CASE STUDY

The Growth "Flywheel" at Rackspace

In ten years, San Antonio–based Rackspace, a global leader in the hosting and cloud computing industry, grew from $12 million in revenue to $800 million, and from one hundred employees to four thousand. Its growth has been nothing short of meteoric .a

What's the lesson? Rackspace first had to get its service model under control before it had any chance of expansion. The company started by retooling its service offering, a series of trade-offs it stumbled on when it ran out of money with its first strategy. The lack of resources—an event CEO Lanham Napier describes as a "blessing"—forced the company to confront the brutal truth that its original service model wasn't working. That model was designed to rent out server hardware and then basically to wish customers the best in figuring out how to use it. Cofounders Pat Condon and Dirk Elmendorf characterized the original concept: "If you don't know how to use the technology . . . that's your problem."

Since conventional wisdom had convinced the team that meaningful customer support wasn't affordable or scalable, very little resources were being directed toward it. The combination of an empty bank account and a pattern of angry service calls led to a breakthrough that defied the industry's prevailing assumptions: Rackspace's best shot would be to viably deliver a premium offering the company characterized as "fanatical service." So the company began to build a service model and service culture to pull it off:

• *Key trade-off in its offering:* Higher prices would be needed in exchange for a high-touch, high-service experience.

• *Funding mechanism:* In addition to higher prices, the real key would be higher retention. By the company's estimates, existing, satisfied customers were up to ten times more profitable than new customers. As a result, according to CEO Napier, the company funds its premium service levels through customer retention: "We don't see service as a cost, we see it as an investment."

• *Employee management system:* The company uses values-based selection of "rackers"; clear, team-based incentives; and lots of decision rights in the hands of the front line—"not the guy in the finance office," according to Napier, who recognizes that it's a "frightening concept . . . but you have to believe that over time, [frontline employees] will make the right decision."

• *Customer management:* Rigorous tracking tools—a pricing tool, a churn tool, a retention tool—make the profitability of every customer completely transparent, along with the cost of every internal action.
Employees use these tools to develop deep intuition about customer behavior and nudge customers into the bounds of expected profitability.

And then there's the Rackspace culture. Its distinction is codified in a series of living values that starts with "fanatical support." Focusing on service as a mission for the slightly unhinged encourages people to bring their humanity into the workplace, even the crazy parts, which helps them to connect with customers in an authentic way.

Rackspace's most remarkable assumption, which informs almost every decision the company makes, is the belief in the capability of the workforce. Napier calls his employees "precious entities." They're treated that way, not with kid gloves or lavish rewards (although clear recognition, monetary and otherwise, is part of it), but with a celebration of their unique gifts and quirks. Sometimes that means a customized management approach that's designed to enable an individual's strengths. And sometimes that means renting out a movie theater so the company can go see *Transformers* together. "We're a bunch of geeks," Napier clarifies, by way of explanation.

The CEO is animated in discussing all aspects of the Rackspace business model, but never more so than when he talks about his employees: "I'll look you straight in the eye and tell you that I think they're the best humanity has to offer." Rackers have internalized Napier's belief, which gives them permission to deliver uncommon service to both their customers and each other.

It all adds up to a virtuous cycle of growth. The team's assumption is simple: if they serve customers well, customers will give them more work. It means that Rackspace will grow 20 percent in any given year without adding a single new customer. Napier describes it as a flywheel that starts with happy employees delivering excellent service. Excellent service leads to stronger, more successful client businesses, which leads to increased demand for Rackspace services. That increased demand is more profitable to service, since Rackspace has already learned exactly how to satisfy it. And the cycle begins again. It's what our colleagues Earl Sasser, Jim Heskett, and Len Schlesinger call the "service profit chain," and it's alive and well at Rackspace. b

Napier's flywheel keeps accelerating. Eight years into its growth sprint, Rackspace is growing faster than at any period in the company's history, despite its larger size. As Napier himself pointed out, "that's crazy."

a. Information presented in this case is derived from W. Earl Sasser, Jr., James L. Heskett, and Tom Ryder, "Rackspace Hosting (2000)," video, product number 9–811-701 (Boston: Harvard Business School, 2010).
b. James L. Heskett, W. Earl Sasser Jr., and Leonard A. Schlesinger, *The Service Profi t Chain* (New York: Free Press, 1997).