EXECUTIVE INSIGHTS

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Nudge Your Way to Higher Value

I confess: it was the cover of the book that caught my eye. Bright yellow, with a single-word title: *Nudge*. In black silhouette, a mama elephant gives her baby a shove on his rump with her trunk.

What's *this* about?

The book, by Richard H. Thaler and Cass R. Sunstein, is about choices – how we make them, and how we might he helped to make better ones. It's a quietly radical proposition: If you change the "choice architecture" that people face without restricting their options unnecessarily, you can help them make better decisions. The first example that Thaler and Sunstein cite in their book involves a woman they call "Carolyn," who is the director of the food-services program of a large urban public school system. Carolyn wonders how much the purchases that her customers make is based on the presentation of their choices – their location in the larger food line, their location in their respective "columns" (belt-level, eye-level, etc.), and other factors. Through trial and error, she discovers that she can change her students' purchasing habits by as much as 25%.

The authors apply their framework to a wide range of challenges: increasing organ donations, improving school choices, saving the planet (Chapter 12), and others. Conspicuous by its absence from the book, though, is any sustained discussion of choice architecture as it applies to business. That's what I want to attempt, briefly, in this column.

Let's jump in by looking at an interesting nuts-and-bolts example: Minnesota-based Fastenal Co., Inc., which among other things is a seller of nuts and bolts. Through some 2,400 stores in the U.S., Puerto Rico, Canada, Mexico, and five additional countries in Europe and Asia, Fastenal distributes almost a million types of industrial and construction supplies, including 410,000 varieties of threaded fasteners – screws, bolts, etc – 136,000 types of tools, 251,000 varieties of cutting-tool blades and abrasives, and so on. The company's net sales in 2009 were just under $2 billion.

Many of Fastenal's customers are manufacturers based in North America, who of course have come under intense cost pressures in recent years as they have done battle with Asian competitors. As a result, Fastenal has had to scramble to reduce its own costs – and, at the same time, provide higher levels of service. The company has plenty of skilled competitors, including Barnes Distribution, Grainger, McMaster-Carr, and others. So what has Fastenal done, beyond cost-cutting, to affect the choice architecture, and make itself the "path of least resistance" among its customers?

Let's look at two answers that have "nudge" elements in them. In 2008, Fastenal began a program to upgrade its on-site vending machines, called "SmartStore", to make them more user-friendly, cost-effective, and appealing to smaller and medium-sized customers. Fastenal's "SmartStore" machines give customers 24-hour, onsite access to safety supplies, main-

Nudge Your Way to Higher Value was written by **Stuart Jackson**, Vice President of L.E.K. Consulting and author of *Where Value Hides: A New Way to Uncover Profitable Growth for Your Business* (Wiley 2007).

tenance items, and other general-purpose goods. Employees swipe their ID badges, the machine dispenses what they need, and the company is able to control and account for the materials that are consumed.

So what does Fastenal do to nudge customers in its bread-and-butter realm of threaded fasteners? For one thing, the company has developed an aggressive "keep full" program for key customers. Of course, the program varies from customer to customer, but several basic elements apply across all of the specific applications. Fastenal maintains a fleet of delivery vans that have assigned routes – these manufacturers on Tuesday, those construction companies on Wednesday, and so on. The drivers of those vans have access to the client's inventory of nuts and bolts, and can see what's running low. They make a note to bring additional inventory on their next visit (or, if the situation seems urgent, schedule a special delivery). The default, in other words, is that the bin keeps getting filled up without any action being required on the part of the customer.

At the same time, those drivers and vending-machine service people are available to answer questions and trouble-shoot for their clients. And – not insignificantly – they can ask whether there's anything else that the factory needs at the moment. More lightbulbs? A new power tool? Another case of 6" by 48" aluminum oxide sanding belts? Sure, these items are available elsewhere – competitors will gladly supply them, often with next-day shipping thrown in, and of course their web sites are just a few clicks away. But by putting a familiar and friendly face on the scene, Fastenal makes it *easy* for the decision-maker at the factory to get a handful of small aggravations off his or her plate. In the process, Fastenal becomes more firmly fixed in the mind of that decision-maker as the vendor who seems to pop up at the right time with good solutions. The approach has really paid off for Fastenal shareholders. Over the last 10 years, the company has maintained industry-leading profit margins while sales have grown at double the rate of other major industrial suppliers.

The same dynamic goes on in the consulting field, although it takes a different form. Good people in my industry are sometimes deployed for weeks, even months, at a time to a client facility. They're at that site to examine a particular challenge or opportunity on behalf of the client, but – assuming that they are, indeed, good – they wind up being a sounding-board for a variety of people at the company: "Hey, that consultant Joe is down the hall, and he seems to understand the business pretty well; let's ask him if he has any ideas." People sometimes accuse consultants of dreaming up endless projects once they have their foot in the door; in fact, it usually works the other way around. In most cases the client has more than one problem. When they go looking for a problem-solver, the "choice architecture" leads them naturally to Joe, down the hall.

Retailers have developed store layout into a science, balancing the need to provide logical product groupings that customers can navigate while linking "destination items" to complementary impulse purchases. Sometimes this leads to strange combinations – the official "Nudge" web site suggests putting pingpong balls next to beer for "beer pong." I'm not sure about that one, but when done well, thoughtful store layout leads to satisfied customers and higher-value shopping baskets for retailers.

In fact, once you start thinking in terms of the "nudge," you can see manifestations of the phenomenon in almost every industry.

What are the larger lessons? Here are five that come to mind:

- Don't always maximize efficiency at the expense of visibility. What's the opposite of "out of sight, out of mind"? That's where you want to be. Woody Allen said that *90% of life is just showing up* – an aphorism which has a special connotation, in this context.

- Make your service force serve as your "shadow" sales force. Here's how you might gain back some of the efficiency lost in my previous point. If you have a service rep on site anyway, set up systems that help that person sell additional products or services on your behalf.

- Think "easy." What's the relatively painless thing you can do to make life way easier for your customers? In 1974, the manager of the Enterprise rental car company in Orlando, Florida, came up with a good "nudge" idea: offer his customers a free ride to the rental office, thereby overcoming a key psychological hurdle in his customers' minds – and in the process, inventing Enterprise's hugely successful "We'll Pick You Up" service.

- Simplify their decision-making. This gets us back to elephants and nudges. If people have too many choices, they often wind up choosing nothing. Give your customer a great default option, and he or she is very likely to take it. Good examples are investment options or soft furnishings, where the sheer range of options can stun customers into inaction. Virgin "tracker funds" and Ikea furniture are good examples where companies have worked to overcome this.

- Use your web site as a "nudger." Be honest: how easy is it to complete a transaction on your site? Water runs downhill. If someone else makes it easier to buy a bell, book, or candle than you do online, that's where the transaction will happen. Amazon is best in class at this. Many business-to-business enterprises have a long way to go to get this right.

If the world was perfectly rational, consumers and businesses would always buy the best value product or service, through the lowest cost and most efficient channel, in just the quantity they need. Despite the best efforts of consumer guides and centralized purchasing organizations, a substantial part of purchasing behavior continues to defy this logic. If you can make your organization one of the beneficiaries of this inefficiency, you will be in a good position to out-perform your peers and deliver incremental value to your shareholders.

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For further information contact:

Boston
28 State Street
16th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago
One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles
1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York
650 Fifth Avenue
25th Floor
New York, NY 10019
Telephone: 212.582.2499
Facsimile: 212.582.8505

San Francisco
100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

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