Gunnar Brock

Personal details

Born in 1950.

Swedish nationality.

M.Sc. degree from Stockholm School of Economics, Sweden, 1974.

Fluent in Swedish, English, German and French.

Career

1974-1992: Various positions within packaging systems company Tetra Pak.

1992-1994: President and CEO of the industrial company Alfa Laval.

1994-2000: President and CEO of the Tetra Pak Group.

2001-2002: CEO of Thule International, manufacturer of load carrier systems for cars.

Since 2002: President and CEO of the Atlas Copco Group.

Other responsibilities

Board Member of:

- *toy manufacturer Lego A/S, Denmark*
- *forest products company Stora Enso Oyj, Finland*
- *the Association of Swedish Engineering Industries.*

Member of the Royal Swedish Academy of Engineering Sciences (IVA).

About Atlas Copco

Atlas Copco is a world leading provider of industrial productivity solutions. The products and services range from compressed air and gas equipment, generators, construction and mining equipment, industrial tools and assembly systems, to related aftermarket and rental.

Headquartered in Stockholm, Sweden, the Group's global reach spans more than 150 markets. In 2005, Atlas Copco had 27,000 employees, revenues of 5.6 billion Euro, an operating profit margin of 17.8 percent, and a return on capital employed of 28.5 percent.

"Ours is not a glamorous business, but we make sure it is kept simple, innovative and profitable"

Interview with Gunnar Brock, President and CEO of Atlas Copco

Arthur D. Little: Could you describe Atlas Copco's business model for us?

Atlas Copco is a decentralised company. The operations (product development, manufacturing, sales, aftermarket, etc.) are run at the level of the divisions, of which we have about 17. These are grouped into four business areas. Both the business areas and corporate headquarters are very lean. For example, at corporate headquarters we are only 35 people.

> *"We want to be first in mind with all our stakeholder groups: our customers, employees, investors, and society at large."*

Arthur D. Little: In such a decentralised business model, what role does the CEO play?

Brock: The role of the CEO with regard to innovation is not in the details. It is to make sure that one plus one equals three. It is also about setting up the vision for the company and its businesses, and ensure they live up to it. Atlas Copco's vision is embodied in our corporate slogan "First in Mind, First in Choice". Second, the CEO sets the financial objectives, which are fairly simple: annual revenue growth of 8 percent, operating margin of 15 percent, and return on capital above cost of capital. And third, the CEO steers the businesses along what I call the performance staircase. A business must first get its processes under control and make its performance predictable. Once that is assured, it can start working on profitability, as measured by return on capital. And only after that is assured, can it focus on growth.

Arthur D. Little: How does your corporate slogan "First in Mind, First in Choice" affect the way you do business on a daily basis?

"Big white elephants can be disastrous. They consume enormous amounts of money yet are rarely successful."

Brock: What I like about our corporate slogan is that we can measure how well we live up to it, that it is inclusive of all stakeholders, and that it is uniformly applicable across all our businesses. We want to be first in mind with all our stakeholder groups: our customers, employees, investors, and society at large. We set targets for and track customer share, rather than market share. It is a direct expression of customer satisfaction. A satisfied customer buys more from us, an unsatisfied customer buys less, and it is then up to us to find out why. Customer share is more powerful than market share because it can help you to focus and steer your organisation to specific customers rather than to general market actions. We also track how much of a preferred employer we are, and how financial analysts look at us. Admittedly, measuring "first in mind" toward society at large is more difficult.

Arthur D. Little: Coming back to the role of the CEO: how do you make sure that "one plus one equals three" in innovation? Atlas Copco has no central R&D, for instance.

Brock: We do not have any central R&D - neither at corporate level, nor at business area level. Big white elephants can be disastrous. They consume enormous amounts of money yet are rarely successful. We are a product-centric company, and products get created at the division level. What we do have in every business area, however, is an R&D company that develops the central core components that are being used by more than one division.

Arthur D. Little: In what way do you then influence innovation within Atlas Copco?

"We are a product-centric company, and products get created at the division level."

Brock: The starting point is that we want and do occupy the #1 or #2 position in our different industry segments. If we don't, it is a signal for exiting the business, like we did with the electric power tool business, which accounted for 10 percent of our sales, where we were acting in the consumer goods market and occupied only #4 and competing with companies whose sales were 100 percent in that business. Furthermore, consumer and B-to-B businesses require different genes. In order to occupy the #1 position, you simply must have good products, that is products whose perceived value is better than competitors', and therefore can be priced better. My role as a CEO is to stimulate a productive R&D process that is geared for leadership positions in our chosen segments.

Arthur D. Little: How do you do that in practice?

"The worst thing to happen is a customer telling you that your service people don't understand your new products."

Brock: You have to measure. Atlas Copco is a process-driven company, and we have a system for innovation. At my level, we use a few simple metrics. First we measure the gross margin on new products. At the end of the day, that's the only thing shareholders are interested in. Linked to gross margin is the percentage of sales that is generated by products less than 3 or 6 years old. You can always argue - and my managers do, of course - about the definition of what a "new product" is compared to a product extension. But the important thing is to trigger a discussion about the need for a renewal of the product portfolio.

Arthur D. Little: What other metrics do you use?

Brock: The key metric we use is relative market share: our market share against that of the #2. By tracking relative market share and profitability across divisions and over time, we have found there is a strong correlation between the two. That is why we orient our product development activity toward projects that will lead to an increase in relative market share.

Arthur D. Little: Gross margin and market share are lagging indicators. How do you steer the innovation process pro-actively?

Brock: We put a lot of emphasis on what managers do to make sure the products do not only get developed but also sold. The process that comes after the physical development process is as important. You have to take care of the launch process, and train the sales force and the after-market people. The worst thing to happen is a customer telling you that your service people don't understand your new products. So you have to bring your marketing and sales people and after market organisation into the physical development process.

Arthur D. Little: How important is innovation in your aftermarket business?

Brock: Our innovation efforts are geared at getting more knowledge into our products, such as software content. It makes it harder for competitors to imitate us. It also helps us secure the aftermarket business. The product development process for equipment is well known and understood but it is much harder to apply this within the aftermarket.

Arthur D. Little: How differently do you run the capital equipment and the aftermarket businesses?

"A good aftermarket business is the best insurance policy for your next product generation. In most companies, money is not the problem. Processes and people, these are the bottlenecks."

Brock: Our aftermarket business is a business in its own right, with its own P&L. It is not considered a support to the capital equipment business, for several reasons. First, if you combine the P&Ls, there is always a tendency for the capital equipment business to give away the product for free, with the false argument that we will recover the lost margin through lifetime revenues. Likewise, we want the aftermarket business to be a high performer. You know, life is pretty simple. If you have a good product, your customers are happy. And if your aftermarket service is good, your customers come to love you. If you have a good aftermarket business, you can afford the occasional hiccup in your product. Aftermarket is also a great way to get to know your customers' business and problems intimately. To put it differently: a good aftermarket business is the best insurance policy for your next product generation. The third and maybe most important reason for treating the aftermarket as a separate business is that it helps improve its status internally. The aftermarket people are the real heroes of the company, but it is a business that is a bit looked down upon by the colleagues in the products business.

Arthur D. Little: As you mentioned before, Atlas Copco is a process-oriented company. Can innovation be organised into a process?

Brock: You know, in most companies, money is not the problem. Processes and people, these are the bottlenecks. There is an over-belief in that money can solve a problem. It is indeed tempting to hire more people to boost a development project, or to outsource activities. But having more people also raises the complexity and management difficulties of your project.

Arthur D. Little: Talking about outsourcing: how do you involve suppliers in the development process?

Brock: Generally, we are very mindful of making any cost variable that can be made variable. That allowed us to increase our EBIT even during the difficult economic times in 2001-2003. But in product development, we should do more of it. As in most companies with a proud culture, we are not good enough at utilising our suppliers for product development as well as we should. The same thing is true for working with customers. We need a change in mentality, and get rid of concerns such as “but this supplier also supplies to our competitors...”, “but the customer may get to know our cost structure...”, “but we risk divulging company secrets ...”, etc.

Arthur D. Little: How much latitude do you as a CEO give to your managers to pursue also longer-term radical innovations?

"Incremental innovations pay for the mistakes with breakthroughs. They carry much less risk, cost much less money, are quicker to market, and are easier to handle."

Brock: You may be surprised, but we are not putting undue stress on the organisation to come up with radical innovations. It would be dangerous if we created the impression among our managers that the CEO doesn't care about the bread and butter of the business. At the end of the day, you live off your incremental innovations. They give you the luxury to spend money on initiatives that once in a while may - or may not - result in breakthroughs. Incremental innovations pay for the mistakes with breakthroughs. They carry much less risk, cost much less money, are quicker to market, and are easier to handle. Incremental innovation may not be glamorous but it makes money. Radical innovations are important but there must be a balance.

Arthur D. Little: How do you manage the risk that the multitude of incrementally different products leads to excessive and costly business complexity?

Brock: Adding incremental innovations does not necessarily lead to more complexity. Above all, you have to kill off old products. Old products cost money, such as for knowledge, manuals and spare parts. Killing old products must be a systematic process. Lifecycle planning is a crucial competence. Furthermore, we are extremely focused on standardised products, including for the aftermarket business. We make very little tailor-made solutions. Standardised products are the key to profitability and less complexity.

Arthur D. Little: Isn't product customisation a way to make good money then?

Brock: Either you are a manufacturer of standardised products or an engineering company. Very few companies can profitably be both. We made the strategic choice to be the former. Of course, it means you must have discipline and accept to lose certain customers. To show you how serious we are about this: if we study an acquisition target, we always look at the percentage of bespoke products in their portfolio. If it is too high, we don't pursue it. This being said, we do a bit of engineered products because it is a way to get a better understanding of our customers' applications and environment. But we keep it limited to about 10 percent of our sales.

Arthur D. Little: But how do you tailor your products to local demands, say in China?

Brock: For us there are no local demands. Our product is basically the same in Germany, Argentina, the US or China. We have the luxury of being able to say to our customers: our standard product is suitable for you worldwide as their processes are very much the same all over the world. And our customers appreciate that. They too are global and care about standardisation. Our business model is globally standardised.

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Arthur D. Little: To what extent does Atlas Copco see opportunities for conducting development activities in economies such as China's or India's?

Brock: We have manufacturing activities in China, but no product development. Maybe we will need to do that in the future, but not today. There is indeed a huge reservoir of engineering graduates in China, but quality is as important as volume. What we do is localisation, that is replacing certain components by locally produced ones, yet without changing the specs. In other words, and in line with our standardised products strategy, there is no adaptation of the product to the local market. India is a different story. There we have an R&D hub for compressor technology. They do calculations and testing, in liaison with the division headquarters in Belgium, on a 3 shift basis.

“We like to help a customer improve his total energy efficiency or productivity, rather than just sell compressed air. We are innovation leaders, and want to get paid for it.”

Arthur D. Little: A number of traditional product companies are exploring innovative revenue models. For example, instead of selling a product for a fixed price, they charge by unit of consumption. What is Atlas Copco's stance on that?

Brock: To a major car company, we sell tools used in making safety-critical joints in a car. The quality of each joint is controlled in real-time. This customer doesn't pay us when he purchases the tools from us, but for each car that comes off the assembly line. In a similar way, we have mining customers that we charge per drill-meter, which allows us also in addition to drilling machines and loaders to supply the drilling head, which is a consumable. We also have industrial gas customers that we charge for compressed “air over the fence”, i.e. per cubic meter supplied. Generally, we tend to be prudent with these kinds of set-up. First of all, it is more difficult to agree on a fair price and risk sharing arrangement. But more importantly, you cannot really get paid for innovation. We like to help a customer improve his total energy efficiency or productivity, rather than just sell compressed air. We are innovation leaders, and want to get paid for it.

Arthur D. Little: How important is it to be an innovation leader rather than a fast-follower?

Brock: Leadership means that you yourself make your current product generation obsolete even before your competitor has reached the level of your current generation. We have amply proven to be capable of doing that. You may also agree with me that it is mentally difficult to condition your company for being a follower, even if it is a fast one. It is important to feel the pride of being a leader.

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Arthur D. Little: Does the world also see Atlas Copco as an innovation leader?

Brock: We are not in a glamorous business. Contrary to what happens when a new truck or mobile telephone set hits the market, the world doesn't get excited because we launch a new compressor, hydraulic breaker or an assembly tool. But we make sure our customers do. We may not to the general outside world have a high innovation image, but we do innovate a lot - and make good money.

Arthur D. Little: In your career, you have worked first at a family-owned company (TetraPak), then at a company owned by a private equity investor (Thule), and now at a listed company. Does ownership affect the way innovation is managed?

Brock: Company ownership per se is not really an issue. At a family-owned company, what counts is the attitude of the owner towards innovation. At a listed company, if you perform reasonably well, you have no limitation on doing what you want to do in innovation. When the company is owned by a private equity investor, the game may be different. As the investor has a short time horizon till exit, there is always the temptation to cut R&D. The last thing I want to cut is R&D: it is the easiest to cut, but it is the smallest in absolute money terms, while being the biggest lever for improved performance.

Arthur D. Little: Under your leadership, Atlas Copco has achieved stellar financial performance. What is the source of the company's high profitability?

Brock: Our high margins are linked to four factors. First, we have products customers want to pay a good price for. We spend a lot of money on R&D and innovation - in many of our businesses 2 to 3 times more than competitors. Second, we have the lowest cost production. Third, we have a big aftermarket business. And fourth, we are globally present. As I said before, ours is not a glamorous business, but we make sure it is kept simple, innovative and profitable.

Interview conducted by Jan Beckeman (Director in the Stockholm office), Per M. Nilsson (Director in the Gothenburg office) and Herman Vantrappen (Director in the Brussels office and Chair of the Prism Board).