

MIT Sloan

Management Review

Stoyan V. Sgourev and Ezra W. Zuckerman

Improving Capabilities Through Industry Peer Networks

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By sharing insights and perspectives with a group of noncompeting peers from other regions, managers can stay abreast of industry trends and combat complacency.

Stoyan V. Sgourev and Ezra W. Zuckerman

In a world of increasing globalization, companies of all sizes need to stay attuned to new developments and currents of innovation beyond their core markets. Now more than ever, managers need to be aware of the dangers of dependence on entrenched beliefs and technologies. This article highlights an intriguing way in which managers at smaller regional companies in the United States improve their ability to stay abreast of industry trends: with the help of networks of noncompeting peers from other geographic areas. We call these networks *industry peer networks* (IPNs).

While trade associations are the best-known venue for interaction among companies in the same industry, industry peer networks comprise small groups of noncompeting peers who gather regularly, in an atmosphere of significant intimacy and trust, to exchange information and discuss matters of company performance. The group members come from companies that provide similar services but operate in different regional markets and compete for different customers. Although industry peer networks have not received very much attention in the business press, thousands of U.S. companies in dozens of industries participate in them.

IPNs help members learn vicariously from the experiences of their peers and address deep-rooted problems common to many companies. These problems assume various forms, but the most important can be categorized as *myopia* and *inertia*. In a strategic context, *myopia* refers to managers' tendencies to emphasize the significance of local developments and familiar things at the expense of the global, distant and unfamiliar. This fixation on the local frequently leads managers to ignore more distant developments that are likely to be important sources of learning over the long term.¹ The inability of U.S. manufacturers to respond effectively in the 1980s to the entry of Japanese brands into the automotive, camera, copier and television markets is a prime example of how immersion in a local context may blind companies to disruptive external events.

Stoyan V. Sgourev is a postdoctoral fellow at the MIT Sloan School of Management. **Ezra W. Zuckerman** is an associate professor of strategy and international management at the MIT Sloan School of Management. Contact them at stoyan@mit.edu and ewzucker@mit.edu.

The tendencies toward myopia and inertia pose threats to companies of all kinds, but the challenges are particularly acute in industries in which competition is predominantly local.

Related to the problem of myopia is that of inertia. Employees and managers alike tend to cling to assumptions and time-tested ways of doing things, and companies grow comfortable in their familiar niches. Managers tend to give priority to knowledge and procedures that are well-mastered and controllable, rather than investing in the exploration of unfamiliar terrains. This inertia is usually accompanied by a sense of overconfidence, based on the belief that things will continue as they are. There are many instances of now-defunct companies that saw themselves as market leaders with superior products and customer loyalty, only to fall victim to wishful thinking and complacency in the face of rising competitive threats.²

As a key preventive measure against tendencies toward myopia and inertia, managers are often advised to compare their companies' capabilities systematically to those of more successful rivals.³ Yet, such comparison is no small feat. It is natural for competitors to do everything possible to prevent critical knowledge from leaking to their rivals. Because of the difficulties involved in getting a good look at the competition, learning from other companies is often less effective than desired. And even success at replicating the capabilities of well-known rivals is insufficient, because it does relatively little to reduce vulnerability to unfamiliar solutions.

The tendency toward myopia and inertia and the difficulty of learning effectively pose threats to companies of all kinds, but the challenges are particularly acute in industries in which competition is predominantly local, such as auto retailing, residential remodeling and the restaurant business. The nature of the competition in such fragmented industries reinforces managers' natural tendency to focus on the local market. It is therefore not surprising that industries of this kind have witnessed the proliferation of industry peer networks as a means of offsetting the forces of myopia and inertia. Our research explores the nature of these networks and the way they help members improve their competitiveness through opportunities for learning.

The Origins and Characteristics of Industry Peer Networks

IPNs appear to have originated in the auto retail industry in 1947. The owner of several Ford Motor Co. dealerships in the Kansas City, Missouri, area came up with the idea of convening managers from his dealerships to share information and exchange ideas with each other. Once he realized the broader appeal of the concept, he and other partners established a company to facilitate meetings

among owners of dealerships from different regions. These gatherings were called *20 Groups*, a name that reflects the use of size caps to restrict each group's membership to no more than 20 members. The company is now known as NCM Associates, Inc. and is based in Overland Park, Kansas; it remains the leading IPN in the auto retailing industry. It has consistently sought to diversify by developing IPNs in other industries.

To gauge the pervasiveness of IPNs, we carried out a broad Internet-based survey of U.S. industries. (See "About the Research," p. 35.) The survey revealed that IPNs are most widespread in the retail and service sectors; about 10% of industries in these sectors have one or more IPNs, with penetration rates varying from about 1% in industries such as residential remodeling to at least 25% in the auto retailing industry. No IPNs in manufacturing were uncovered, probably because competition in this sector tends to cross geographic lines. Examples of industries with IPNs include advertising agencies, car rental agencies, community banks, office furniture distributors and graphic arts and printing companies. Common names for these networks include share groups, peer forums and executive roundtables, but the most common term we encountered was *20 Groups*, reflecting the concept's roots in the auto retailing industry.

While IPNs vary in their practices and structure, typical key practices and characteristics include:

- **Multiple groups of noncompeting peers.** IPNs comprise multiple groups, with each group's membership capped at 20 members. A group's members come from companies of similar size, and, within a group, no two members compete in the same local market. For example, one auto retailing IPN facilitates groups of same-brand (such as Toyota, Ford) sole-dealership owners from different cities, groups of owners of multiple dealerships from various parts of the country ("megadealers") and groups designed specifically for dealership managers rather than owners.
- **Selective admission to groups.** Members exercise considerable control over group boundaries, with admission of prospective members typically requiring unanimous consent of the existing members. Prospective members have to convince the members of the group that their inclusion will benefit the group as a whole.

- **Face-to-face group meetings.** Typically, meetings among company owners and key staff members last for two to three days and are held two to four times a year. In many IPNs, members meet in a resort location and focus each meeting on a preset theme, such as a specific operational, strategic or industry issue. Sometimes the group invites an outside expert on that theme. Members typically spend the morning in discussions, in which they report on the state of their businesses, accept suggestions for improvement and describe their progress on implementing past suggestions. The afternoons and evenings are usually devoted to leisure activities; all IPNs include significant time for socializing as well as discussion. Some IPNs convene not in a resort location but in a member's hometown, and devote much of the meeting to an in-depth examination of the host member's business.
- **Detailed discussion of management issues.** Meetings involve discussions of topics such as organization design, personnel issues, marketing and sales, accounting, information systems and strategy. During group meetings, members report on the state of their businesses, accept suggestions for improvement and describe their progress on implementing past suggestions from the group.
- **Sharing of financial data.** During group meetings, confidential financial data are typically disclosed and presented in standardized formats that allow peer-to-peer benchmarking. In many IPNs, the data are compiled in a way that allows the comparison of performance averages within and across groups. This practice of disclosing confidential data is one of the most distinctive features of IPNs. The financial data are for the specific IPN's internal use only and are not to be disseminated outside the IPN.

How IPNs Help Companies Address Their Limitations

Our research shows that IPNs offer managers valuable opportunities to benchmark against similar companies, gain access to a rich pool of knowledge and obtain additional incentives to achieve high performance. IPNs help build superior capabilities by avoiding the competency traps associated with an overemphasis on local markets, past experience and existing technologies. (See "Why Companies Join an Industry Peer Network," p. 36.)

Combating Myopic Tendencies The information accessible through an IPN is critical in counteracting myopia. Participating in an IPN allows companies to enhance their capabilities on a regular basis and achieve a better sense of their market position. Mem-

About the Research

Our research collected data about the role and pervasiveness of relationships among noncompeting peers and, more specifically, industry peer networks in the U.S. economy. It has so far included (1) a survey of contractors who belong to the National Association of the Remodeling Industry; (2) a nationally representative survey of remodeling contractors; (3) a two-wave online survey of members of an IPN in residential remodeling; and (4) a cross-industry Internet-based survey of IPNs. The latter two are our most important data sources.

The Internet-based survey of U.S. industries was conducted to gauge the cross-industry variation among IPNs. We conducted a stratified random sample of four-digit Standard Industrial Classification Codes in the U.S. economy in the manufacturing, distribution, retail and services sectors. We started with 872 SIC codes, of which 49% were in manufacturing, 7.6% were in wholesale or storage and 29.1%

were in retail or services. We then took one or more random samples from each of these three sectors in proportion to the number of codes, beginning with one sample of 49 manufacturing industries, four samples of 29 retail or services industries and three samples of seven wholesale and distribution industries. For each sample, we conducted database and Internet searches and then made phone calls to trade association representatives to find out whether they sponsored IPNs or knew of consultancies or companies that did. When we found groups that resembled IPNs, we followed up with interviews with their representatives.

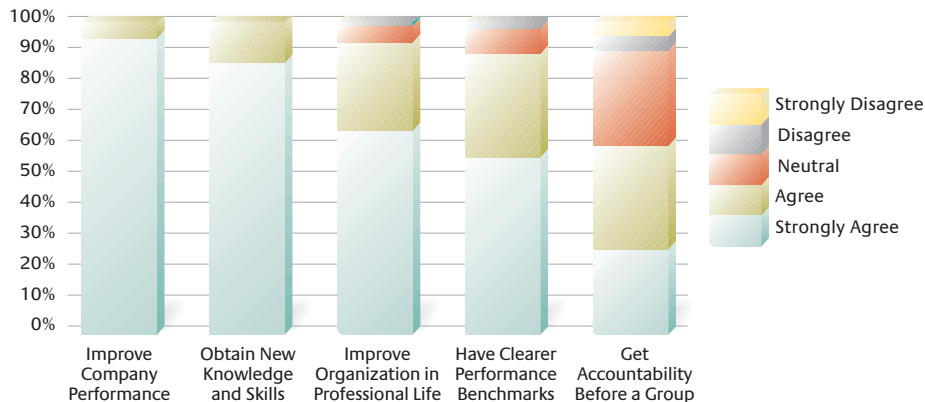
The IPN we surveyed in depth is Business Networks, Inc., a private company based in Waltherville, Oregon, which organizes "networks" of small, private, residential construction companies specializing in home remodeling or disaster restoration. As of spring 2005, there were 18 networks in Business Networks, with

10 members each on average. An annual Web-based survey of BN members was conducted in 2002 and 2003. The surveys had very high response rates (86% in 2002; 89% in 2003). The questionnaire used in both years was the same, and included questions about satisfaction with performance, the value of membership, agreement with collective norms and values and members' social contacts within and outside BN.

The fieldwork part of the project has included numerous visits to IPN meetings in residential remodeling and auto retailing. Those visits resulted in more than 50 interviews with IPN members, facilitators and CEOs. Based on these rich sources of survey and performance data, we have analyzed a number of questions, such as the reasons companies join or leave IPNs and the factors that lead to performance improvement. We have been following some of the networks included in our research for more than five years.

Why Companies Join an Industry Peer Network

In our in-depth survey of Business Networks, Inc., an industry peer network in the remodeling industry, we asked the network's members to identify reasons that were important to them when they joined. In a 2002 survey with 151 respondents (86% response rate), 100% of the respondents agreed or strongly agreed that a desire to improve company performance was an important reason for joining the network. The other two factors most frequently seen as important for joining were a desire to obtain new knowledge and skills and a desire to improve organization in one's professional life.



Members typically report that the in-depth information obtained from the IPN is unavailable through other sources such as suppliers, competitors or clients. In meetings and in informal conversations with their peers, members receive ample and, most importantly, credible information about industry trends and the performance of comparable companies in other markets. That information helps members build realistic expectations for the future and correct for misperceptions about the strength of their own performance. The access to reliable information is seen by most participants as a key aspect of IPN membership. In a survey of an IPN in remodeling, nearly all (99.3%) members acknowledged that an important reason for both joining the IPN and continuing to be a member was the desire to obtain new knowledge and skills. More specifically, 89.9% agreed that the desire to have clearer performance benchmarks was important to their decision to join an IPN. One member of an IPN in auto retailing summarized this membership benefit: "You cannot really get [the] information from other sources ... With these guys, in informal conversations and in meetings we talk frankly about what's going on in the industry."

The information received about peers is to some extent a substitute for what companies would most like to have: information on rivals. The exchange of information also helps companies achieve competitive advantage by introducing them to a wide array of business practices. Key in this regard are the "best practice" contests common in many IPNs, in which members describe an innovation they have implemented and the group votes on which idea is the most useful. For example, in one auto retailing

IPN, each dealer contributes \$20 toward a pot, and then each member presents his or her best idea to the group. A secret ballot at the end determines who wins the pot. As the CEO of this IPN explained, "We want them to present an idea that fellow members could put into practice, and make at least enough to have paid for their time away from the dealership."

Another way in which IPNs combat myopia is that their members are actively encouraged to critique one another and ask searching questions that challenge one another's assumptions. In the process, members can achieve greater clarity about why a given company is performing as it is. The formal critique process and the creation of an environment in which assumptions are actively challenged promote a deeper understanding of

cause-and-effect relationships within companies and a more effective transfer of knowledge among companies.

In addition, the extensive sharing of information helps companies maintain a big-picture orientation by keeping abreast of industry trends. One intriguing implication is that it also allows them to get a better sense of their local market position. Although the market landscape is relatively clear in some industries, many industries are too fragmented and turbulent to produce clear competition maps by which companies can orient their strategies. For example, in our research, many respondents from the remodeling industry reported that they have only a very weak sense of who their competitors are, how they operate and what their level of profitability is. This experience of the market seems to be quite common in other industries as well. The open disclosure of company-specific information in IPNs helps companies gauge industrywide margins and evaluate with greater precision how they stack up against their peers on key dimensions of performance. The sharing of information and experience also fosters greater sensitivity to the constraints imposed by suppliers and customers, offering companies insights into how to navigate more successfully the web of relationships in which they operate.

Combating Inertia One of the most important functions of IPNs is to stimulate members to make performance-enhancing changes. Many successful and innovative companies become victims of hubris, failing to sustain a competitive advantage that gradually becomes eroded by advances engineered by their rivals. Many IPN members told us that a key driving force behind their deci-

sion to join an IPN was the fear of getting caught in the trap of complacency. They acknowledged a need for a group to urge them into pursuing change more vigorously. For example, the owner of a very successful auto dealership in the Chicago area admitted that his favorable location and capable staff ensured a profitable operation and that he needed additional challenges to make him raise his company's performance level.

The motivational force of membership is embodied in members' desire to avoid inferior ranking in the group and the peer pressure to meet collective performance standards. Two processes are particularly important here: the financial rankings within groups and the mechanisms for holding members accountable for their commitments. In many IPNs that we studied, members are ranked routinely on a number of performance indicators. Members typically display a strong desire to gain recognition in the eyes of their peers through a high ranking. IPNs make consistent efforts to maintain an environment in which members are encouraged to make concrete commitments to incremental improvement and to be accountable for the fulfillment of their goals.

In part, members seek the accountability imposed by membership because they typically are owners of small private companies that do not face public scrutiny by analysts, by the media or by boards of directors. One member told us that owners are the last people to hold themselves accountable. This statement and similar sentiments expressed by others reflect a belief that too much autonomy may prevent business owners from making difficult but necessary changes because they can become set in their ways.

The importance of accountability is illustrated in our survey of the remodeling IPN. Nearly 60% of members admitted that the desire to become accountable before the group was an important reason for pursuing IPN membership. That number, however, rose to 93% when members were queried about the role of accountability in their decision to continue being a member. Members apparently come to appreciate the enhanced sense of accountability even more during the course of their membership. The role of the incentives for improvement provided by IPNs is also illustrated in the fact that three out of four members recognized that a "very important" reason for continued membership was that "one's commitment to improve the company's performance be enhanced."

Limitations of IPNs: The Pitfalls to Avoid

We do not wish to give the impression that IPNs are a panacea. In the course of our research, we have identified several factors that may limit their value. For example, one key challenge for IPNs lies in keeping their more successful, longer-tenured members engaged even when they may be learning less than newcomers. Such an imbalance threatens the vibrant exchange of ideas that supplies the knowledge gained in IPNs. One method for alleviat-

ing this problem is to help members find new groups in which they will be able to learn more. In some cases, the problem seems to be lessened by the feelings of obligation that develop due to the friendships formed in the groups.

A second set of issues confronts networks as they age. Many respondents describe a process in which members are typecast into particular roles of repeatedly stressing certain issues and voicing particular opinions. This can lead their peers to view their comments as reflecting personal prejudice rather than an objective critique. Another damaging tendency occurs when group members start to feel too close to one another to voice trenchant criticism. Finally, a process of homogenization may take place over time as a group converges on a set of practices its members think are "best," but that leaves them with a lower capacity for absorbing new ideas. Potential solutions to all these tendencies include periodic rotation of members to different groups and the assignment of new members to existing groups.

Another challenge for IPNs concerns the comparability of member companies. While IPNs are founded on the premise that a company in one region may learn a great deal from a peer in a different region, it is also possible that they will learn inappropriate lessons from one another.⁴ This danger is by no means unknown to IPN participants, and they strive to ascertain which aspects of their peers' experiences are relevant, useful and transferable.

A final challenge to IPNs is rooted, ironically, in one of the key factors for their success: the cohesion of the groups. Cohesion is the result of the establishment of many informal relationships that bind members together and forge loyalty to the group, but it also creates the preconditions for turmoil should influential, well-connected group members leave. The value that each member derives from membership depends on the degree to which others find their membership valuable. This form of interdependence, if properly channeled, can yield mutually beneficial outcomes, but it can backfire if simmering tensions in the group are not diffused in time. For example, one of the more cohesive groups in a remodeling IPN imploded in a spectacular fashion in a matter of days after dissatisfaction with a particular issue led to the departure of a few core members. Their departures triggered more departures shortly after, effectively breaking the group apart.

Other Forms of Peer Networking

IPNs are not, of course, the only type of association that brings together noncompeting companies. There are other networks that facilitate a mix of relationships within an industry, including those among noncompetitors. Trade associations are a primary example. National conventions provide opportunities for non-competitors to meet, share knowledge and compare themselves with one another, albeit to a less extensive degree than in an IPN. For example, the National Association of Wholesaler-Distributors (NAW), based in Washington, D.C., organizes conferences

that include as a main feature “discussion groups that enable [participants] to benchmark with noncompeting peers.” These groups are billed as “rare opportunities to network with noncompeting peers representing various commodity lines, enabling [participants] to solve pressing business problems.” Another example is Affiliated Distributors, a marketing group for industrial distributors that is based in King of Prussia, Pennsylvania. Each of the 350 members of Affiliated Distributors belongs to a network consisting of “approximately ten to twelve noncompeting, same industry companies ... [that] meet twice annually ... [to] share successes, challenges and best practices.”⁵

While IPNs facilitate relationships among noncompeting peers in the same industry, other organizations facilitate relationships among noncompetitors in distinct but related industries. For example, there are groups of suppliers to Toyota Motor Corp. known in Japan as *jishuken* and in the United States as plant development activity core groups. Each of these comprises five to 12 Toyota suppliers. Members of these groups visit one another’s place of business and develop social ties in an atmosphere of openness and trust that is akin to what we observed at IPNs.⁶ There are also peer networks designed to exploit the potential for learning among companies in different industries. Examples include the Executive Committee, the Alternative Board, the Young Presidents’ Organization and the Inner Circle, each of which organizes small networks of entrepreneurs or managers from different industries to discuss common business challenges. Sometimes shared membership gives rise to informal arrangements that strongly resemble IPN practices. For example, one entrepreneur created an advisory board of other entrepreneurs he met through the Young Presidents’ Organization. The advisory board meets once a month and assists him with strategic decisions. Its members collectively devise a schedule for change and ask him to make progress on each objective by the next meeting.⁷

These examples reveal that the IPN is one of a family of institutions in the U.S. economy that fosters relationships among noncompeting peers, and that there are ample opportunities to reap the benefits of such association outside the IPN context. It should be underlined that the value of peer networking is not restricted by company size or governance form. For example, while there has been significant consolidation among auto dealers in recent years, people we interviewed in our research told us that megadealers, who own multiple dealerships, are even *more* likely than the typical dealer to belong to an IPN. And note that most of the benefits of peer networking can be realized under the corporate roof as well. Business units at large corporations often become inward-looking, evaluating themselves relative to the rest of the company and tending to “play it safe” by setting goals for the unit that are relatively easy to achieve.⁸ As consistent behavior of this kind leads to poor corporate-level results, it is not surprising to find that several of the consultancies that organize

IPNs also facilitate similar meetings for subunits of large companies or franchisees in large franchise systems.

While IPNs are more widespread in industries with regionalized competition, opportunities for active exchange with noncompeting peers exist in a wide array of industries. If a manager decides to establish relationships with noncompeting peers, the decision about which network to join depends on his or her preferences with respect to industry overlap (peers from the same industry, related industries or unrelated industries), the level of financial disclosure (none to full), the frequency of meetings (twice annually to monthly) and the rank of involvement (owners, managers or division heads).

The variety of forms of peer networking we have encountered indicates that it has a broad appeal. As these forms are just beginning to attract attention from scholars, there will be a period before their performance implications are fully researched. Our research, however, indicates that many companies join them, that they do not seem to be a passing fad, and that members have a strong sense of the reasons why they join and the value they obtain. The surveys we have conducted register a very high level of satisfaction with IPN membership, a level significantly higher than for trade associations in the same industry. For example, fully 95% of the members of the remodeling IPN we surveyed were willing to endorse it to nonmembers. Naturally, performance has a lot to do with satisfaction: More than 90% of those members reported that the performance of their company was benefiting from membership. There is little we have seen so far to suggest they are wrong.

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