

R.R. Donnelley & Sons: Digital Division

MBA 625: Strategy in Action

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Problem Definition

Donnelley's Design Division (DD) finds itself at a pivotal crossroad. The directions and course of action taken over the next few months will make the difference between success and prosperity of the division and unprofitability and failure. The ideal situation for DD is to become embraced by the business groups which would help leverage internal business as well as win new business with external customers. Digital has a chance to be at the foundation of a new competitive advantage for Donnelley which will likely prove critical for long-term success given the quickly approaching Digital Era which is bound to have severe impact on the traditional commercial printing industry.

With Janet Clark and Barb Schetter heading the division within the Information Services Group (ISG), DD finds itself in a better and much more structured environment than when the division was first established. The new technology development process enabled DD to be grandfathered into Phase III. The main issue at hand is there are many misalignments that still need to be dealt with. A current challenge for DD is attaining buy-in from groups and divisions within the organization. One of the first steps to help bring the DD to profitability is by winning the growing digital business of the Books Group. This win is imperative for DD in order to demonstrate its potential value not only internally but also to customers' bottom line. DD needs to find a way to be seen not just a technology looking for a market but as a platform that is going to bring organization into a new era where Donnelley can continue its leadership position and aggressive growth plan.

Market Analysis

In 1995 the commercial printing industry seems to be getting pulled in two different directions, Traditional vs. Digital. Traditional printing which involves high capital investment in machinery tends to revolve around long production runs. The second new and growing sector is digital technology which is making big strides in automating the industry. The 1995 projected growth forecasts for the two are 3% and 16% respectively. Industry trends are moving increasingly towards "Mass Customization" which focuses on local, targeted communications – shorter runs, more versions, simultaneous global distribution and ability to revise material quickly.

Digital technology is a disruptive technology that will have a profound impact on the industry as a whole. It has been stated that "Digital technology will atomize the printing industry the way the microprocessor did the computer industry". Some of the technological developments include; filmless printing technologies' and digital four-color. In addition to shifting the landscape on how business will be done in the future digital technology has also had a profound effect of the barriers of entry for competitors. Less capital investment is needed than historically required for traditional printing. Alliances among smaller printer companies and even multiparty agreements with firms that have high-capacity

networks for transmitting files are becoming more common. This is having a market impact where smaller players are able to gain a further reach in the industry than historically possible.

Rising postal rates and paper prices matched with increased inventory, warehousing, and shipping costs is a trend that has been noted as increasing costs faced by customers. This has led to a further push in the industry to develop alternative, electronic media and new channels for distribution.

A Look at Donnelley

R.R. Donnelley & Sons is printing giant with revenues of \$49B. They are considered the world's largest commercial printer company, with 41,000 employees in 22 countries. Donnelley is larger than its next 9 rivals combined. As an organization Donnelley is in excellent financial health. Over the last 10 years; Net sales, Operating Cash Flow and Earnings from Operations have all more than doubled. ROE is 14.1% which is good but ROA is 6.03% and ROS is only 5.49% because of high capital investment needed for Heavy Iron.

Donnelley has a divisional structure and is organised into:

- 3 Sectors (Commercial Print, Network Services & Information Resources)
- 8 Business Groups (Catalogs, Retailers, Magazines, Telephone Directories, Software/Hardware, Books, Financial & Metromail)
- 38 Divisions (highly autonomous division managers responsible for multiple plants)

Historically Donnelley's business and much of its success has been tied to economies of scale which it generates from producing long printing runs (low variable costs) on "heavy Iron", which consists of gravure and offset/web presses. Manufacturing and sales have always been core functions and strengths of the organization. Donnelley is still generating more than 60% of its revenues from directories, catalogs/retailers, and magazines. An important observation is that digital print is rapidly growing to retail, which is currently a huge revenue stream for traditional printing at Donnelley.

The strategy that Donnelley has had in place for a long time revolves around securing multi-year "enabling contracts" and then building plants specifically to meet new clients' demands/needs. According to Allen Cubell this gives "an emergent strategy based on opportunities", as opposed to selecting the right opportunity based on a strategic assessment of alternatives". Therefore it begs the question, although this technique has been successful in the past is it the right one moving forward into the Digital Era.

Traditional Competencies at Donnelley:

- Competitive advantage derived from the scale economies associated with heavy iron
- Salesforce of 500+ employees – often described as the company's greatest strengths
- Long-term relationships with customers, key to its commercial printing business.

Competencies that Donnelley brings to digital printing (information architecture):

- Scale advantages

- Ability to negotiate volume discounts
- Efficiencies in using sophisticated production control systems
- Advantages in manufacturing (somewhat transferable to digital)

Division level (Digital Division):

There is definitely a market for the division, though something that is currently being struggled with is how to properly introduce it to customers internally and externally. A critical variable that is essential for the success of DD is the creation of an information architecture to leverage the digital presses. This has essentially already been put in place with the creation of the Memphis plant. The division seems to have the right staff in place to help move the division forward. Janet Clark & Barb Schetter are aligned on the vision of the division and what they are trying to accomplish. Where they are struggling is on the tactics – finding convincing arguments and the right set of incentives.

Group & sector level:

Rory Cowan was one of the first people in the organization who saw the importance of digital technologies and the impact that it would have on Donnelly's traditional business. His strategy was to build the new business in parallel with the old rather than directly challenge the traditional organization. Bart Faber is the head of the Information Service Group (ISG) and essentially the one responsible for DD. Though both Cowan and Faber have an open ear and interest in DD, it is performance that speaks louder than words. The real challenge for DD is they are not embraced by the rest of the organization, and this is seen currently as one of DD's largest obstacles to success. This challenge stems from the fact that by June 95 many groups and division managers had yet to sign-on to the strategic potential of digital technology or accept the Digital Division as the most appropriate locale for the business. Division managers were highly autonomous and often focused on what benefited their division in the short-term – therefore often not seeing the immediate value of DD. Making things even more challenging is ISG as a whole has a hard time getting their work into non-ISG plants.

Organization level – Top management & Company Strategy:

Donnelley has always put customer focus at its core, but given the organizational structure and the introduction of digital technology divisions are pushing on customers what in turn benefits their division's profits as opposed to what best caters to the customer. This is taking the organization away from one of their key success factors and core focus. The company strategy and vision as a whole has not been revisited to integrate digital technology as a pillar to its success in the future. There seems to be a wait and see from the management committee. This behaviour has cascaded over the sectors and business groups. To make matters worse business group presidents and sales managers will not encourage their people to spend time selling the services of the DD because profits will accrue to another group. This is a

fundamental fault of the current incentive structure, it leads to goal incongruence – where a decision that is in the managers best interest is not aligned or in the best interest of the organization as a whole. While Donnelley is often one of the first with new technologies, they rarely capitalize on the full market potential. This is extremely dangerous for the company as the industry is moving into the Digital Era. Though the technology development process has been put in place and added much needed structure, it is not enough to ensure the adaption of digital technology across the company.

Misalignments

Structure: ❌

Current company structure is misaligned to the needs of DD, it in fact inhibits DD as oppose to enabling it to grow. There is a divisional organizational structure with highly autonomous division managers who can choose the printing jobs they want to run and the equipment they want to buy. There is not adequate communication or cooperation between sectors. Division and business group managers are focused on maximising the profits for their division/group as opposed to maximizing the profits for the company.

People: ✅

People within DD are aligned and have a clear vision of what they are working towards. The right people are in place. With the onboarding of Janet Clark it really rounded out the division and filled in any gaps that Bard Schetter might have been missing. What they need is support from top management in order to encourage buy-in from the rest of the company.

Processes: 🟡

A big process improvement was the implementation of the Four Phase Review process for technology development. This helped provide structure and direct funds to the projects that show the best return for the company. Given the technology is rather new in DD and more specifically the Memphis plant there are no best practices or processes in place for how to best utilize the technology and push it throughout the organization.

Incentives: ❌

In the commercial printing sector incentives became sectorwide in 1993, which was a large improvement and helped with goal congruence in that sector. Unfortunately this did not rectify the misalignment of incentives between sectors/groups outside of commercial printing sector. DD therefore still suffered greatly since managers encouraged their sales forces to sell and increase capacity utilization in their division plants. Clark has proposed but not implemented¹ an aggressive commission plan to motivate other groups' reps to sell work into Memphis.

¹ Making an assumption that the aggressive commission structure has not yet been implemented since it was stated as "had proposed" and there is no information on the impact the new structure has had on the division or the Memphis plant

Leadership: ✘

Leadership and the management committee have not cascaded down the message that digital technology is a strategic initiative for Donnelley. In fact they have not done anything to encourage business groups or other divisions to embrace the new technology. Rory Cowan and Bart Faber within the Information Resources Sector seem to be favorable to DD but that is where the buy-in seems to stop.

Culture: ✘

Company culture is still very much catered to the old way of doing things. It is more in-line with Heavy Iron as opposed to digital technology. ISG has a different culture and selling style from the rest of the company. Inside the division it seems to work but it doesn't align well to the company culture as a whole.

Alternatives

Given the current structure and incentives in place, Donnelley as a company is not prepared to take the company into the Digital Era. Moving forward there are several alternatives available to the company in order to improve their current situation – Pro's and Con's for each alternative can be found in Exhibit 1. In order to evaluate the alternatives the following decision criteria has been used:

- Digital being embraced by the rest of the organization
- Digital becoming a competitive advantage for Donnelley
- Attaining the digital business of the Book Publishing Services group
- Impact on the long-term success of Donnelley
- Cost / Risk of the alternative

Alternative 1 – Status Quo

Donnelley is an organization focused on results they should not treat DD as an exception. If DD cannot become profitable on its own then perhaps it is not a division they need. On the same token if left to their own merit and they are able to prove digital technology is profitable then the company as a whole can look at adapting it more widely. The Digital Division has made many strides to get to where they are today, the best decision is to wait and see. The big breadwinner in the company continues to be traditional printing therefore that is where the largest focus for Donnelley should be.

Alternative 2 - Digital Expansion

With the Memphis plant up and running, the company's best course of action is to invest in additional print-on-demand (POD) sites. DD represents a completely new model from traditional printing and the incremental approach to investment is unlikely to succeed. They really need to leverage first movers advantage and get as many POD sites established as possible, this will give the company a stronghold on the growing digital market. The focus should be on the development of robust capability and efficiency of their growing information infrastructure. Building synergies across PODs derived from the software tools; Target-IT, Send-IT and Order-IT.

Alternative 3 – Realign Vision Placing Digital Technology as a Core Strategic Initiative

Digital Technology will be restructured as cross-sector business unit (see Exhibit 2). Digital will be treated as a cost center internally and a profit center externally. Although it will be treated as a cost center internally it will be measured and rewarded on business and revenue driven internally from Digital as well as P&L from external customers. There can now be a true partnership between Digital and the different sectors. Focus can return to best serving client's needs as opposed to focusing only on individual divisions/groups profits. Digital needs to be seen as an essential competency for all sectors and that is why being its own division or even its own sector is not viable in the long-run. In order for this alternative to be successful there needs to be a realignment of the company vision and strategy. There must be a companywide roll-out plan, with top down management support. Digital should be considered an important strategic initiative and communicated across the organization on why this change is necessary for long-term success. When it comes to Digital, location is not the most important factor, as it often is with Traditional print. Take the Memphis plant as an example it can be outsourced business from the three sectors and 8 business groups without disrupting the client relationships in place. To do this there will be cross functional teams created across the business groups to help cater the digital service offering to satisfy customers' needs. At the beginning there will be a lot of educating customers on what exactly those needs are and how they will benefit in the short and long-term from digital technology. The important thing here is the current sectors and groups will not feel they are losing their business to a new division and will be more open to working with digital technology. A perfect example is Retail is currently under Commercial Print Sector, even though digital is already migrating to the retail market the group would be hesitant to use Digital because the revenues will not count towards their group P&L. Incentives will be heavily weighed on company P&L, as well as additional incentives for driving digital business at Donnelley. Sector level P&L will still be budgeted and monitored but incentives will not be based as heavily on it as it was in the past. The new incentive structure will help bring about goal congruence between the sectors and the new vision/strategy.

Recommendation

After evaluating the alternatives based on the decision criteria identified (See Exhibit 3) the best alternative is alternative 3, Implementing Digital Technology as a cross-sector business unit. Donnelley needs to take a companywide position that digital is a strategic necessity if the company wants to continue to be the leader in the industry and remain customer focused. Current industry trends towards digital cannot be ignored, digital is a disruptive technology and Donnelley risks being left behind if they do not move with the times. This recommendation does not suggest abandoning traditional print instead it believes there is value in both. Digital technology needs to be treated as a "Star" – low market share, high growth potential, high costs, low short term returns (Verdict, Invest). Traditional printing should be

treated as a Cash Cow – high market share, low growth, high returns (Verdict, Milk). As long as Digital is in its own division and other business groups feel they are losing business (profits) by sending it to DD there will be goal incongruence and Donnelley overall as an organization will suffer in the long-run. Digital needs to be seen as an essential competency for all sectors.

Implementation

Implementing this recommendation is no easy feat and in order to gain acceptance by all those that are impacted by the change, proper change management is needed. In order to do so the Kotter's 8 step model will be used. Implementation has been broken down into a 5 year plan, Short-term (1 year) Mid-term (2 to 3 years) and Long-term (4+ years).

Short-Term (First Year)

- The first step is to create a sense of urgency around Digital Technology at Donnelley. Communication should be opened to the organization as a whole. Assurance should be provided that though Digital is becoming a part of the company's vision & strategy, Traditional printing and Heavy Iron is still essential to Donnelley's success there will not be any drastic changes on that front.
- Simultaneously focus needs to be on attaining the Book Groups Digital business. This should be relatively simple given that the department will now be able to maintain accountability for the profits from the partnership and the group investing in digital technology would simply cause duplication and redundancy within the organization. This project is essential as a pilot project to showcase Digitals capabilities to internal and external customers, and highlight that all parties involved benefit.
- Cowan should head the guiding teams and make sure that the right people are involved. Once that is set there should be an offsite management meeting for the managing committee, sector and group heads. This is where the new vision and strategy will be discussed and buy-in will be attained from key representatives. It will be a round table discussion where challenges or potential hurdles can be identified.
- Cowan can look internally (Someone like Faber) or externally to bring onboard someone to head the cross-sectional business unit. Clark and Schetter will still play an important role, and much of their functions remain the same.
- Creation of a Balanced Scorecard as a strategic planning and management system (See Exhibit 4), KPI's will start to be measured in the short term but the tool will really only be rolled in the mid-term then used continuously for monitoring.
- Continue on push Prototype Jobs to demonstrate the cost saving and profit generating capability of digital. This will also be used to highlight short-term wins as well as building whitepapers and marketing material to demonstrate the effectiveness and customer satisfaction.
- Training and processes need to be put in place to help sales staff not only sell digital but to help them work with customers and to show them it is a fundamental need for business moving forward. A much more consultative selling approach is needed.
- A focused approach on learning and building best practices at the Memphis plant in order to better prepare for future PODs.

Mid-Term (2 to 3 years)

- Highlighting short term wins that Digital has attained over the last year. Make companywide press releases and featured success stories. Use Book Groups Digital business as well as the Prototype Jobs as reference to other business groups and customers.
- Use the Balanced Scorecard that was created in the short-term to evaluate the progress today and monitor areas for further attention. Re-evaluate the alignments to vision and strategy with specific focus on the misalignments that were listed in the analysis section.
- Opening two additional PODs, and solidifying the information architecture (Target-IT, Send-IT and Order-IT).
- Given the good financial situation that Donnelley is in, they need to make substantial investments in digital technologies and create competencies that will be difficult to be replicated by their competitors.
- Donnelley should be consistently growing its market share and leveraging their competitive advantage in digital technology. With a stronger foundation now, more aggressive growth strategies in Digital should be set and targets put in place.
- Having quarterly meeting on developments in the Digital Technology sector and identifying the impact that it will have on the cross-sector business unit, traditional print and Donnelley as a whole. Constant monitoring is necessary since continuous changes and innovations are happening at all times. Special focus should be placed on monitoring competitors and their service offering.

Long-Term (4+ years)

- Continue to leverage the Balance Scorecard and make necessary modifications as needed to make sure there is alignment and goal congruence throughout the company.
- Sustaining the changes, constant monitoring is essential and modifications as need to keep Digital as a growing competency of the organization.
- Investment in R&D within Digital to identify new trends and technology that can be taken advantage of by Donnelley. This will help spur creativity and innovation while also provide a structure to help new ideas get rolled into the Technology Development Process.
- The traditional print and Heavy Iron aspect of Donnelley need to be thoroughly investigated. Are profits and market share still growing? Is digital taking over the market? Though it would be too early to make any concrete decisions Donnelly needs to start evaluating the future it sees for traditional print, will it be kept as a “Cow” or should the company start to look to other options.

Conclusion

In conclusion Donnelley is in a good situation at this time. They have identified a disruptive technology in their industry prior to it being too late. In fact they have even put measures in place such as DD in order to provide Donnelley with the capability to compete in the emerging Digital Era. The fact of the matter though, is that in order for Donnelley to really benefit from Digital and attain a competitive advantage in the market they need to do more. They need to make Digital a fundamental component of their business and tie it in to their vision and strategy. With the recommendation proposed not only will the current misalignments be fixed but Donnelley will position themselves to continue being the leader in their industry for decades to come.

EXHIBIT 1 – Alternatives, Pro’s & Con’s

Alternative 1 – Status Quo

Pro	Con
No large changes needed in current structure	Business groups are no more likely to embrace DD
Division and group managers are not negatively impacted – maintain autonomous control	Does not address the major misalignments identified
	Does not ensure that Donnelley will be prepared to compete in the Digital Era.

Alternative 2 - Digital Expansion

Pro	Con
Encourages first movers advantage in the industry	Increasing POD capacity does not mean that there is enough demand to utilize it
Shows that the organization believes in the long term benefit of Digital	Without making changes to the company vision and structure Digital will always be considered secondary to traditional print
In-line with what Schetter feels is the best course of action	Very risky, the Memphis is not yet profitable and there is no guarantee that Memphis is the best set-up to be mirrored for additional PODs

Alternative 3 – Realign Vision Placing Digital Technology as a Core Strategic Initiative

Pro	Con
Aligns company vision with Digital as an important focus for the future	Implementing substantial change to the organization
Increases the likelihood of DD being embraced business groups	Could create resistance and challenges from other divisions and groups
Builds a competitive advantage around Digital and increase the chances of the company being successful in the long-turn	
Allows Donnelley to take advantage of the quickly growing digital market	

EXHIBIT 2 – New Structure

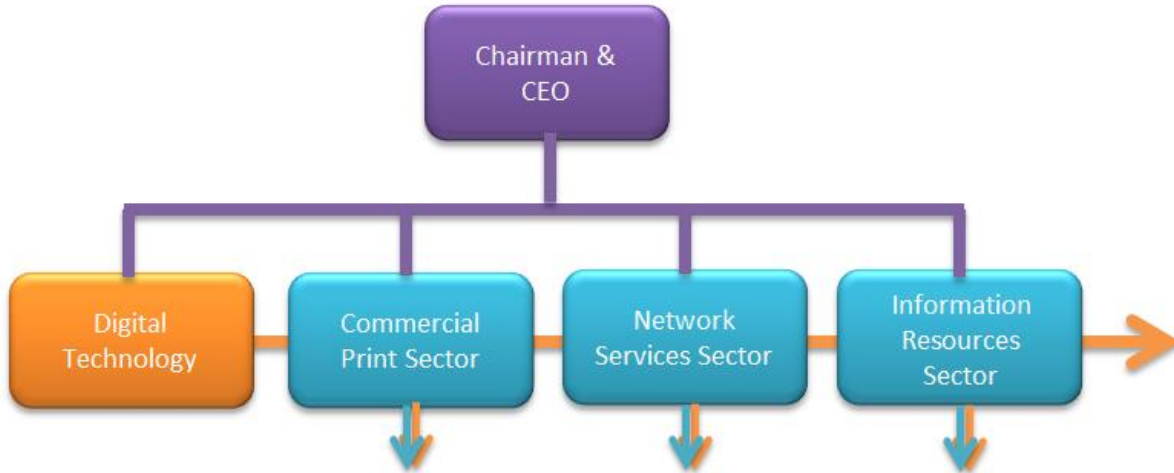


EXHIBIT 3 – Decision Criteria

	Status-Quo	Expansion	Digital Core
Digital embraced by the organization	✗	✗	✓
Digital becoming a competitive advantage	✗	✓	✓
Winning the Book Publishing digital business	—	—	✓
Long-term success of Donnelley	✗	—	✓
Cost / Risk	✓	✗	—

EXHIBIT 4 – Balanced Scorecard

Financial	Customer
Gross profit Net income Revenues from Digital Revenues from collaborative initiatives	Customer acquisition Satisfaction and retention Likelihood to recommend Market Share (Digital & Traditional)
Learning and Growth	Internal Processes
Best practices portal Learnings from PODs Digital selling training success rates Voice of the employees (suggestions)	Digital focus Asset optimization Degree of cross-sector success Processes violations

VISION
&
STRATEGY