



Interviews with leading minds

Prof. Hermann Simon on true business virtues and key success factors in the post-crisis period

Professor Hermann Simon, a respected international expert on strategy, marketing and pricing, is often regarded as to the most influential management thinker next to the late Peter Drucker in the German-speaking countries. On the occasion of the Graduation Ceremony in December, he will receive an honorary academic title and the distinction of "Doctor Honoris Causa" by the IEDC for his important contribution to management and leadership development. In this interview with Metka Šilar Šturm of IEDC he reflects on the learning points gained from his long-standing friend Peter Drucker, explores the factors that impact the competitiveness of European companies in the global marketplace, and suggests some possible ways to overcome the current economic crisis.

You have spent many years of your successful career as a professor of business administration and marketing at universities in Germany and abroad, including Stanford University, Harvard Business School, INSEAD, London Business School and other respected institutions. Was bridging the gap between theory and practice the major driving force for your decision to enter the consulting business?

From the beginning of my academic career back in the early seventies I was interested in the practical application of my research results. This was largely due to the influence of Professor Horst Albach, my academic supervisor and mentor, who always maintained close relations with practitioners and companies. When I became a professor

About Hermann Simon

Hermann Simon is Chairman and was till May 2009 CEO of Simon-Kucher & Partners Strategy & Marketing Consultants with offices in Europe, USA and Japan. He is an expert in strategy, marketing and pricing. In the German language area Prof. Simon was voted the most influential management thinker after Peter Drucker.

Before committing himself to management consulting, Prof. Simon was a professor of marketing at the Universities of Mainz and Bielefeld. He was also a visiting professor at Harvard Business School, Stanford, London Business School, INSEAD, Keio in Tokyo and the MIT.

Professor Simon has published over 30 books in 22 languages, including the worldwide bestseller Hidden Champions (1996) and Power Pricing (1997), as well as Strategy for Competition (2003) and Think! (2004), Manage for Profit, Not for Market Share (2006). His book Hidden Champions of the 21st Century, Success Strategies of Unknown World Market Leaders was published this year, and it investigates the strategies of little known world market leaders. His most recent book Beat the Crisis – 33 Quick Solutions for Your Company is published in the USA, China, Korea, Italy, Brazil, Russia, Spain and Slovenia.

A native of Germany, he studied economics and business administration at the universities of Bonn and Cologne. He received his diploma and his doctorate from the University of Bonn.

in 1979 I started some small consulting projects. This was very unusual in Germany at that time. But in my year as postdoctoral fellow at the Massachusetts Institute of Technology I had learned how fruitful close cooperation between

academics and practitioners can be. It's a win-win situation. Academic researchers direct their research towards projects that have value in the real world. Practitioners stay abreast of the latest developments and get concrete support in their decision making process. While working on their doctoral dissertations, my first assistants Eckhard Kucher and Karl-Heinz Sebastian showed how consulting work was in their blood. When they finished their dissertations in 1984/85, we founded a consulting firm together. We gave it the name "UNIC – University Connection". Our idea was to transfer knowledge from academia to practice, not in the form of education, but as concrete solutions to problems. Of course starting it was difficult, but UNIC grew consistently. From 1985 to 1994 I stayed on as professor and devoted about one day per week to consulting. Influencing practical decisions and dealing with top managers and entrepreneurs had become a strong motivator for me. In late 1994 I decided to leave the university, give up my tenured professorship and devote myself full-time to our consulting firm. At that time we had 40 employees in our only office in Bonn, Germany, with revenue of 5.9 million Euros. In 1995 I became CEO and we renamed the firm Simon-Kucher & Partners Strategy & Marketing Consultants. In 1996 we opened our first foreign office in Boston, Massachusetts. As of 2009, we have 19 offices in Europe, the USA, and Asia, and some 450 employees. We focus on revenue-driven profit growth; we call it "Smart Profit Growth", with a core competency in price consulting where we are the world market leader. In May 2009 I retired as CEO and am serving as chairman.

Coming back to the question of my motives: My main motive was to apply knowledge to practical problems and, in this way, to influence managerial decisions. Or you may say, to change the world a little – a little more than I could have as a university professor. Of course a professor has a lot of influence, but it's more indirect, through the students he or she teaches. With consulting the influence is more direct, though not necessarily stronger or longer lasting.

Your work has been significantly influenced by your long-time friend Peter Drucker, with whom you corresponded for many years and whom you often met at his home in California. What are the key learning points that you took from him and would like to emphasize in the context of the current business environment?

Peter Drucker as such was an impressive human being: unpretentious, modest, and at the same time an outstanding thinker with an almost infinite knowledge – particularly when the discussion turned to history. What did I learn from him? First, I would mention that managers (myself included) have to think more before they act. Managers are always working under time pressures and stress and do not devote enough time to deep thinking. I am convinced that this is behind many poor decisions. Closely connected with this is Drucker's holistic approach. He viewed and understood challenges in a comprehensive, not a narrow way. He was not a specialist, but a generalist. In contrast to this, I do think that it is necessary to be a specialist in one field.



This is indispensable today if you want to compete on an international level. But in the course of specialization you should retain a certain degree of "generalism", a holistic view of the world. Peter Drucker was somewhat split on this

issue. On the one hand, he admired the specialists, the "monomaniacs" as he called them. In his biography *Adventures of a Bystander* (1978) he described two historically famous scientists he knew personally, the physicist Buckminster Fuller and the communication expert Marshall McLuhan: "They exemplify to me the importance of being single-minded. The single-minded ones, the monomaniacs, are the only true achievers. The rest, the ones like me, may have more fun, but they fritter themselves away. The Fullers and the McLuhans carry out a 'mission'; the rest of us have interests. Whenever anything is being accomplished, it is being done by a monomaniac with a mission." But Drucker's strength was exactly that he saw the larger picture and, in this way, contributed immensely to our better understanding of the world. Thirdly, Drucker's knowledge of history was exemplary and led him to idiosyncratic interpretations of both the present and the future. A lack of historical knowledge is a weak spot for many economists and management scientists – myself included.



With regard to the crisis, the significance of Peter Drucker is evident and much discussed. His approach to management was value-oriented, based on

fundamental values and virtues. And that is exactly what was missing and what brought about the current crisis: greed, excessive bonuses, megalomania, and even crime. When our discussions turned to the topic of exorbitant manager bonuses, he became extremely agitated. Usually he was very calm, but this type of misconduct made him very angry.

The 1st Global Peter Drucker Forum, held 19-20 November in Vienna, marks the centennial of this influential management thinker. On this occasion, you spoke about "Peter Drucker's importance for the 21st century business world", while Prof. Danica Purg positioned him as "more than a management thinker". Could you share some of your thoughts on his important role for the business sector?

At the 1st Global Drucker Forum in Vienna I mostly used the Hidden Champions to illustrate Druckerian leadership. Most of the excesses of the recent past have occurred in large corporations, and especially in the financial sector. In Germany alone the top managers of Siemens, Deutsche Post, Volkswagen, Deutsche Telekom and many leading banks have been removed from their positions due to some kind of misconduct. I do think, though, that in the real economy we find role models for leadership and conduct consistent with the values set forth by Drucker. I am talking here of very concrete, business-related values – not of general human virtues. Truly serving your customer, creating real value through innovation, mutual loyalty between employer and employee, long-term orientation, avoiding excessive risk – these are the values I have in mind. One may contend that these are traditional values of good entrepreneurship and management and nothing new. That's exactly what they are. I see these values every day in mid-sized enterprises, typically family-owned, rather than in large corporations where the ownership and management are often separate entities. In my opinion these are also the values of the future. I suggest that in order to learn how to

manage well, we should look more often to mid-sized companies for an example. This is a big challenge for business schools, since they and their case studies are largely oriented around large companies.

Danica Purg is, of course, right. Peter Drucker was much more than a management thinker. I once asked him whether he considered himself more a historical writer or a management thinker. Without hesitation he answered, "More a historical writer." What I said about his holistic view definitely makes him much more than a narrow management thinker.

In your lecture on the occasion of the IEDC's 20th anniversary in 2006, you mentioned that companies should strive to increase profits, not their market shares; you have even published a book *Manage for Profit, Not for Market Share*. How do you relate a profit-driven scheme to longer-term sustainable development?

Yes, I continue to emphasize that companies should be profit-oriented, not market share-, volume- or revenue-oriented. This is the core message of our book. I am actually a fan of the shareholder value concept. Only this summer I published a column in *manager magazin* (a leading German business monthly) entitled "In Praise of Shareholder Value". I cite a passage from this column: "What is shareholder value? Very simply: long-term profit orientation and the creation of value. There can be no doubt that this is the only meaningful objective for the management of a company. Even Peter Drucker was not against profit nor being profit-oriented. On the contrary, he said 'profit is the cost of survival'. Profit is not a 'nice to have', but a condition for corporate survival. It is management's responsibility to position itself between revenue and costs, and to keep the two separate. Shareholder value can never mean driving the profit or the stock price up with short-term actions that destroy long-term value. But exactly this has been practiced by numerous managers who pretended to create shareholder

value. They did exactly the opposite, they destroyed value."

And I would like to emphasize the highly consistent interest among shareholders, employees and society as a whole. The only companies I know who do a lot for both their employees and for society are those who are profitable. And the companies that consistently cut costs are hurting their employees and society as a whole – take General Motors for example.

It has become popular to talk of "mere profit-orientation". What does this mean? A company never has just a single goal. It always has to find a balance between contradictory objectives: long- vs. short-term, market share vs. profit, cutting costs vs. retaining qualified employees. But there is one master goal: profit. Because profit, as Peter Drucker once said, is the cost of survival.



In the countries of CEE and beyond, many companies are concerned about their lack of competitiveness due to high labor costs (compared to companies in other regions), while at the same time they don't work to create sufficient value. What would your advice to them be in order to enhance competitive advantage?

Indeed, many companies in Central and Eastern Europe face a dilemma. On the one hand their products are not yet fully competitive in the world markets. There may be deficiencies in quality, in technology, in marketing, in branding,

etc. At the same time their costs are high relative to competitors from Asia and other regions, which in turn prevents them from being able to compete on price. The root of the problem lies in the extreme speed of development among emerging countries over the past 15-20 years. When the Iron Curtain came down, the CEE companies simply didn't have enough time to catch up – the competition from China and India swooped down too quickly. There is no easy solution. The importance of time is always underestimated in management. Developing competencies takes time; the same is true in establishing a sales organization or, even more, for building a brand. This cannot be done in a few years, rather it takes decades. My advice is that CEE companies must first focus on securing product quality and technical competencies. Only if they achieve excellence in these fields will they be successful outside their home markets. Branding is a big challenge. There are few brands from the CEE that command international awareness and reputation. But building brands is the only way to avoid selling on price alone, which – as was said – is incompatible with the cost disadvantages relative to competitors from Asia. Ultimately, sustained perseverance and a good dose of patience are required. I do think that human resources and education in CEE offer a good foundation on which to build long-term success. Young people in CEE are more energetic and ambitious than in West European countries.



Your new book *Hidden Champions of the Twenty-First Century* explores unique companies that present an alternative to the well-known multinationals. What are, in your opinion, the key measures that small and relatively unknown companies should take in order to become international champions?

The Hidden Champions are mid-sized, little known companies who are also market leaders in the world or on their continent. They often command global market shares of 50 percent or more. They are very ambitious with long-term orientation. They attain world-class status through a narrow focus on a market and/or a technology. This makes their markets small. But through decisive globalization they make their markets sufficiently large. The combination of narrow focus and regional expansion marks the essence of their strategy. Beyond that they are extremely innovative, very close to their customers, and have pronounced competitive advantages in both product and service quality. While hardly noted in management literature and business education, they are actually excellent role models of exemplary strategy and leadership. Both other companies (even large ones) and business professors can learn immensely from the Hidden Champions of the 21st century. While

many of them are from Germany, I actually found them all over the world. I identified such companies in New Zealand, South Africa, China – basically around the globe. It is amazing how similar their cultures and strategies are. This proves that they can be created everywhere. However, a condition sine qua non is a strong entrepreneurial spirit.

Many economists claim that the crisis is already over – do you think we can, in any way, go back to where we were before the crisis and what are, in your opinion, the key determinants in a successful recovery scenario?

There are indeed many positive signals. Stock markets have rebounded, in recent quarters we have seen growth in many countries, new orders are coming in, especially from China where the economy is growing at more than 6 percent. At the same time, the dangers cannot be ignored. The stimulus packages cannot be continued for long. After the various stimulus programs for the automotive industry expired, car sales collapsed in some countries. In 2009 several million new cars were bought as a result of these stimuli. These purchases will be missing in 2010. How will this gap be filled? We have to expect rising unemployment and a wave of insolvencies.

All in all, I see some reasons for optimism. I am, however, concerned about the longer term: the exploding public debt and the high probability of strong inflation over the next few years are not exactly the best conditions for a healthy future. In any case, it seems that it will take until 2013 or even 2015 to get back to the levels of 2007/8. Almost all managers and entrepreneurs I have spoken to recently feel this way, and I share this view.

With regard to the recovery, I think companies who have retained their qualified employees will be in a much better position than firms that have laid off a large part of their workforce. There will be attractive acquisition opportunities. We are already seeing an increase in takeovers and M&A activities. But there will also be a new level of

modesty. We will see more products in the lower price ranges. Companies who understand this change and are prepared will come out stronger. This definitely – and already applies to emerging countries. But we shall see a similar trend in highly developed markets.

One of the highlights of your recent book *Beat the Crisis – 33 Quick Solutions for Your Company* is the fact that companies should not get involved in slashing prices as a reaction to reduced demand. What is, in your opinion, the best alternative to this?

The central thesis of the book is that this crisis is a sales crisis, not a cost crisis. Therefore it has to be fought on the sales front, not only on the cost front. That costs must be slashed in a crisis of this dimension is obvious. But if sales tumble by 30 or 40 percent, which has been the case in many industries, there is no way to survive on cost cutting measures alone. Companies must do their utmost to fight against declining sales and prices. The most common mistakes in this situation are strong and premature price cuts. Why are managers doing this? The reason is obvious: Demand decreases, and in order to defend sales volumes, managers cut prices. This almost always turns out to be an illusion. The hoped for sales increase doesn't materialize. There are two reasons behind this. Firstly, price elasticity has changed in an adverse way during the crisis. Price cuts have become less effective in driving sales volumes up. Customers refuse to buy *not* because the price is too high, but because they are unsure of the future and want to save their money. This fear is difficult to overcome through price cuts. Secondly, the competition is likely to react to the price cuts with their own. In the worst case, both prices and volumes are down. Rather than cutting prices, I recommend reducing volume or supply. The producers of champagne in France provide a good example. Global demand for champagne is down from 340 million bottles in 2008 to 270 million bottles in 2009. Instead of cutting prices, the champagne vintners left some 30 percent of the grapes on the vines. Due

to this reduction in supply, prices have not been driven down. This is definitely better than trying to fight the decreased demand for champagne with excessive price cutting. Airlines are doing the same by reducing the number of flights they operate.



Of course, concessions on the price front cannot be totally avoided. In that case, I recommend granting discounts in kind, so-called natural rebates, rather than direct price discounts. This method is better for employees, for the stability of nominal prices and ultimately for profit levels.

At the IEDC President's Forum you also spoke about the success factors that will determine the winners in the post-crisis period. Could you say a few words about the most important factors? Are they similar (universal) regardless of the type of company, sector, and/or geographic area?

Globalization will go on. It remains one of the most important trends. Therefore, taking advantage of the opportunities it affords separates the successful and less successful enterprises. This is not only a question of increasing revenue through sales in foreign markets, it is also a question of defending a company's position in its home market or region. In a global market a company has to be present and active everywhere. Companies who successfully navigate the daunting waters of globalization will belong to the winners.

We will see a massive wave of innovation, particularly in the energy sector. I wouldn't be surprised if we had totally new energy storage and

propulsion technologies within the next 20 years. And it could very well be that the Americans win this race. If they throw their R&D resources at these challenges, there is nobody who can match them. I expect that we will see totally new winners in this sector, as has already proven the case in wind power and photovoltaic technologies.

I already mentioned the emergence of a new, ultra-low price segment, coming out of emerging countries. This segment did not originate in the crisis, but its growth will be accelerated by the crisis. And even leading companies from highly industrialized countries have to participate in this segment because it's growing twice as fast as the rest of the market. Companies who excel in this segment will be winners.

In Europe as in the US, we will have as many Chinese and Indian companies as we have Japanese today. 40 years ago the Japanese presence in Europe was negligible, like the Chinese and Indian presence is today. Actually, the development will come faster than it did for the Japanese. As we speak, the first factory of a Chinese construction machinery firm is being built in Germany, an investment of 100 million Euros. Many will follow. Today hardly anyone in the West knows the names of Chinese companies. In 20 years we will know as many Chinese company names as we know Japanese names today.