster pace with new options. Not deciding or not acting is a choice, but one that comes with its own consequences.

New approaches for keeping workers healthy and engaged also are defying conventional wisdom. For instance, medicine is ushering in an era of customized solutions.

In this new world, there is no assurance of the financial success of mass production and scale. Personal productivity is now an organizational goal to avoid burnout and retain workers.

Many organizations depend on growth and are finding it in unique places: capitalizing on their processes and knowledge, in partnerships outside their core industry or restructuring to adapt. And, yes, some close their doors—not every corporate history ends well.

DAVID TEECE
Chairman
David Teece

PHILIP ROWLEY
Executive Director & Chief Revenue Officer
Philip Rowley

Decoding the Messages in CEO Pay

Are you "in this together," or is yours a zero-sum company?

David Lewin

Every so often, the compensation package of a publicly held company's CEO makes news and the CEO's computed annual salary or hourly wage gets compared to that of the average or lowest-paid employee. Sometimes this comparison takes the form of a question, such as, "How many Teslas or iPhones can the CEO purchase compared to the average or lowest-paid employee?"

The ratio of CEO to lowest-paid employee has risen from about 75-to-1 in 1970 to as much as 500-to-1 today.

Outrage over this matter is easy to express. I risk incurring some serious wrath in saying that *some* CEOs are worth the premium because of their ability to lead their companies to achieve exceptionally high performance, manage through crisis or create visionary opportunities that others might not see. Examples include Southwest Airlines, eBay and SAS, respectively. Nonetheless, it is difficult to tie CEO compensation to stock price or other performance indicators and then wait years to see if CEO pay was actually based on company performance.

Lost in the outrage over CEO pay are the factors that influence such pay. These include CEO tenure, the company as a tournament and organization culture and size.

Take the Money and Run

CEO tenures are getting shorter and shorter as impatient activist shareholders and other external actors look for stock charts that go only skyward. In 1990, a CEO of a publicly traded company had served more than 10 years, on average. By 2015, average CEO tenure was about 3.5 years.

This turnover—the flip side of tenure—creates a run up of CEO "prices" as companies look for new top talent. For this purpose, corporate boards often turn to recruiters or executive compensation specialists. In doing so, however, boards hand over their responsibility to say "No" to so-called objective outsiders. That sends a message of playing with other people's money and opens up the "everyone else is doing it" defense.

Handing the CEO a pile of cash and stock or forgiving loans for funding a lavish lifestyle tells investors that you're not all in this together. Instead, it sends the message that the company is like a tournament or beauty pageant. Some players will get a minimal amount for participating, while the big rewards will go only to the top two or three finishers, who get outsized payoffs. Like a lot of games, the "Tournament Pay" of 21st century CEOs gives the largest check to the winner.

At corporations where CEO pay is limited, status distinctions are minimized, which can lead to a collaborative culture and the message "we're in this together."

Consider the lesson of Southwest Airlines. Its unionized employees own 18% of the company's shares, and the CEO prefers to keep pay lower than peers, to avoid class warfare and demonstrate values. Over 90% of Southwest's employees own shares—another way to spread wealth and rewards for success.

Growth at All Costs

Core business performance measures, such as revenue growth, market share, rate of return on invested capital and stock price, are widely thought to be "determinant" of executive compensation, but they are not. Rather, the key variable at work is organization size.

Whether measured by revenue or assets or full-time equivalent employees, company size remains the single strongest factor correlated with CEO pay—and this correlation is highly positive. The larger the company, the higher the CEO's compensation.

When companies mature, face stagnant markets or encounter new competition, organic growth is sluggish, nonexistent or negative. As these companies shrink or stabilize, their CEOs often look to grow through M&A. But such externally sourced growth increases CEO compensation—which may be the motivation.

Notably, financial economics research shows that, on average, an "M" or an "A" results in a substantial loss of value to the acquiring company. Keep this in mind the next time a CEO predicts a "win-win" merger synergy or acquisition proposal.

CEO TALENT

NUMBER OF CEOs
> 5,000

PRIOR TO CEO
Finance 22%
Operations 20%
Marketing 20%
Other 38%

INTERNATIONAL EXPERIENCE
34%

SAME COMPANY ENTIRE CAREER
19%

MILITARY EXPERIENCE
34%

MBA DEGREE
34%

Spencer Stuart (2007, 2008); The Conference Board (2014)

David Lewin is a BRG managing director in Los Angeles who specializes in labor, employment and executive compensation issues. He is the Neil H. Jacoby Professor Emeritus at UCLA Anderson School of Management.

Rowan Philp

ENDURING COMPANIES SEEK OUT SMALLER, NIMBLER PARTNERS AND TRADE SCALE FOR SKILLS

More than a third of the world's corporations are expected to be gone within 10 years.

Companies of all sizes are dealing with threats from disruptive startups, technological agility, fading barriers-to-entry and rising consumer expectations. It's a common forecast, focused on competition.

Leading experts and new research now suggest that the corporation itself, as traditionally structured, could be just as endangered as the slowest individual companies. They suggest that it might become an antiquated way of doing business and of harnessing talent. By 2027, the global conglomerate may no longer be the optimal way to create value.

Large companies are taking hits from multiple fronts: fickle consumers seeking out local, craft-made products; ever-shorter CEO tenures yielding shifting strategies; millennial workers seeking mission and quality of life over long-term corporate careers; and an uncertain global regulatory environment.

"(The traditional corporation) could be at a disadvantage in the future because of speed, most of all," says Wayne Delker, director of the capstone program at the Fung Institute for Engineering at University of California at Berkeley. "The question becomes: Do you even need to have a corporation as a standing entity, or does your business become much more about managing this external network of partners?"

Research by coworking real estate giant WeWork suggests that half of all large companies will incorporate shared office space models by 2020. And some 80% of corporations plan to expand into a more flexible workforce model, including the greater use of freelancers and off-site independent contractors, according to Intuit's 2020 Report.

This evolution is hundreds of years in the making—as guilds and small-town companies gave way to global keiretsu models—that are now devolving through localized disruption and adaptation in a faster, consumer-empowered and connected environment. Survivors are expected to be team-based, external-innovation corporate models, cooperatives, family-controlled firms and cash-rich global players.

Beyond the uncertain future, the productivity report card also represents a failing grade for the corporate-driven economy: US Department of Labor statistics show that growth in business productivity in the past decade has been at its lowest since the early 1970s. And corporate lifespans have already been slashed from 45 years in 1960 to less than 17 years today.

In response, leading companies are already changing three fundamental characteristics:

- From inward-looking to outward-looking;
- From in-house working to campuses and coworking options; and
- From owning talent and capabilities to finding ways to access them as needed.

One central strategy is to reorganize people and skill sets into dynamic internal and external teams, and engage with vendors and startups.

Cisco is among the enterprises currently pursuing a fundamental structural transformation. In 2015, Cisco's outgoing CEO, John Chambers, issued a warning that 40% of large companies "will not exist in a meaningful way in 10 years"—and that only 30% of the corporations that attempt to reinvent themselves for the digital landscape would likely succeed.

One response is the company's innovation model. Each year, a companywide funding competition encourages global teams to propose new products, services or even entire companies, with the winners receiving money and resources to pursue their markets, ideas or inventions.

THE ENTERPRISE PIVOT TO FLEXIBLE WORK MODELS

From its 2009 launch, Boston-based Workbar has been a resource for freelancers and startups, but over time, the audience quickly changed, said CEO Bill Jacobson. In 2016, three Staples retail stores opened Workbar locations. The move reflects how corporations view coworking spaces as a solution to the dual workforce problem of low engagement and high turnover.

"We just spoke with a large insurance company that's interested in an enterprise approach," he says. "Instead of people having to commute for an hour or two to a central office, they want them to be able to work flexibly and around other potential collaborators. If you look around a traditional corporate office, you'll see a bunch of empty chairs. There is a wholesale reorganization happening,

CHANGE IN FORTUNE 500 FIRMS

SURVIVING FIRMS
153 (30.6%)

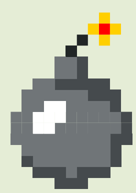
NEW FIRMS
347 (69.4%)

NEW FIRMS PER YEAR
8.5

SURVIVING FIRMS
188 (37.6%)

NEW FIRMS
347 (62.4%)

NEW FIRMS PER YEAR
14.2



FORTUNE 500 FIRMS 1955 V. 2016
Only 12% remain

US Department of Labor

including the embrace of remote work, external partners and network collaboration."

Jacobson says other indicators suggest that, beyond 2020, 70% of work by staff professionals will be conducted outside the corporate main office.

According to Deloitte's 2017 Global Human Capital Trends report, 92% of executives replied that their organizations are incorrectly structured to compete in the future. And only 11% of respondents said they know how to design organizations to thrive in the connected, digital future.

There is a strong correlation between today's top-performing companies and those that are pursuing operational success with a plan for future survival. Many are using external partnerships and business model innovations to compete and preserve options.

In the past, companies had to respond to economic cycles, but today's volatility is a broader set of challenges, says Susan Foley, managing partner of Corporate Entrepreneurs LLC. The ability to capitalize on circumstances—with available cash, talent or vision—is key. Another important but rare skill is actively charting a future course that is NOT based on existing knowledge or history, adds Foley, who taught intrapreneuring at Babson College.

"The failure rate for that kind of transformation is high," she says. "But you can't rely on the past; you have to create the future."

BIGS NEED SMALLS

Research by INSEAD and 500 Startups shows that 52% of the Forbes Global 500 are "engaging" with startups. But it found that the top 100 on that list were actively engaging with startups at almost twice the rate of those ranked between 400 and 500—and at a far higher rate than most old companies down the list. The overall engagement trend was also increasing significantly. Its authors noted, "There is a strong correlation between the rank of the corporation and the engagement with startups . . . there's a gradual decline as the ranking decreases."

Delker warned executives at the Front End of Innovation Conference in May that, as currently configured, corporations may prove ill-suited for the speed and market forces in the new business landscape.

He should know. Delker led major innovation transformation efforts at GE and Clorox, including stints at Clorox as chief innovation officer and senior VP of research and development. A common corporate fall-back, he contends, is an argument for brand loyalty—a defense that is showing signs of cracking. Consumers now have web-based information, and on-demand disruptive business models—from autos to hotels to power tools and pets—that redefine the need for personal ownership or brand reliance.

COMMERCE WITHOUT COMPANIES?

"We saw this even at Clorox—that as the consumer has more sources of information, the reliance on brand lessens a little," says Delker. "For example, when Procter & Gamble created Tide detergent, consumers had almost no other sources of information on how good Tide was versus other detergents. Now, there is so much out there in terms of consumer review and product performance."

Venture capitalist and entrepreneur William Frezza says the question about future corporate relevance "seems ridiculous." A 40-year veteran of the technology industry, Frezza advises a biotech startup, Boston Microfluidics.

"The limited liability corporation is one of the great inventions of western civilization and an essential part of the foundation of capitalism. It is the only way to channel capital (savings) into businesses that does not expose investors to downside risk beyond the size of their equity investment. That alone will make sure it never dies," he says.

Even he agrees there could be a decline in the future proportion of LLCs and a higher proportion of unicorn-like privates. Fewer growth-oriented companies might choose to go public "as a means of avoiding the burdens . . . (such as) mandates, taxes, litigation sinkholes, reporting mandates and other impediments that legislators and regulators keep heaping on corporations."

> **"CORPORATIONS MAY PROVE ILL-SUITED FOR THE SPEED AND MARKET FORCES IN THE NEW BUSINESS LANDSCAPE."**

"The only thing that this will do is deprive small investors from participating in wealth creation," he says. "Employment customs will continue shifting as employees become more mobile, changing jobs and careers more often, and the average lifespan of corporations might grow shorter, but it is unimaginable to see how scale businesses can be built without using the corporate form."

Rowan Philp reports on technology, strategy and global business from Boston. He was chief international correspondent for South Africa's largest newspaper, The Sunday Times, and held fellowship reporting positions at The Washington Post and MIT/Knight Science Journalism program.

REMAKING YOUR COMPANY BEFORE SOMEONE ELSE DOES

CEO Herman Bosman came to the US from Africa in 2016 in an active search for entrepreneurs whom, he feared, would disrupt the regional financial industry. Bosman heads up RMB and RMI Holdings, with a combined market cap of US$14 billion, including South Africa's largest bank.

Bosman said his board chose to actively seek long-term partnerships with overseas startups—partly based on fears sparked by a 2016 report saying that Australian banks stood to lose US$27 billion to startups. He explained the strategy in an interview for the Silicon Valley-based Sable Accelerator, a networking site for South African companies.

"The velocity of change—especially with technology transformation—is only increasing, so even if we can't recognize the white spaces in our own portfolios, they are going to be disrupted in some way—and we'd rather be part of that disruption than its victim," he says.

Wayne Delker, of UC-Berkeley's Fung Institute, says broad misconceptions persist about the decline and death of corporations, including the most iconic failures, from Blockbuster to Kodak Corp. He says it's often incorrectly assumed that companies failed to recognize the coming market disruptions, or lacked the technical know-how to deploy new digital solutions.

Instead, legacy culture and the inward-looking focus tend to pose the central threats. *-RP*

CEO Herman Bosman came to the US from South Africa to examine possible global impacts of competition in the bank and insurance industry.

Photo: Russell Roberts

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MANAGING THROUGH UNCERTAINTY

TAME THE TURMOIL

Joseph Guinto

In 2002, Stream Energy became the first electricity reseller to enter the deregulated Texas utility market. Cofounder Rob Snyder knew he was wandering into the unknown.

“I had to become comfortable within a chaotic operational and strategic environment,” Snyder says. “That is not as easy as it sounds. As humans attempting to plan for the future, we tend to gravitate toward the implementation of certainty and order. But shifts in the market landscape could eviscerate overnight certain foundational elements of our firm’s strategic planning. So we had to roll with the punches.”

They rolled well. The company Snyder founded with a small amount of capital posted 2017 revenues of $14 billion. In retrospect, Snyder says that his strategic plan relied on a lot of guesswork. Stream built an army of employees through a direct-sales model similar to door-knocking neighbors offering Mary Kay cosmetics or Primerica investments. And it used that army to inspire confidence in consumers who were being asked, for the first time, to select their own electricity merchant.

PRO TIP
Start with evaluating organizational capacity and culture check before embracing new business models or implementing new technology platforms.

No one at Stream knew whether that strategy was going to work, especially since other firms came rushing into the market right behind Stream. So, Snyder says he took his journey into uncertainty with "a blind confidence that the companies that best advanced consumer interests, without giving away the farm, would be the firms that eventually won long-term customer loyalty."

That kind of confidence is rare in corporate America. It may be needed more now than ever. Today's executives can zip through reams of customized data daily, sure. Even with information, there are unknowns. For leaders like Snyder, who decide to go headlong into that uncertainty—about strategy, innovations, competitors, regulators, technology or political upheaval—it is important to be bold and to bring talented people along for the ride.

In corporate-speak, it's become a "VUCA World" with Volatility, Uncertainty, Complexity and Ambiguity creating a catch-all acronym for challenges. Managing through these conditions requires both firm leadership and a willingness to shift when conditions demand it.

Matthias Müller, CEO of Volkswagen, said he is having difficulty convincing other leaders in the automaker to move toward electric and self-driving cars. "I don't know if you can imagine how difficult it is to change their mindset," he told a trade show audience, speaking of his fellow executives.

Such a move might seem an obvious one for a company dogged by an emissions scandal that angered customers and environmentalists who had been told for years that Volkswagen and Audi diesel engines were cleaner than rivals. Yet, the company's focus remains centered on fossil fuel vehicles.

"Engagement is so important during uncertainty because employees who are engaged go above and beyond what they're asked to do," says Mary Lippitt, founder of Enterprise Management Ltd. and author of *Brilliant or Blunder: 6 Ways Leaders Navigate Uncertainty, Opportunity and Complexity.* "They will take initiative. They will identify opportunities for improvement and will spot trends among competitors."

Higher levels of engagement when tackling uncertainty require the right corporate culture and workplace attitude.

"Engagement is so important during uncertainty because employees who are engaged go above and beyond what they're asked to do.

“Companies should be at work now cultivating agility in the organization,” says Allan Cohen, a strategy consultant in private practice who has worked with IBM and Corning Inc. “And the biggest challenge to being agile lies in the culture. If you have a culture of rewarding perfection, of deferring to experience and of suppressing risk—nothing else you do will produce agility. Managers are needed who are practiced at being at the bottom of learning curves, at learning through piloting and prototyping, and at managing risk rather than eliminating risk.”

Some companies seek out merger partners; others make cuts and hope for a cyclical rebound. But long-term gains in uncertain times come from investment in existing knowledge or extracting greater value from assets, says Todd Antonelli, a BRG managing director in Chicago. That can lead organizations to pursue new business models and leading-edge approaches.

In another example of scouting the future, Verizon Corp. is converting unused real estate into coworking spaces, where the company gets a sneak peek at emerging technologies and companies. Verizon is collaborating with New York-based Alley for curated applications to the first East Coast locations, according to *The Washington Post*. Other sites include facilities as far away as Singapore.

FACT
AT&T is spending $1 billion to retrain one-third of its global workforce—about 100,000 people—as part of its Workforce 2020 plan to have a flexible, evolving skill set.

Jim Collins and Morten Hansen found a success trait in their 2014 book *Great by Choice: Uncertainty, Chaos, and Luck—Why Some Thrive Despite Them All*. The authors studied eight companies that vastly outperformed their peers over the course of the last half-century when addressing uncertainty. They concluded that those companies are not bigger risk takers than their competitors. Instead, they are more willing and able to do things where specific strategic steps and the ultimate outcome can’t be specifically predicted. Discipline AND creativity, combined properly, can help with focus while avoiding unforced errors.

One way to cope, Lippitt suggests, is to imitate the way doctors respond to catastrophic events. “You basically do a triage process,” she says. “In triage, doctors and nurses will take an assessment and decide what the most important things are that have to be done—who is in the most critical condition, who needs to be operated on, who can survive with only limited treatment for now and so on."

This Workbar location, in Cambridge, MA, has monthly membership options ranging from shared open tables to private office space.

Photo: Tiffany Knight

Another tactic, used at spirits giant Diageo and pharmaceutical company Pfizer, is to employ “mission leadership” borrowed from the US military. With mission leadership, commanders set a direction and a timetable—the mission—and then equip their teams, preparing them to act independently to accomplish the mission.

Mission leadership and similar empowerment strategies can also get workers at different levels focused on spotting disruptive market trends, competitive actions or new technologies. “If people understand the bigger picture of what important things need to be done, they won’t see that as one department or group failing and another succeeding when resources are shifted to deal with new business realities during uncertainty,” Lippitt says.

In a research study titled "Managing Uncertainty: Strategies for Surviving and Thriving in Turbulent Times," *The Economist* found that companies like Honda Europe, Random House, Capital One Bank, Balfour Beatty and RBS accept that they will have incomplete information when making decisions in times of uncertainty. Those companies, the study found, “use option evaluation, pattern recognition and scenario planning” to tell stories about competitive pressures and to set a future course. Some of them simply accept that they’ll need to be agile and adaptive because they can’t be sure what lies ahead.

Joseph Guinto is a journalist based in Washington, DC. A former White House correspondent for Investor’s Business Daily, he writes for Politico Magazine, American Way, and Washingtonian about business, travel, and politics.

Next page: How a cancer center is reacting to uncertainty.

Cancer Care *Accelerated*

Sharing history, knowledge from Moffitt Cancer Center

Nancy Ayala

Cancer often forces patients to fight for more than their lives.

Patients and their families face a landscape of uncertainties, from scientific to financial, as well as an emotional toll. There are astronomical drug prices, rapid changes in treatment options, selective insurance coverage and coordination of teams of new specialists.

There are approximately 1,500 cancer centers in the US as of 2017.

Emerging treatments confound patients and insurance carriers and can require negotiations to determine if treatments or drugs are even covered. The path forward can be confounding and a Tampa cancer center is navigating that complexity to deliver its unique brand of care anywhere in the world.

The H. Lee Moffitt Cancer Center & Research Institute has been building a business plan around developing managed tracks for patients. It is creating a new revenue opportunity by unlocking its organizational knowledge and sharing it with other cancer centers to improve options and integrate care.

Once diagnosed, patients are given a "pathway" of treatment options, which includes follow-up schedules, possible drug-interaction warnings, dietary suggestions, drug selection and other inputs. This creates a thorough care plan.

Moffitt's "pathways" resulted from years of evidence-based modeling in oncology treatment protocols. By one estimate, 90% of cancer diagnoses could be treated with a pathway Moffitt developed, says Jack Kolosky, executive vice president and chief operating officer of Moffitt Cancer Center.

"Our patient outcomes are better nationally than some of our peers, particularly at the late-stage diagnoses of patients, " Kolosky says.

Some cancer patient numbers are increasing. By 2020, care costs are projected to reach $158 billion in 2010 dollars—a 27% jump in a decade.

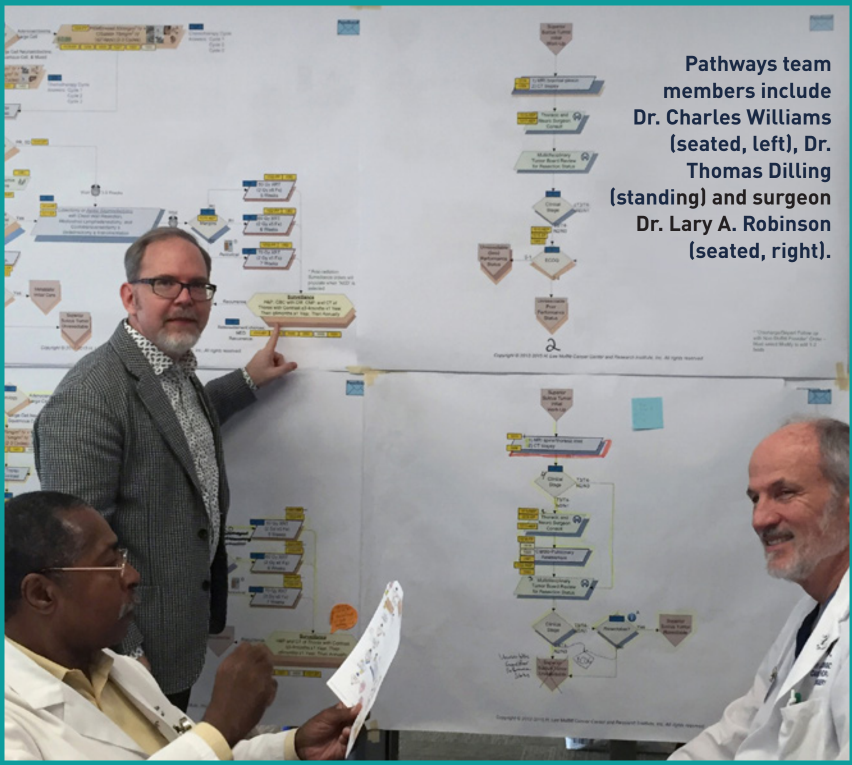
Moffitt executives recognized the potential to share their model with smaller clinics and hospitals. Cancer specialist doctors are seeing business models erode because of payment challenges and hospital-based care. The Moffitt methodology might help smaller practices and rebalance the playing field across the US. Since 2010, more than 200 community cancer practices have closed, according to Zitter Health Insights, even though they deliver care at a lower cost than major medical centers.

Most important: Patients benefit.

Instead of traveling to specialty cancer centers for lengthy, expensive treatments and being separated from friends and family, patients can get care and services closer to home and at lower costs. Telemedicine and other connective technologies have helped improve the level of care at local cancer treatment centers through connections to experts and programs like Moffitt's pathways.

While people are familiar with drug development in pharmaceutical companies, the concept of a pathway being branded or licensed is unique and emerging as a best practice, says BRG's Todd Antonelli.

"Moffitt needed to explore the revenue potential and value for its knowledge and how to go to market. There are doctors commercializing drugs and receiving royalties, but this is a multimillion-dollar stream of revenue and provides help with a referral system on Stage 3 and 4 cancers," he says. "At the bottom line, it's a process that helps other organizations raise their standard of care."



Pathways team members include Dr. Charles Williams (seated, left), Dr. Thomas Dilling (standing) and surgeon Dr. Lary A. Robinson (seated, right).

Photo credit: Moffitt Cancer Center

Nancy Ayala is a New York-based journalist who has worked as a digital producer for CNBC and ABC News, and covered US Hispanic business news for Adweek magazines.

Tom Nealon at the Southwest Airlines corporate hub in Dallas.

Inside Southwest's Digital Upgrade

THE SWITCH TO A NEW RESERVATION PLATFORM CLEARS THE WAY FOR GROWTH

Joseph Guinto

Photo: Trevor Paulhus

Tom Nealon was at Southwest Airlines' headquarters at Love Field in Dallas on July 20, 2016, when a router failed and a backup system also collapsed, overloading IT systems and knocking the entire reservation system offline. The airline was virtually grounded—2,300 flights canceled, thousands of passengers stranded.

"It shouldn't have happened, but it did happen." Nealon tells *ThinkSet*.

That's the thing about digital disruption. It can be positive or negative. It can force your organization back to using pencil and paper, or it can create new opportunities if your company gets through the immense challenges of building, training and implementing a complex platform.

Nealon has seen both. At midnight on May 9, 2017, Southwest switched over to a new reservation system. It cost an estimated US $500 million and took 500,000 hours of employee training to get online. The airline worked with Amadeus, a Spanish company that provides a technology backbone to much of the airline industry.

The upgrade, called Amadeus Altéa, was the first full-scale overhaul of Southwest's passenger booking processes in more than two decades, and it has laid down a technological foundation for the future.

That change, as well as a continuing investment in other technology systems, will move passengers more efficiently through Southwest's route network, solving a growth challenge that was years in the making.

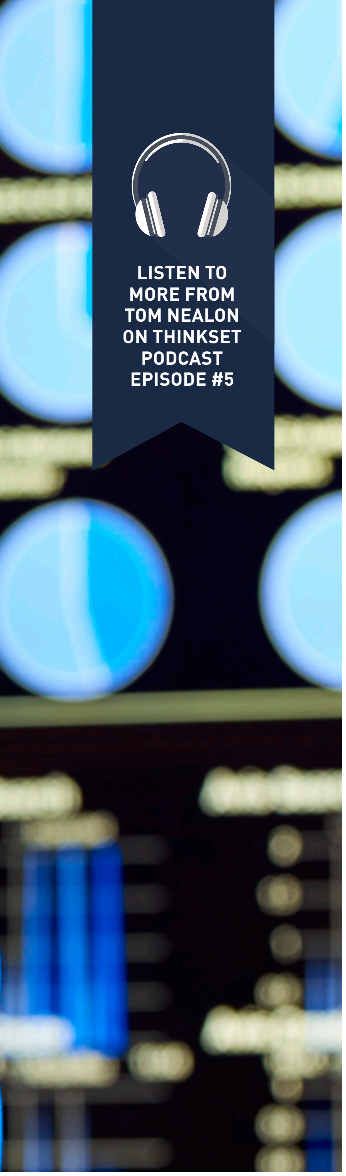
Nealon likens technology reinvention to a jigsaw puzzle, and everyone from top executives to front-line employees has to understand the impact as it gets assembled.

"A multi-year plan is essentially the box top of a puzzle," he says. "You see what it's supposed to look like. You see what you're getting and a clear vision of how it all fits together."

GETTING EVERYONE "ON BOARD"

Since his early days working on an IT Help Desk, Nealon has understood technology and change. One of his earliest work projects involved replacing IBM 1288 scanners with handhelds. His father, Tom Nealon Sr., had helped developed the 1288 as an engineer at IBM.

Nealon's leadership has included tech transformations at Frito-Lay Inc. and a consulting role as Southwest's CIO. As CIO at J.C. Penney Co., from 2006 to 2011, he revamped the E-commerce operations—a unique career path for a marketing major. In 2016, he rejoined Southwest and was elevated to president in 2017.



He won a 2010 MIT Sloan School of Management Award for Business Innovation and received other industry kudos for a savvy mix of technical understanding and implementation skills.

The Altéa upgrade was not a response to a one-time outage. Rival carriers had already merged into new combined systems or taken the plunge with new reservation platforms.

An internal analysis revealed that Southwest could not grow quickly and efficiently while using an outdated reservation system that didn't allow payment in foreign currency, required the same flight schedules every day of the week and could not offer overnight, red-eye flights.

Nealon says Southwest's objective to be "the world's most loved, most flown, most profitable airline—the best airline in the world," was not aligned with the systems in place.

Indeed, analysts had been wondering if Southwest would find ways to keep up with other carriers. Kevin Crissey, a senior analyst at Citi Research, said in a 2017 research note that a top investor concern is Southwest's ability to add capacity.

That's one issue Altéa addresses. "It gives them scalability for future service," Savanthi Syth, a Raymond James Financial analyst, told *Bloomberg Businessweek* about the new reservation system. "Southwest is definitely, more and more every day, looking more like a network carrier."

Most Southwest employees didn't need a lot of convincing to buy into the big changes they were asked to make. Nealon's leadership and listening skills are a strong match for Southwest's legendary can-do culture.

"It would be naïve of me to suggest that there wasn't nervousness or anxiety," Nealon says. "This was a hard change. A lot of our employees have been working on the same system since the day they came here.

"Of course, the new system has a huge technology element to it," Nealon says. "But it was very much a business and technology thing. In fact, if it was only a technology thing, you could not have gotten it done because you wouldn't have had the buy-in support. This change required a lot of effort and a lot of buy-in and a lot of organizational change."

Technology provides enabling tools, but people determine success in serving customers. Change is hard, especially when it directly affects the work processes of 35,000 of your 55,000 employees. Thousands of people nationwide had to change their work ways, and all affected employees—operational network teams, ticketing agents, and front-line gate agents—had to be trained well before it went into use.

"It was really tailored and customized to how Southwest did things," Nealon says, explaining how committed front-line workers were to the training. "And when they put the new system into use, they really nailed it," he adds.

Southwest learned from the errors of other airlines. In March 2012, after United Airlines merged its reservation system with Continental Airlines, technical glitches were rampant. Flights were delayed. Kiosks didn't work. Callers to the reservation centers mainly heard busy signals. Virgin America had similar problems in 2011 when it converted to a new system.

Instead of converting on a single day, Southwest started in December 2016, using its new system to sell tickets for flights that would occur after May 8, 2017. The old system processed all other tickets.

PREPARED FOR WHAT'S NEXT

Another reason for Nealon's big-picture view is that he held an independent board of directors seat from 2010 to 2015, and currently serves on the board of Fossil Inc. After returning to Southwest as an executive, he took charge of the finance and innovation operations with an eye on long-term strategy.

As big as the change was to Southwest's technological backbone, though, for the airline's customers, the switch needed to be seamless. Technology has to be consistent and reliable. The Altéa switchover had to be nearly invisible to travelers, he says.

"We did not want the customer to feel a change," Nealon adds. "It's one thing training all of our 55,000 employees. It's another thing training 125 million customers."

Nealon says the new platform offers the airline new options. "We have much more sophisticated ways of managing the inventory blocks of our reservation management systems." That means Southwest can change its flight schedule more easily—something that's historically been rigid.

Southwest is already reporting a 10% improvement in on-time performance during inclement weather events as compared to 2016 results.

Southwest could also assign seats. The airline's famed boarding process by groups has never matched flyers to seats in its 46-year history.

"But it's nice to have that capability," Nealon says.

Joseph Guinto

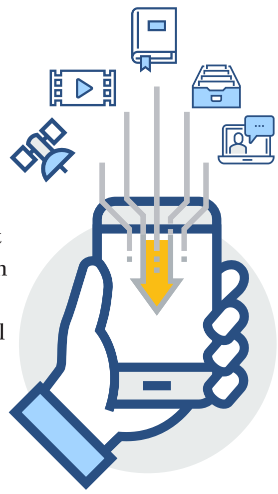
> **Most of the airline's 55,000 employees had to change the way they work without affecting daily flights and reservations.**

Media Content, Delivery and Industries Collide

How to define or manage a 21st century media company

Mark Williams

Consumers are setting the pace in a fast-moving telecommunications and media landscape as program viewing and communication habits change rapidly. The industry is restructuring. Yet, regulatory authorities are struggling to keep up.



It is now standard practice for established players in one market segment to move into another. Google has extended from search into networks, while Amazon has leapfrogged from ecommerce to content origination. Comcast Corp.—owner of NBC Universal with its networks and movie library—offers cellular phone services through partnerships. In European markets, a wide variety of company types combine some or all features of network operators, service providers and media businesses.

So, how can we define these pathbreaking multiple-choice companies? How should they be regulated? As technologies converge, will sector regulation, merger review, antitrust, privacy and media oversight converge with them? What are the implications if they don't? Will the failure of regulatory policy to keep up with and support industry evolution ultimately derail innovation? Regulation, in fact, could spark innovation by forcing traditional companies out of their comfort zone.

The "over-the-top" revolution connects many of these questions. When companies started providing communications services via the internet without needing to build their own networks, many traditional network operators responded with strenuous attempts to lobby regulators to help mitigate the impact on their existing business models. Regulators have been unsympathetic and have made it harder for network operators to defend themselves through net neutrality rules in both Europe and the US.

LISTEN TO MORE FROM MARK WILLIAMS ON THINKSET PODCAST EPISODE #4

Meanwhile, customer attitudes are shifting towards service providers and their expectations about where and when they should be able to consume media services.

We're only part way through this chapter; as it unfolds, it offers fundamental strategic questions:

- Will it be better for telecom providers to retreat to protected services in a more sedate market with less profit upside—or expand into new business areas and risk a rivalry with global players?

- For content owners, is it better to distribute directly to consumers or sell via aggregators such as Netflix or Amazon? How much of the network infrastructure do they need to own or control to protect the content's value? And who then owns the customer?

Major strategic moves by players in the sector are fraught with risks, both technical and regulatory. Alphabet Inc. found out the hard way that being the global leader in search does not necessarily translate into being able to deliver networks, as demonstrated by recent problems with rolling out Google Fiber.

Regulatory rules can also produce headaches for industry players trying to move from one segment of the market into another. The EU's €2.4 billion fine imposed on Google for the way in which it treated smaller providers of price-comparison services is one example. Similarly, if the US government were to block an AT&T-Time Warner merger, it would signal a blow to the strategy of vertical integration.

But regulatory policy can also create new opportunities by upending existing business models. One current EU priority is to build out the single market—highly functional for goods, less so for services—by creating a border-free market for all things digital. The "digital single market" initiative stands to wipe away the advantages enjoyed by pay TV providers that are ensconced in select national markets. By creating a pan-European market for premium pay-TV services, for example, the EU could open the path for a major US tech giant to win broadcasting rights for delivering premium content to a larger pan-European customer base.

Likewise, uncertainty envelops net neutrality rules in the US. There is robust debate in Washington, DC, over rules that enforce the same speed limit on every lane of the information superhighway. Dilution or elimination of net neutrality by the Federal Communications Commission would hurt some parts of the industry but breathe new life into the old business model of vertical integration of content providers and distribution platforms.

Innovation, evolving consumer tastes and spending habits, and broader economic parameters will shape the new environment, but regulators—flying with limited visibility— will be no less critical. Intentionally or not, they will enable some business models and put the brakes on others.

Mark Williams is a BRG managing director in London, specializing in telecommunications/media and regulatory matters.

Integrative Health Gains Ground

Well-being at all levels to cut stress and improve performance is a holistic approach that is finding corporate support

Ruthann Russo

Stress can aggravate chronic diseases, diminish job satisfaction and decrease productivity, resulting in burnout. Burnout is a concern of every organization and particularly those with high levels of crisis response and uncertainty.

There's no better place to study this issue than a doctor's office.

Some 54% of US physicians reported at least one symptom of burnout in 2014, up from 46% in 2011, according to a 2015 study published in Mayo Clinic Proceedings.

One way to combat stress and burnout is by creating and implementing an integrative health skills program.

Individuals who participate in a typical skills program form a core component of the ecosystem that supports each of the group's members in the learning and change management process. Participants may be the patients in a healthcare system, employees in a firm, or even a handful of family members.

> **"In a study at a Fortune 100 firm, BRG found that 95% of employees who participated in integrative health skills groups felt they would take better care of themselves.**

A mind-body medicine tool-box goes beyond conventional medicine to encompass the broader range of mental, emotional, social, spiritual and physical well-being.

Here, again, health professionals may be canaries in the coal mine. Physicians' satisfaction with work-life balance is on the decline.

"Burnout appears to impact the quality of care physicians provide and physician turnover, which have profound implications for the quality of the healthcare delivery system," concluded the study, led by Dr. Tait Shanafelt, an expert who will be Stanford Medicine's first chief wellness officer.

Integrative health skills groups are grounded in evidence-informed practices such as self-efficacy and behavioral changes that yield sustainable results. For instance, breathing exercises help to shake off the cares of the day.

Research at Massachusetts General Hospital demonstrated that individuals who engage in integrative health skills groups are likely to need about 50% fewer healthcare interventions than similar individuals who do not participate. In a study at a Fortune 100 firm, BRG found that 95% of employees who participated in an integrative health program felt they would take better care of themselves thanks to the skills they learned.

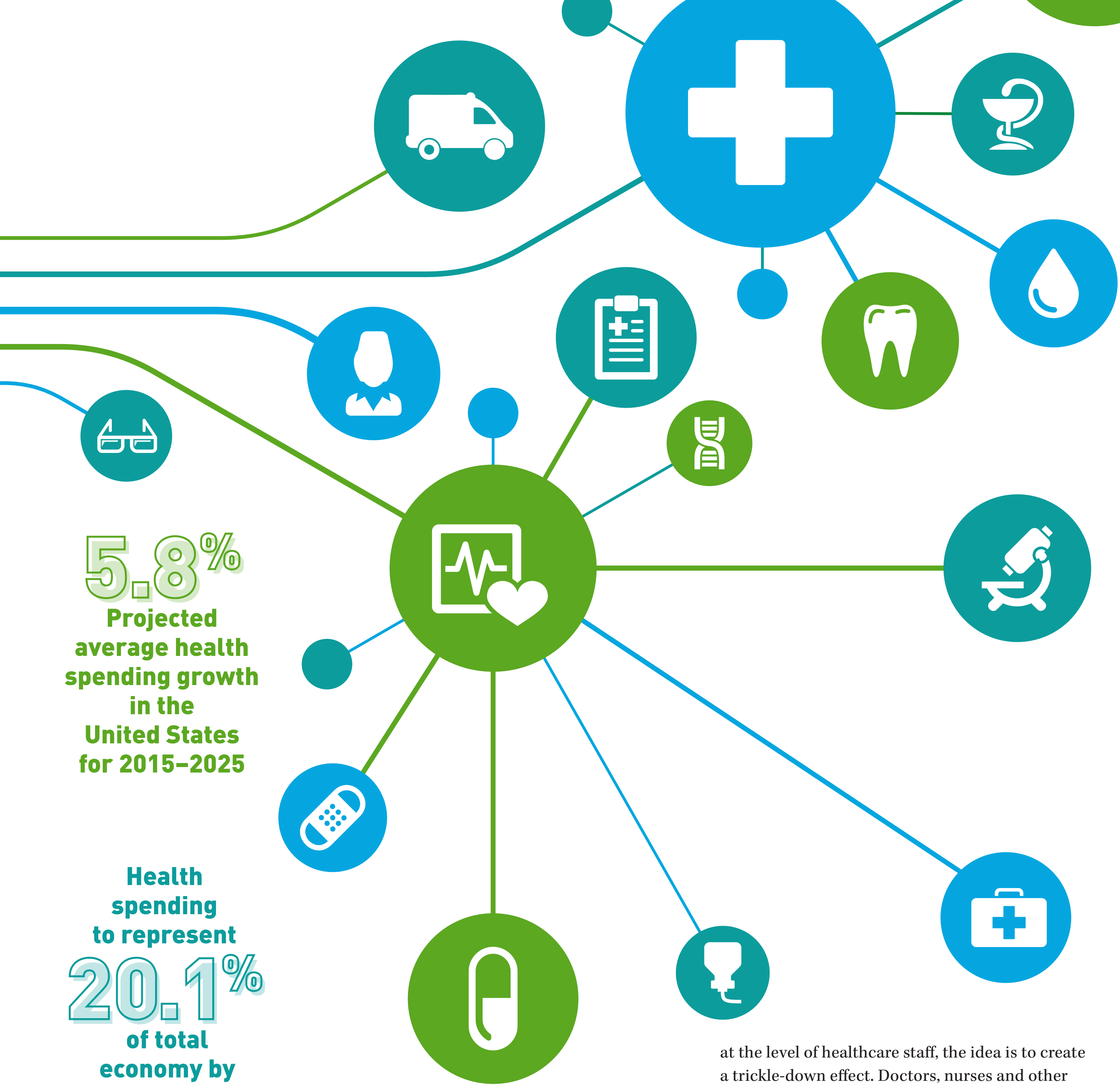
It may sound surprising that practitioners of conventional medicine are receptive. The goal is to anchor participants in a broader appreciation of, and responsibility for, their health and well-being.

"It is not an either/or—it is a both/and," says Lori Knutson, administrative director of Meridian Integrative Health & Medicine in New Jersey, which offers comprehensive health and wellness programs. "The focus is on helping individuals understand how to access the body's innate capacity for healing and health."

The emphasis on skills ranging from meditation and acupressure to reflective journaling and mindful eating gives every individual a toolset that can adapt to her or his own needs.

In one case, these skills helped an epilepsy sufferer overcome years of recurrent, uncontrollable seizures, discontinue most medications and reduce out-of-pocket annual healthcare expenses.

Employers are affected in a number of ways. Productivity losses linked to absenteeism cost US employers $226 billion annually, or $1,685 per employee, the Centers for Disease Control and Prevention estimated in 2015. Not all costs are quantifiable: Consider the lost output of "presenteeism"—employees who come to work



5.8%
Projected average health spending growth in the United States for 2015–2025

Health spending to represent
20.1%
of total economy by 2025

Total health expenditures is projected to increase to
47%
by 2025

despite sickness, out of fear or commitment, but who do not perform at their best.

Chronic diseases and conditions such as diabetes, high blood pressure, tobacco abuse and obesity account for more than 80% of annual US healthcare spending.

"The costs are financial, environmental, social, generational and, of course, human and personal," Knutson says.

Increasingly, healthcare systems are recognizing the utility of integrative programs. When implemented at the level of healthcare staff, the idea is to create a trickle-down effect. Doctors, nurses and other healthcare providers can instruct and coach patients on these skills, creating a virtuous circle of improved health outcomes, quality of life and even occupational performance.

Beyond subjective assessments, data points to a decreased use of healthcare services for individuals who develop and use these skills. A greater focus on screening and early treatment will result in a more profitable healthcare system with healthier, happier patients.

Ruthann Russo is a BRG managing director with the firm's clinical economics practice in Baltimore. She has worked with NYU Langone Medical Center and Memorial Sloan Kettering Cancer Center in New York.

Is Your Board Prepared?

Boards need to play a bigger role in helping firms through perfect storms and uncertainty

Philip Rowley and Bruce Cuthbertson

CEO misbehavior, corporate scandals, lack of leadership diversity, activist shareholders. These are all flashpoints that clearly indicate how difficult it can be to create a culture of strong governance in a firm. Building one that lasts is even tougher.

Incidents ranging from fraudulent emissions testing at Volkswagen, unauthorized accounts at Wells Fargo & Co., alleged harassment of women by Fox News executives or the complaints over Silicon Valley's "bro" culture have turned the spotlight inward, on the board and its accountability. Boards are no longer immune to the negligent or illegal actions of firms or their senior employees.

Today's board members are being called upon to respond publicly in a crisis. Even before that point, it is the board's role to cultivate other senior leaders and plans that matter most, says Matt Kelly, editor of Radical Compliance and a long-time writer about corporate governance.

"I do think one big problem for boards, especially boards in startups or high-growth businesses, will be how to act as a check to a 'strong personality' CEO, whose behavior and tone can eclipse other voices that might help keep the company on mission and on an even keel," Kelly says.

> **"Board diversity is one way to prevent too many like minds from letting a strong CEO go unchecked.**

The current pace of change and global, unanticipated events play a larger role in corporate leadership than for earlier generations of boards and CEOs. They have to work together, sometimes disagreeing on culture or tactics but finding compromises or collaboration that serve the greater good.

Boards of directors, more than ever, require a broad range of expertise and viewpoints—diversity—to navigate both the internal and external pitfalls and disruptive forces that firms face. Risk of groupthink and strategic myopia is high when boards are composed of people whose backgrounds and experiences are similar, who attended the same Ivy schools, who came of age at the same consulting firms and who are mostly men. Remember Enron?

Board diversity is one way to prevent too many like minds from letting a strong CEO go unchecked.

With technology and social forces changing business and business models, boards need to include a wider range of leaders whose diverse perspectives lend a CEO a guiding hand through uncertain environments.

This guiding hand also needs to provide stability as firms undergo leadership changes.

An annual National Association of Corporate Directors (NACD) survey found that 43% of public companies, and only 31% of private companies, have a formal, written CEO succession plan.

Many friends-and-family boards are ill-prepared for what-if scenarios when a CEO is asked to resign or even when one retires. They end up in a fire drill, creating even more doubts for all stakeholders—employees, shareholders and customers

According to an annual survey on CEO turnover by executive search firm Spencer Stuart, from 2006 to 2016, an average of 51 companies per year in the Fortune 500 have seen turnover at the top. In 2016, 58 CEOs were replaced. Of those, 88% retired, 9% were ousted or forced to resign and 3% were replaced through a merger.

In 2016, most replacement CEOs (90%) were promoted from within. Consequently, few of them had been a CEO previously.

Boards are increasingly asking a retiring CEO to stay on as chairman of the board, to provide a stabilizing force when a new CEO is hired.

Whether managing CEO succession or overseeing a transition from a scandal, boards of directors are playing a bigger role in helping decide the direction a firm is to take and how to get there.

A diverse, involved board can help prevent those perfect storms in the first place and can right the ship with more fortitude when change is imminent and necessary.

Stability AND change are a tall order. This takes a while, requiring both patience and impatience. We're counting more and more on our boards of directors to lend a guiding hand, to give us better stability through change and to set the tone for our firms' cultural well-being.

Philip Rowley is BRG's executive director & Chief Revenue Officer.

Bruce Cuthbertson is editorial director of ThinkSet and special adviser with BRG on corporate strategy and innovation.

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Process *or* Content?

What's more important to the company?

Katrina Pugh

We've never had as many choices and options in business when it comes to how we get work done. In the “gig economy,” there's a popular notion that a freelance coalition (gig) can never approach the feel and performance of a company.

One reason, pundits claim, is that because players are independent, they are directly or indirectly in competition. They won't share knowledge freely or subscribe to a common approach.

I disagree.

We can have the cohesion, scalability and quality with the right mix of process and content disciplines. The epic struggle between “what” and “how” is misplaced. The answer is “both.” Another answer is, “It depends.”

Do we use a tangible, activity-based lens (process), or do we use a lens of ideas and meaning (content)? Among big brands, a “process” discipline can be found at Walmart, McDonald's and Dunkin' Donuts. A “content” discipline is seen at Marriott and Apple. For professional service companies, we could ask, “Do we stake our reputation on adapting shared methods (think: technology platform roadmap) or improvising (go-to market strategy) in an eclectic way?”

Oscillation between content change and channel change has also played a role. The epic content vs channel debate is changing companies such as Google, Apple, Virgin, Comcast. These all demonstrate clearly how speed, access, networks and applications feed off each other. Speed enables applications. Usage increases market size. New applications drive both faster speeds and greater access to networks.

Things change.

Successful organizations find their process or content core, and build the other in service to it. This is analogous to the argument that organizations need to take a capabilities-based approach to building strategy. They must build respect for, and competence in, the other as a way to serve and elevate the core.

> “ For the future professional services firm, there are two risks: Using the wrong model or using no model at all.

For example, Dunkin' Donuts tightly manages with deliberate launch protocols for new menu items (process), and innovates around scaling models (content). Starbucks uses “social listening” in a very branded and customer-centric way (content), and tests and invests in local option and customer choice (process).

Where margins are low, process tends to dominate as it allows newer or lower-cost resources to come into play. Yet, this is not as simple as Michael Porter's lauded “cost-focus versus differentiation” model. Consider the ways that “process” can be differentiated and expensive in terms of labor hours.

The stage in an organization's lifecycle favors process or content. During mergers, often the “process” firm dominates just after the merger. That's largely because they “get” process, an essential for achieving integration.

Service Companies Need Both

For the future professional services firm, there are two risks: using the wrong model or using no model at all. When there is a no agreement on the proportion of process versus content, rework rises, communication gets muddy and quality suffers.

A professional services firm needs to find its primary nature, specifically its unique value to the client, and where people excel. Trying to have it both ways is sure to confuse the client, the market and your workforce, regardless of whether they're contractors or employees. Take a few moments to develop an “in service to” model:

- Is this a new problem? Can my team—together—improvise, around the desired outcome, and are we aligned?
- Is this a familiar problem or one where new scenarios can be mapped? Should we pursue a common delivery model?
- How mature is my offering?
- Can I cost-effectively deliver and add more staff with current process-content balance?

Executive bookshelves are overloaded with formulas or inspirational team-building titles like *The Packer Way: Nine Stepping Stones to Building a Winning Organization.*

Each organization needs to find its own solution.

Katrina Pugh is director of Columbia University's master's program on Information and Knowledge Strategy. She has been an executive at Fidelity Investments, JP Morgan and Intel Corp. She is the author of Smarter Innovation and Sharing Hidden Know-How.

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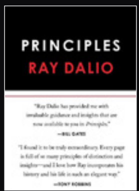

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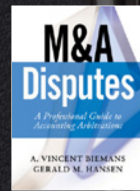

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Brian Stapleton

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Mark Williams, an economist and BRG managing director, explores the rise of "Multiple-Choice Companies" and the impact of forthcoming EU General Data Protection Rules (GDPR) along with Europe's evolution as "digital single market."

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ThinkSet contributing writer Joe Guinto speaks with Southwest Airlines' President Tom Nealon about the carrier's multi-million-dollar digital upgrade that is enabling a range of services and new management insights.

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The State of the C-Suite

Trends and data about top management, pay and tenure

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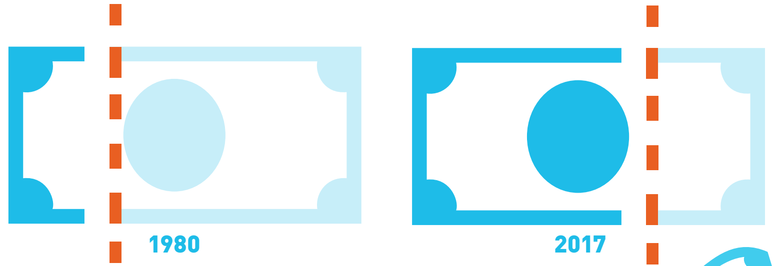


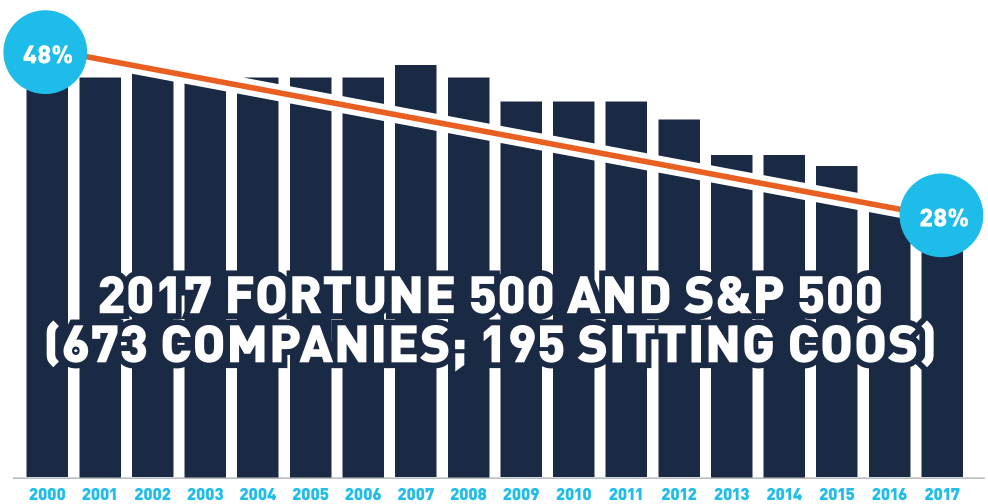
CEO AGE INCREASING

The average age of a Fortune 500/S&P500 CEO when appointed was 50 in 2017, up from 45 in 2012.

DECLINE IN DIVERSITY

Despite a decline in diversity overall, the number of women CEOs peaked in 2017 among the 673 public companies surveyed.

(data as of Aug. 1, 2017 research - CristKolder Volatility Report 2017)



COO BY THE NUMBERS

The number of companies utilizing the COO position continues to decrease; 30% of S&P and Fortune 500 companies have COOs, down from a high of 48% in 2000.

AVERAGE TENURE

CMOs have the shortest average stay of any C-level executives. The 2015 CMO Impact Study found 57% had been in the role three years or fewer. The average tenure is 4.1 years, compared with eight years for a CEO.

The shortest tenures are in consumer businesses. CMOs hold positions longer in financial services and professional services companies.

Sources: Harvard Business Review, CristKolder Volatility Report 2017, CMO Impact Study

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