The Rise and Fall of People Express: A Dynamic Resource-Based View

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Abstract

The People Express case (Whitestone 1983) and simulator Sterman (1988) have been widely used to introduce the pitfalls of fast growth strategy. In real life People Express airline was a fascinating case. The company grew from obscurity to industry prominence in a period of only five years against powerful rivals. Dramatic growth was followed by equally dramatic demise.

The reason for the company's rise and fall is usually explained as a variant of the growth and underinvestment syndrome. Service capacity failed to keep pace with the growth of flights and passengers and so, ultimately, the service reputation of the business was destroyed. At first glance this argument seems compelling. But it fails to explain why, in real life, a company could have made such a fundamental strategic error without realising it.

The paper outlines a method for analysing the rise and fall of People Express in steps that reveal the dynamic complexity of the business.   The approach builds on two influential sets of ideas taken from the strategy field and unites them with conventional system dynamics: 1. the so-called resource-based view of the firm; and 2. the dominant logic of the firm. The first step in applying this "dynamic resource-based view" is to identify the tangible and intangible resources of the fledgling airline, such as planes and service reputation. The second step is to examine the dominant logic of the policies that control the expansion of resources. A combination of partial and whole model simulations then reveals why the dominant logic remains unchanged as the firm loses and destroys its competitive advantage.

The paper ends by outlining some exciting areas for future research that may be amenable to a dynamic resource-based view of the firm.

People Express: Growth and Underinvestment, But Why?

In *The Fifth Discipline* Senge 1990 outlines a theory of what happened at People Express that builds on the growth and underinvestment archetype (chapter 8, pages 130-135). At the heart of the theory is underinvestment in service capacity. Moreover (and most important for such a theory) is the proposition that underinvestment was very difficult for managers at People Express to discern at the time the company's spectacular growth was taking place. Investment in service capacity is driven by a 'perceived need to improve service quality' and fails to keep pace with the growth of passengers. But why? Senge hints at two reasons (each informed by feedback thinking and the chosen archetype): 1. service capacity (controlled by a balancing loop) did not keep pace with the growth of planes (controlled by a powerful re-inforcing loop); and 2. (implicitly) this imbalance was masked by tremendous growth in headcount which did not fully translate into corresponding growth in service capacity. Nevertheless one is left wondering why the company persisted in its aggressive fleet expansion and why (in its hiring policy) the company did not appreciate that headcount and service capacity are fundamentally different.

To examine these anomalies we turn to two sets of ideas from the strategy literature. The first is the so-called resource based view of the firm which explains differences in firms' performance and competitive position in terms of endowments of critical productive assets or resources (Barney 1991, Foss et al 1995). In particular we draw on a dynamic view of resource accumulation developed by Dierickx and Cool 1989 which makes the same distinction between stocks and flows (or levels and rates) as found in system dynamics. The second idea is the notion of dominant logic which provides a cognitive/behavioural explanation for different managerial styles of resource management (originally introduced into the strategy literature by Prahalad and Bettis 1986 as a way of explaining differences of performance in diversified firms). Dominant logic is very similar to policy logic in system dynamics (Morecroft 1985 and 1994).

Resource Accumulation - the Time Dimension of Strategy

Figure 1 below will come as no surprise to system dynamicists. It is the familiar bathtub image of levels and rates. Here the image is being used to depict the accumulation of a strategic asset stock as the result of an inflow of strategic expenditures and an outflow of depreciation. This icon of stock accumulation is a key part of Dierickx and Cool's contribution to the resource-based strategy literature. In a nutshell they are saying that in order to understand resource endowments (and therefore competitive advantage) one has to understand the process of resource accumulation. "A key dimension of strategy is the task of *making appropriate choices* about strategic expenditures with a view to accumulating required resources and skills". At People Express strategic asset stocks (or resources) include tangibles such as the fleet, staff and customers as well as intangibles such as service reputation and staff morale. The success (and sustainability) of People Express' competitive strategy then depends on the balance of resources achieved in relation to competitors.

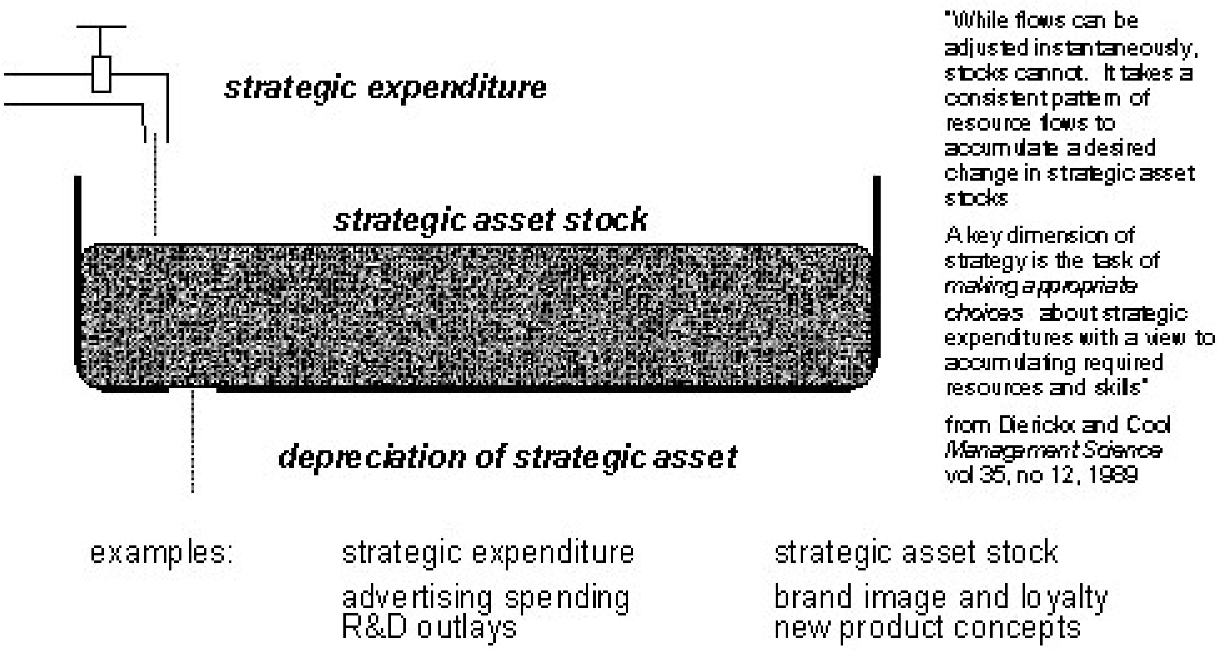

Figure 1: Visualising the Accumulation of Resources, First Step Toward a Dynamic Resource-Based View of Strategy

Resource Management and Dominant Logic: a Framework for Understanding Dynamic Complexity at the Level of Resources and Policies

Dierickx and Cool's ideas have been important in the strategy literature because they directed attention away from static endowments of resources toward the dynamics of resource accumulation. However, their thinking about flows is framed in terms of strategic expenditures and does not adequately deal with the managerial logic that drives resource management. In People Express we really want to know *why* the fleet of planes grew at the rate it did, and *why* service capacity failed to keep pace with the growth of either planes or staff (headcount). Once we can understand the logic driving resource accumulation then it should be possible to explain how competitive advantage turned (invisibly) to disadvantage.

Resource management fits naturally with resource accumulation in system dynamics. Figure 2 shows an operating policy for resource management overlaid on a generic resource accumulation process involving both a fully productive resource and a resource in development. The resulting stock and flow network is familiar to all system dynamicists. The policy governing corrective action contains information feedback and goal adjustment that encapsulates the dominant logic of resource management (Forrester 1961 chapter 10, Morecroft 1994, Sterman 1989). The terminology of the diagram needs no further explanation (at least for ISDC 97 readers). Its power (for dynamic theories of strategy) lies in its ability to represent both resource accumulation (Warren 1997) and dominant logic. When these two powerful ideas from the strategy literature are united through the discipline of system dynamics and brought to life with simulation, a versatile framework then exists to develop and test dynamic theories of resource accumulation - including cases such as People Express where initial success turns inadvertently into failure.

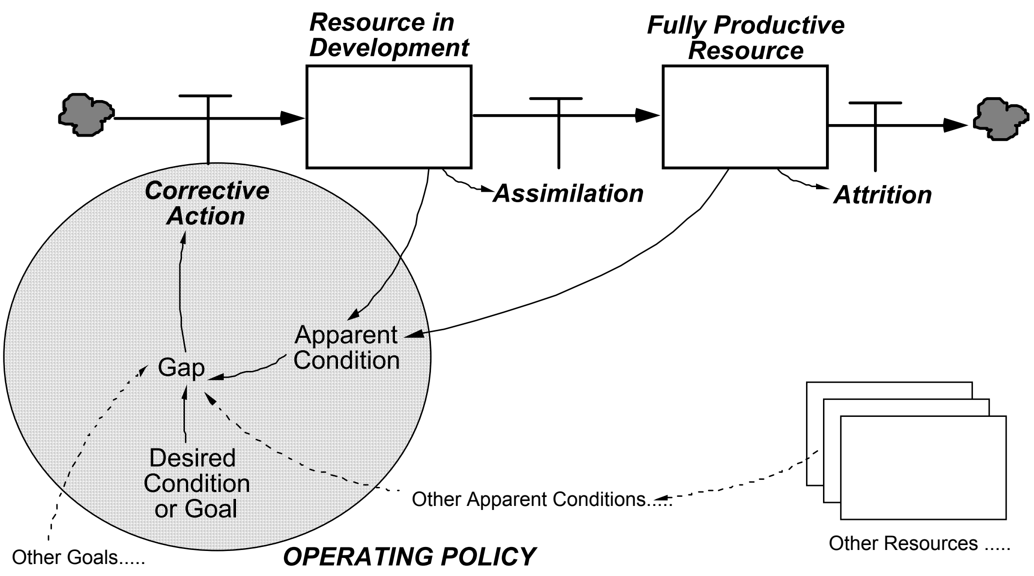

Figure 2: Operating Policy for Resource Management - Goals and Information Feedback

Applying the Framework to People Express

The first step in a dynamic resource-based analysis is to classify resources into tangible-intangible and managed-unmanaged. For People Express the relevant information is in the case and it is a matter of (modelling) judgement which of the many listed resources to include. Obvious tangibles are planes, staff and passengers. Intangibles include service reputation and staff morale. The classification into managed and unmanaged resources is quite subtle, but it is vital because it is often unmanaged resources (usually invisible at the operating level, and often intangible) that are the undoing of an otherwise successful strategy of resource accumulation. Figure 2 above provides some clues of what to look for in making the managed-unmanaged classification. For a typical managed resource there is usually a clear desired condition or goal. The apparent condition of the resource is often measurable. As a result the gap that drives corrective action is objective and beyond dispute and the managerial feedback control process is purposive and goal-directed. A simple and familiar example would be a production policy that manages factory inventory to a strict goal. If all resources in a firm were managed with such ideal clarity (and if all underlying goals were not only clear but also internally consistent) then an effective resource strategy should emerge. However, in many cases key resources are not well-managed, or not managed at all. There are many small hints and clues to isolating unmanaged resources in practical situations. Often the resources are intangible or soft, so that it is difficult to discern the apparent resource condition. The desired condition or goal may itself not be clear or appropriate. The resource in development may be invisible. In the case of People Express unmanaged resources include potential passengers, service reputation and staff motivation.

A rough classification of resources leads to the second step of analysing dominant logic. This phase of analysis is demanding but also interesting because it reveals the managerial rationale for the firm's continuing resource accumulation strategy. Let's start with the tangible resources at People Express. What is the dominant logic of fleet expansion? Such strategic investment decisions could be governed by funding constraints, market share goals, return criteria, demand forecasts, or staffing constraints. The dominant logic at People Express however appears (between the lines of the case and video) to be CEO Don Burr's ambitious personal growth target, stemming from his vision of industry revolution embodied in the precepts of the company. Clearly such logic is both powerful and persistent. The imposition of Burr's dominant logic leads to reinforcing feedback in the resource stock of planes.

The dominant logic of staff expansion is quite different. From the case one gathers the impression of a Human Resource VP insistent on high-quality recruits, carefully filtered (with input from the top management team) and trained on the job. The imposition of this dominant logic leads to reinforcing feedback in which the resource stock of experienced staff is the principal determinant of hiring.

The dominant logic of passenger growth is also noteworthy at People Express. Customers are a vital resource stock for all companies. Some companies explicitly manage customers: by setting sales targets; tracking customers in huge databases; and implementing marketing programmes to eliminate any gaps relative to goal. Other companies don't really actively manage the customer base, but instead allow it to evolve from advertising, word-of-mouth and churn. People Express seems to have adopted an ambitious but essentially unmanaged approach to growth of customers. Deep price discounts coupled to targeted advertising unleashed a powerful word-of mouth effect that caused a very rapid build-up of potential passengers (those fliers willing to try People

Express should the opportunity arise). The imposition of this dominant logic embodies reinforcing feedback characteristic of word-of-mouth.

The resulting tangible resource system contains three reinforcing feedback loops, each a compelling engine of growth, but each operating seemingly independently to produce autonomous expansion of planes, staff and passengers. Partial model simulations reveal the power of these growth engines to underpin the kind of spectacular growth achieved by the People Express in reality.

Resource System and Baffling Growth Dynamics

The third step of the dynamic resource-based analysis looks to the behaviour of the intangibles (service reputation and motivation) to explain the demise of People Express and (more importantly) the invisibility of the company's mounting resource problems. From the case it appears that neither service reputation nor staff motivation is managed. This observation is no surprise when one considers that almost all the requirements for active resource management (in figure 2) are absent: operating goals are not clearly defined; and the apparent condition of the resource stocks is unknown (how to do get inside the mind of the customer to measure service reputation, or into the emotions of staff to discern motivation?). So reputation and motivation just evolve from operating conditions. Motivation responds to a range of dynamic factors such as company growth rate and profitability and then goes on to influence staff productivity. Reputation responds (with a time lag) to the balance of flying passengers and service capacity, while service capacity itself is a complex dynamic mix of the number and blend of experienced and newly-hired staff as well as staff productivity.

When the three tangible engines of growth are out of step (and it would only be an accident if they were exactly co-ordinated, since their dominant logic is so different), then problems begin to accumulate in the intangibles. No management action is taken to fix these problems because: 1. the unmanaged intangibles provide only weak signals to rest of the organisation of latent growth stresses; and 2. the powerful dominant logic governing tangibles is insensitive to such weak signals. This seeming paralysis in the face of impending doom is symptomatic of management under conditions of dynamic complexity

As figure 3 shows, service reputation declines steadily for the first six years in an 8-year simulation of People's growth strategy (the apparent recovery in the last two years results from an unintended abundance of staff as disillusioned passengers switch to competing airlines). Motivation (though invisible and beyond direct management) remains both steady and high for the first six years, underpinning People's competitive cost advantage. But as the customer base saturates and then collapses, the excitement and profit-lure of a fast-growth enterprise evaporates. Employees are demoralised. Planes fly half-empty. The company dies with a configuration of resources (both tangible and intangible) that is markedly inferior to its major competitors. There is no commercially viable route of recovery from this resource trap.

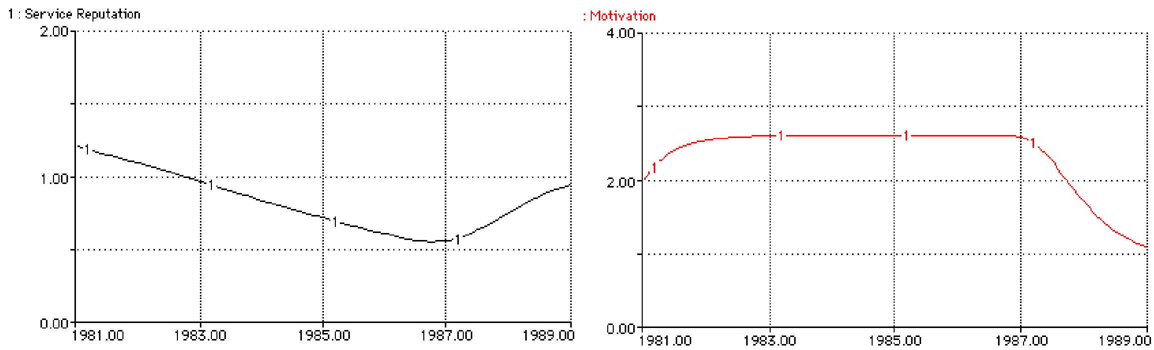

Figure 3: Time Behaviour Charts of Intangible Resources: Service Reputation and Staff Motivation

Implications of a Dynamic Resource-Based View of the Firm

The paper presents a dynamic resource-based view of the rise and fall of People Express. At the heart of this view is a synthesis of two powerful and influential sets of ideas from the strategy field: 1. resource accumulation as a way of understanding firms' resource endowments and enduring differences in firms' strategy and performance; and 2. dominant logic as a way of understanding firm-specific traits of resource management as they affect firm performance.

System dynamics is a natural way to unite these ideas. Stocks and flows portray resource accumulation, while information feedback and policies embody dominant logic. The stock/flow and policy framework provides a versatile means of visualising firms' resource systems and (through simulation) for understanding the dynamics of strategy as it arises from underlying resource management policies.

The framework throws-up new vocabulary and concepts for analysing strategy and business dynamics. Firms are viewed as resource systems. Resources can be classified into tangible-intangible and managed-unmanaged. Patterns of resource accumulation (both effective and ineffective) result from firms' dominant policy logic for managing resources. Strategies (like People Express) where failure follows dramatic success can be explained in terms of flawed dominant logic for managed resources (operating goals and feedback information that is inadvertently at odds with overall strategy), along with unintended accumulations of invisible or unmanaged resources that interact with managed resources in unexpected (and usually detrimental) ways.

The framework has the potential to be applied in any areas where the ideas of the original (quasi-static) resource-based view and/or dominant logic have taken root. This potential is particularly exciting for those working in system dynamics, because the resource and dominant logic 'paradigms' are to be found at the heart of mainstream strategy in areas such as competitive strategy, diversification, corporate portfolio management (joint ventures and acquisitions), and international strategy (geographical diversification). Until now, most firm-related system dynamics has (like People Express) focussed on single businesses. A dynamic resource-based view opens the door to the intriguing and dynamically complex world of the multi-business firm with the possibility of model-based contributions to the dynamics of diversification, transformation and internationalisation.

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