The X Factor TO BUILD A BUSINESS THAT DOMINATES, YOU NEED TO DISCOVER AN EDGE THAT PUTS YOUR COMPANY WAY AHEAD OF ITS COMPETITORS. JUST ASK STARBUCKS, OUTBACK, AND OTHER SUCCESSFUL ENTREPRENEURIAL STARTUPS.

By Verne Harnish
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(FORTUNE Small Business) – Running a business can be an insane gamble, given the odds of failure. But it doesn't have to be that way--not if you discover your company's X factor. That's what allowed ventures such as Starbucks, Blockbuster Video, and Outback Steakhouse to dominate their industries. By finding their X factor--that is, an exponential advantage that put them at least two times ahead of competitors in a key area like pricing or employee retention--they left their rivals gasping for breath and unable to catch up.

You, too, should make it a top priority to find your company's X factor and put it to work for you. (Then keep it as quiet as possible so that your competitors don't catch on.) This is the most important advice I give to CEOs who seek help from Gazelles Inc., my consultancy for fast-growth firms. In fact, failing to establish such an edge puts a business in peril. It leaves it too easy for others to sneak up from behind. Vern Raburn, a former Microsoft executive, understood the power of the X factor when he founded Eclipse Aviation four years ago in Albuquerque. His company made history last August when its six- seat jet, the Eclipse 500, took its maiden flight. Powered by twin engines that together weigh just 170 pounds, the Eclipse 500 costs only 56 cents per mile to operate. Therein lies Raburn's X factor: This private plane's engine weight is about five times lighter than that of its closest competitor, Cessna's CJ1 Citation Jet (the CJ1 costs about $1.75 per mile to fly). Moreover, at $837,000, the Eclipse 500 is about a quarter of the price, making it affordable for firms that might never before have considered buying a plane. Indeed, at least one entrepreneur is planning to start an air taxi service using the Eclipse. Given that it costs about the same amount to put a passenger on these planes as it does to buy a full-fare airline ticket, it's easy to see how the Eclipse could revolutionize the air travel industry. Raburn hasn't yet proved that his business has staying power, of course, but based on the efficiencies he has created, I'm betting he will.

The Container Store is also thriving because its executives discovered their own X factor--one that's altogether different from Eclipse's. The Dallas-based chain, which sells items to help people organize their homes and offices, gives its employees ten times more training than the typical retailer in order to stay ahead of competitors across the country. It currently offers new full-time salespeople a whopping 235 hours of preparation, compared with the 23 hours typical in the retail industry. It's no wonder that with just 28 locations, the Container Store is on target to bring in $300 million in sales this year.

So how do you establish a competitive position that keeps your business exponentially ahead of the pack yet still allows you to gain ground? A close look at three of America's best-known companies should provide you with some ideas.

PRICE PERCOLATION

Many people doubted that consumers would routinely pay $2 or more for a gourmet coffee drink when Howard Schultz launched Starbucks Corp. in Seattle back in 1987. At the time, you could easily buy a cup of joe at a doughnut shop for 50 cents. But as most Americans know, Schultz soon proved the skeptics wrong. Offering customers an extensive selection of unusual roasts in sophisticated, European-style coffee bars, he drew long lines of connoisseurs who liked the idea of indulging themselves for just a few dollars. Schultz's X factor--charging prices that were several times higher than the norm--gave him the wherewithal to hit big. His genius was in using the money he made to open thousands of cafes across the country where he could multiply his steep markups many times over. Schultz understood that attracting millions of repeat customers would require careful quality control, so he refused to franchise--a decision he could afford to make because of his pricing. Similarly, as he looked for new venues in which to sell his coffee, he forged deals only with partners that placed a similar premium on consistency, like Barnes & Noble. With more than 5,600 stores already, and its international expansion moving at a rapid clip, Starbucks expects to open 1,200 more in 2003.

It's no wonder that Roger Scheumann, founder and CEO of Quartermaine Coffee Roasters in Rockville, Md., smelled the mocha java. He sold four of his six shops earlier this year and shifted his focus to the wholesale part of the business instead. "Starbucks reset the customer's expectations around the retail coffee experience and is now setting new ones--and none of us can keep up," says Scheumann.

PLAY-IT-AGAIN SAVINGS

Renting videos was a frustrating affair before Blockbuster Video turned the industry upside down. Forced to pay movie studios about $65 for each video, many mom-and-pop businesses struggled to eke out a living and could barely afford to keep hit items in stock. Then, in 1997, CEO John Antioco cut a groundbreaking deal with Hollywood studios such as Disney in which Blockbuster would buy thousands of copies of popular films for $6 apiece, plus a 40% share of rental fees. Bingo. Blockbuster had found its advantage--up-front costs that were more than ten times lower than those of its smaller rivals. With the money it saved, the Dallas-based company expanded its selection dramatically. Not surprisingly, an estimated 2,500 video shops--about 10% of the total in the U.S.--went out of business during the same period, according to the Video Software Dealers Association. Blockbuster kept growing, and today it has more than 8,000 stores. But what was an advantage five years ago isn't one today. The big question for Blockbuster and its parent company, Viacom, is whether they can pull off a sequel to the early success story. It could be a tough challenge now that virtually any movie-rental store can obtain DVDs for $10 to $15 each. Services like Netflix are renting DVDs through the mail (see our story on page 42), and cable stations are offering video on demand.

MASS-PRODUCED MILLIONAIRES

Manager turnover was killing many restaurants in 1987, when industry vets Chris Sullivan and Robert Basham formed the Aussie-themed Outback Steakhouse. Wisely noting that many big chains spent millions of dollars to recruit and train new managers each year, they realized that if they could retain theirs for more than the typical six months or so, they'd have an edge. So in 1988 they initiated a breakthrough compensation plan. They asked key managers to sign five-year contracts under which they would invest $25,000 in the restaurant they were going to manage in exchange for 10% of the store's cash flow and a base salary. The deal had the potential to turn $45,000-a-year employees into millionaires, and ultimately it worked. Today about 95% of managers stay with Outback for at least five years--giving the company a 10X

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advantage over its rivals--and about 80% renew their five-year contracts, says president Paul Avery. And with more than 750 restaurants and a market capitalization of more than $2 billion, Outback has kept its lead--at least for now.

MULTIPLYING YOUR X FACTOR

Of course, even huge, exponential advantages can expire. So in the event a new technology or upstart company suddenly changes your marketplace, you should never stop looking for ways to keep competitors eating dust. You don't want to be caught unprepared.

Fortunately, there are unlimited ways to find an edge. The key is to pull yourself away from day-to-day operations long enough to think more broadly about your business. And whether you find your strength in speed, repeat sales, number of acquisitions, or any other avenue, by maximizing your X factor, you can catapult your company into first place.