Inhoudsopgave

1. What is Strategy? (Porter)

Operational Effectiveness is not strategy

The root of the problem is the failure to distinguish between operational effectiveness and strategy. Operational effectiveness and strategy are both essential to superior performance, which, after all, is the primary goal of any enterprise. But they work in very different ways. A company can outperform rivals only if it can establish a difference that it can preserve.

Operational effectiveness (OE) means performing similar activities better than rivals perform them. Operational effectiveness includes but is not limited to efficiency. It refers to any number of practices that allow a company to better utilize its inputs by, for example, reducing defects in products or developing better products faster.

In contrast, strategic positioning means performing *different* activities from rivals' or performing similar activities in *different* ways.

Productivity frontier: State of best practice.

Why is improved operational effectiveness insufficient?

1. OE competition shifts the productivity frontier outward, effectively raising the bar for everyone. But although such competition produces absolute improvement in operational effectiveness , it leads to relative improvement for no one.
2. Competitive convergence is more subtle and insidious.

Competition based on operational effectiveness alone is mutually destructive, leading to wars of attribution that can be arrested only by limiting competition.

Strategy Rests on Unique Activities

Competitive strategy is about being different. It means deliberately choosing different set of activities to deliver a unique mix of value.

Strategy positions emerge from three distinct sources:

1. Variety-based positioning: based on producing a subset of an industry's products or services. Based on product/services varieties rather than customer segments (focus).
2. Need-based positioning: serving most or all the needs of a particular group of customers.
3. Access-based positioning: segmenting customers who are accessible in different ways (e.g. Going for rural instead of urban-based customers).

- Strategy: the creation of a unique and valuable position, involving a different set of activities.

If there were only one ideal position, there would be no need for strategy. If the same set of activities were best to produce all varieties, meet all needs, and access al customers, companies could easily shift among them and operational effectiveness would determine performance.

A Sustainable Strategic Position Requires Trade-offs

Straddling: Type of imitation, the straddler seeks to match the benefits of a successful position while maintaining its existing position.

A strategic position is not sustainable unless there are trade-offs with other positions. Trade-offs occur when activities are incompatible. → more of one thing necessitates less of another. Trade-offs create the needs for choice and protect against repositioners and straddlers.

Trade-offs arise for three reasons:

1. Inconsistencies in image or reputation.
2. Trade-offs arise from activities themselves.
3. Trade-offs arise from limits on internal coordination and control.

   - Strategy is making trade-offs in competing. The essence of strategy is choosing what *not* to do. Without trade-offs, there would be no need for choice and thus no need for strategy. Any good idea could and would be quickly imitated. Again, performance would once again depend wholly on operational effectiveness.

Fit Drives Both Competitive Advantage and Sustainability
Positioning choices determine not only which activities a company will perform and how it will configure individual activities but also how activities relate to one another. While operational effectiveness is about achieving excellence in individual activities, or functions, strategy is about *combining* activities. Fit locks out imitators by creating a chain that is as strong as its *strongest* link. Fit is important because discrete activities often affect one another.

Three types of fits:

1. Simple consistency: between each activity and the overall strategy. Consistency ensures that the competitive advantages of activities accumulate and do not erode or cancel themselves out.
2. Activities are reinforcing
3. Optimization of effort

Competitive advantage grows out of the entire system of activities. The fit among activities substantially reduces cost or increases differentiation. Beyond that, the competitive value of individual activities –or the associated skills, competencies, or resources –cannot be decoupled from the system or the strategy.

   - Strategy: creating fit among a company's activities.

Rediscovering Strategy
- The Failure to Choose
- The Growth Trap
  - Compromises and inconsistencies in the pursuit of growth will erode the competitive advantage a company had with its original varieties or target customers.
- Profitable growth
  - Companies seeking growth through broadening within their industry can best contain the risk to strategy by creating stand-alone units, each with its own brand name and tailored activities.
- The Role of Leadership

- With so many forces at work against making choices and trade-offs in organizations, a clear intellectual framework to guide strategy is a necessary counterweight.
- Strong leaders willing to make choices are essential.

A company may have to change its strategy if there are major structural changes in its industry. A company's choice of a new position must be driven by the ability to find new trade-offs and leverage a new system of complementary activities into a sustainable advantage.

2. The Origins of Strategy (Ghemawat)

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3. Fundamental Principles of Value Creation (Koller)

Economic profit can be expressed as the spread between ROIC and the cost of capital, multiplied by the amount of invested capital. The objective is to maximize economic profit over the long term, not ROIC.

Discounted cash flow (present value): you forecast the future cash flow of a company and discount it to the present at the same opportunity cost of capital discussed earlier.

Economic growth VS discounted cash flow → They are the same.

Maximize the intrinsic value of the company (real market) and properly manage the expectations of the financial market (financial market).

Lessons

1. In the real market, you create value by earning a return on your invested capital greater than the opportunity cost of capital (e.g. in the stock market).
2. The more you can invest at returns above the cost of capital, the more value you create (growth creates more value as long as the return on capital exceeds the cost of capital).
3. You should select strategies that maximize the present value of expected cash flows or economic profit (you get the same answer regardless of which you choose).
4. The value of a company's shares in the stock market is based on the market's expectations of future performance (which can deviate from intrinsic value if the market is less than fully informed about the company's true prospects).
5. After an initial price is set, the returns that shareholders earn depend more on the changes in expectations about the company's future performance than the actual performance than the actual performance of the company. For example, if a company is expected to earn 25% on its investments, but only earns 20%, its stock price will drop, even though the company is earning more than its cost of capital.

There are two key drivers of cash flow and ultimately value: the rate at which the company can grow its revenues and profits, and its return on invested capital (relative to the cost of capital).

4. Frameworks for Valuation (Koller)

Model	Measure	Discount factor	Assessment
Enterprise discounted cash flow	Free cash flow	Weighted average cost of capital	Works best for projects, business units, and companies that manage their capital structure to a target level.
Economic profit	Economic profit	Weighted average cost of capital	Explicitly highlights when a company creates value.
Adjusted present value	Free cash flow	Unlevered cost of equity	Highlights changing capital structure more easily than WACC-based models
Capital cash flow	Capital cash flow	Unlevered cost of equity	Compresses free cash flow and the interest tax shield in one number, making it difficult to compare performance among companies over time.
Equity cash flow	Cahs flow to equity	Levered cost of equity	Difficult to implement correctly because capital structure is embedded within cash flow. Best used when valuing financial institutions.

5. Thinking about Return on Invested Capital and Growth (Koller)

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6. The Five Competitive Forces that Shape Strategy (Porter)

Narrow-minded business strategists may focus solely on existing competitors when complaining about decreasing returns in their industry but in “The Five Competitive Forces That Shape Strategy”, Michael E. Porter explains that there are several other forces in the competition for profits that the strategist should be aware of. These five forces are explained in an “industry structure” model where the most successful businesses find the niche in the market where the forces are the weakest. The industry structure is made of New Entrants, Suppliers, Buyers, Substitutes, and Existing Competitors.

Porter explains that all **industries have gross differences in profitability regarding return on invested capital** (14% median in USA, 1992-2006). These returns, for instance 6% in Airlines versus 38% in Soft Drinks, have the five forces to thank. Porter does note that several combinations of forces can create a low or high return industry – a low return industry does not mandate that all five forces be powerful, but one force can disturb the profits in an entire industry. Here we analyze the factors that make up the five forces.

- The **threat of entry** depends on the height of entry barriers including economies/benefits of scale (supply/demand), switching costs, capital requirements, and access to distribution channels.
- The **threat of suppliers** are powerful when there are few suppliers and a multitude of buyers, or when the supplier is also diversified into other industries, when switching costs are high, and there is no substitute.
- The **threat of buyers** is high when there are few buyers as in offshore drilling, when industry products are standardized so there are many choices of manufacturer, when switching costs are low, or when buyers can even integrate backwards – creating the product themselves. Porter also discusses when buyers are price sensitive: purchase represents large portion of overall cost structure and buyer is strapped for cash (group earns low profits).
- The **threat of substitutes** is high if cost of switching to the substitute is low for buyers, and the substitute offers an attractive price-performance tradeoff to the alternative.
- Lastly, the **rivalry of existing competitors** depends on
    - 1) intensity of competition,
    - 2) Basis on which competitors compete.

  Intensity is greatest when there are many competitors with relatively equal size and power, when there is slow industry growth, high exit barriers, highly committed rivals despite performance, and when firms cannot read each other's signals due to unfamiliarity.

APPLY

Applying Porter's Five Forces to my company, Industrial Training International (ITI.com), and our industry, corporate crane, rigging, and heavy equipment training, I have uncovered a few new realities. The industrial training industry serves customers from oil/gas and mining, to construction and power generation – though it is a very niche market, $40 million in the US. What is surprising is that according to a quick (2-day) analysis, we are not really threatened very heavily at the moment, although it doesn't necessarily feel that way.

Recently a new law was established by Federal OSHA (Occupational Safety and Health Administration) requiring crane operators on construction sites to have a nationally-accredited operator certification. Prior to reading about Porter's Forces I understood our industry was very **easy to enter** – this rule from OSHA exemplified that with dozens of new entrants in the past year. Like many consulting industries there are low capital requirements and customer switching costs are jointly very low. When working with a large organization's training budget, demand-side benefits of scale are in favor of incumbents, although the bubble we are currently experiencing did not stop many from entering the industry. When it comes to **suppliers and substitutes**, there is little application to ITI as a service-based company.

An initial learning outcome is that **buyers** hold a great deal of power in this industry and to ITI. Our company's fees are sometimes double that of the nearest competitor due to the high-quality of personnel and curriculum we benefit our customers with. However, because switching costs are very low and buyers can integrate backwards by creating their own internal training programs, they indeed hold a great deal of power that keeps us in check.

The **rivalry among existing competitors** is not a major threat. Although there are numerous competitors, industry growth is rather large due to the recent government mandate. Despite the fact that there are few leaving the industry now, exit barriers are fairly low for the majority of competitors – most competitors do not invest heavily in things like heavy machinery, IT, data management, logistics systems. They simply have 1-2 trainers conduct training at customer locations, on customer equipment.

Despite the rise of market entrants, **price competition** is very low thanks to ITI's quality – customers agree that no other vendor of theirs offers the same quality of training. This means that ITI's product is not identical to competitors. Interestingly, there is fierce price competition for low-quality, easy-to-conduct training programs like "Signal Person Training" (which was also mandated by the same OSHA law mentioned above). Also restraining price competition are low fixed costs and large capacity expansions not being required in the industry. So, despite what it feels like – numerous new entrants jumping in the industry – ITI is comfortable as the leading, high-quality provider in a growing industry. The pie is growing and ITI is increasing its portion as it competes for the *low-hanging fruit* like Signal Person Training with e-learning and other high-investment advances other competitors cannot afford.

7. How Industries Change (McGahan)

Introduction

The article very methodically points out that one can't make intelligent investments within ones organization unless one understands how the whole industry is changing. If the industry is in the midst of radical change, one will eventually have to dismantle old businesses. If the industry is experiencing incremental change, one will probably need to re-invest in the core. To truly understand where the industry is headed, one have to shut out the noise from the popular business press and the pressure of immediate competitive threats to take a longer-term look at the context in which one does business.

Four Trajectories of Change

In the article, the author specifies that an Industry faces two types of threat; *"the first is a threat to the industry's core activities - the activities that have historically generated profits for the industry. These are threatened when they become less relevant to suppliers and customers because of some new, outside alternative. The second is a threat to the industry's core assets - the resources, knowledge, and brand capital that have historically made the organization unique. These are threatened if they fail to generate value as they once did. In the pharmaceutical industry, for instance, blockbuster drugs are constantly under threat as patents expire and new drugs are developed."*

Core assets \ Core activities	Threatened	Not Threatened
Threatened	**Radical Change** *Everything is up in the air.* Examples: makers of landline telephone handsets, overnight letter-delivery carriers, and travel agencies	**Creative Change** *The industry is constantly redeveloping assets and resources.* Examples: the motion picture industry, sports team ownership, and investment banking
Not Threatened	**Intermediating Change** *Relationships are fragile.* Examples: automobile dealerships, investment brokerages, and auction houses	**Progressive Change** *Companies implement incremental testing and adapt to feedback.* Examples: online auctions, commercial airlines, and long-haul trucking

This 2x2 matrix in a very simplistic manner classifies various industries in any of the four categories.

Radical Change

Radical transformation occurs when both core activities and core assets are threatened with obsolescence. The relevance of an industry's established capabilities and resources is diminished by some outside alternative; relationships with buyers and suppliers come under attack; and companies are eventually thrown into crisis. Radical industry evolution is relatively unusual. It normally occurs following the mass introduction of some new technology. Example would be landline telephone handsets.

Intermediating Change

Intermediating change is more common than radical industry evolution. It typically occurs when buyers and suppliers have new options because they have gained unprecedented access to information.

The core activities of industries on an intermediating change trajectory are threatened. Intermediating change is occurring in auto-dealerships, for example.

Creative Change

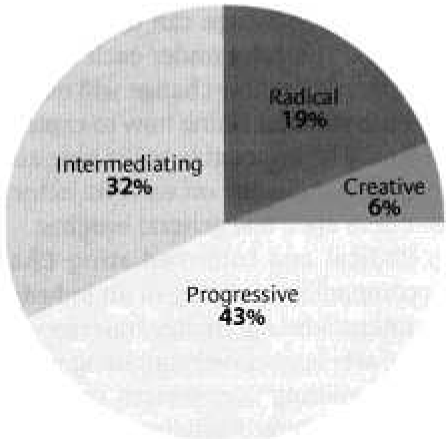
In industries on a creative change trajectory, relationships with customers and suppliers are generally stable, but assets turn over constantly. The film production industry is a good example. Larger production companies enjoy ongoing relationships with actors, agents, theater-owners, and cable television executives. Within this network, they produce and distribute new fills all the time.

Progressive Change

Progressive evolution is like creative evolution in which buyers, suppliers, and the industry's incumbents have incentives to preserve the status quo. The difference is that core assets are not threatened with obsolescence under progressive change, so industries on this trajectory are more stable than those on a creative change trajectory. Today's discount retailing, long-haul trucking, and commercial airline industries are evolving in this way.

A Fair Share

The author has also researched that the four change trajectories are not at all evenly distributed among industries. Surprisingly, given the time and attention much of the management literature devotes to it, radical change affects less than one-fifth of all industries. More prevalent are progressive and intermediating change. The percentages shown are estimates of the distribution of change trajectories among U.S. industries between 1980 and 1999, based on variability in revenues and assets among large firms.



Capitalizing on Industry Evolution

Understanding industry change can do more than help you avoid mistakes. The rules under each trajectory can help you forecast early on how change will occur in your industry - and help you determine how to exploit change as it occurs. It would be impossible to list here all the possible contingencies for change on each trajectory and at each stage. But here a

Surviving Radical and Creative Change: Under these conditions, it is smart to evaluate how quickly your core assets are depreciating. Often, this assessment yields important information about the value of intellectual property and how it can be guarded more intensively.

To navigate radical and creative change trajectories successfully, companies must have the mettle to disappoint some buyers and suppliers, regardless of their track records, if the risks are too high.

Managing Progressive Change: Progressive change is not simple to manage, despite the fact that neither core assets nor core activities are threatened. For example, the standard-bearers in discount retailing (Wal-Mart and Target among them) have relentlessly managed incremental changes in activities for decades. Ultimately, one of the most successful strategies for companies in industries on a progressive change trajectory is to develop a system of interrelated activities that are defensible because of their compounding effects on profits.

Adapting to the Stages of Change: As we've noted, all four trajectories typically unfold over decades, which means organizations have time to outline strategic options for the future. As change happens, fighting it is almost always too costly to be worthwhile. Organizations must reconfigure themselves for lower revenue growth and develop the ability to move activities and resources out of the business.

Diversifying Your Business: Some of the most exciting opportunities associated with industry evolution relate to diversification across industries. By participating in more than one industry on a progressive trajectory, Wal-Mart has enhanced the effects of its powerful distribution systems. And with its acquisition of Kinko's, FedEx has diversified in response to radical change.

The trajectories outlined above can help one anticipate how change will unfold in their industry - and how to take advantage of opportunities as they emerge. To get out from under industry threats, a company must cultivate a deep understanding of how changes to the industry will unfold over time.

The author has very beautifully classified industries in each category and also suggested the most suitable strategies to deal with such changes. The author has used American examples to substantiate the points made, however, the issues pointed out are quite generic, and are bound to be witnesses in all economies, be it American or Indian. The changes somehow are too simplistic, that at times it might be difficult to straightjacket a particular industry in any category of change. In addition, the strategies suggested by the author are very generic in nature, and hence, can just act as a directive to businesses. Also the author has oversimplified the environment in which businesses operate by means of a 2x2 matrix; however, the business environment is just too complex with a large number of stakeholders. Hence, the above-stated matrix has only a limited theoretical relevance and almost negligible practical relevance.

8. Anticipating Competitive Dynamics (Cassiman & Ghemawat)

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9. The Right Game: Use Game Theory to Shape Strategy (Brandenburger & Nalebuff)

1. In 1944, math genius John von Neumann and economist Oskar Morgenstern published their book Theory of Games and Economic Behavior.
   a. Neumann stated that there are two types of games:
      i. "Rule-based games" players interact according to specified rules of engagement.
      ii. "Free-wheeling games" players interact without external constraints.
   b. Business is a mixer of both. Essence of business is to make sure you are playing the right game.

2. The rules in business:
   a. "To every action, there is a reaction" But does not have to be equal or opposite.
   b. "You cannot take away more than you put in" – how do you know what each player brings to the table? Answer: u take that player out of the equation to see their "added value".
   c. Must shift your perspective from egocentricity to allocentrism. Meaning from focusing on your position to the position of other players.
   *need to see all that effects you and have the sight to "change the game!'

(Ex) GM from lose-lose to win-win. Automobile industry notorious for pricing cutting at year-end to clear inventory. Rewards consumer behavior of waiting until year end to get these discounts so dealers would have to place these incentives in earlier during the year. All companies lost because of these price cuts. In Sept 1992 GM launched credit card with 5% of charges to future GM car lease or purchase. Consumers became loyal, did not wait until year end so GM could hold its regular price or have more room to increase, then Ford had more price flexibility as well to get higher prices. WIN-WIN

Other companies such as Ford and Volkswagen copied the credit card idea but imitation is not always bad. It helped the industry as a whole keep their car prices up.

d. Others do not have to lose in order for you to win.
e. Game of business is all about value. Creating it and Capturing it. This is where the "VALUE NET" comes into play.

1st Step: Identify the players in your value net and the interdependencies among them.

- On the vertical dimension: players company does interact but not transact with substitutors: alternative players from who consumers can buy same product from
- and complementors: players that consumers can buy complementary products from or suppliers can sell complementary resources.
- On the horizontal dimension: Consumers or buyers and Suppliers.

2nd Step: Identify all the elements of the game: there are five in the game theory:

a. PLAYERS: As we identified in the "Value Net" . These players are not fixed. Sometimes it is smart to change the players, even yourself.

(Ex) HSC (supplier) enters NutraSweet market because second supplier of aspartame was needed in the cola market for Coke and Pepsi. Pay me to Play. BellSouth: understood that even if you don't get money the old fashion way you can get paid to change it. 3DO, gave license for others to build hardware so that it can concentrate on the complementary software.

b. ADDED VALUES: There are ways to make yourself a more valuable player: to raise your added value or decrease the value of others.

(Ex) TWA – more leg room for in their planes. Overall, added customer value
and decreased the number of seats available to sell in the airline industry. Nintendo decreased supplier and other player values by controlling the supply amount, so that Nintendo can have more negotiation leverage. Minnetoka softsoap dispenser – gambled and controlled pump supply to slow down the competition. Used head start to create brand name
loyalty.

c. RULES: Gives the game structure, rules might arise from law, custom, practicality or contracts. Rules can be revised, new ones established or used to your advantage.

(Ex) 'Judo economics' – newcomers into market limit their capacities so that the incumbents (older, more establish) market does not retaliate by
matching newcomers lower prices. Kiwi International Air Lines – limit
itself to 4 routes per day, Delta leaves it alone. For commodities such as
gas, the meet-the competition clause (MCC) very worth following to
keep competitors from coming in with lower pricing to win business. If
not followed, both will lose because of price war.

d. TACTICS: Are moves used to shape the way players perceive the game and how they play. Tactics can reduce misperception or maintain/create uncertainty. The fog can be lifted or cast.

(Ex) New York Post cut their newspaper price to 25 cents to prove that the New York Times added value was not worth the price difference because people switched, so Times increase their to 50 cents, which is what the Post wanted the rates to be in the industry –proved their point by unveiling added value of NY Times.

e. SCOPE: Boundaries of game. Can expand or shrink scope of players, industry. What should it include?

(Ex) Nintendo did not try to compete against Saga's 16-bit games but decided to stick with its 8-bit games.

3. The Traps of Strategy:
   1. Realizing you can change the game is crucial.
   2. Initiate lost does not only come at expense of others. Look for win-win, or win-lose.
   3. Belief that others can't. All actions can be imitated. Imitation can be healthy.
   4. Failure to see how picture. Use the 'Value Net'
   5. Failure to think methodically to change the game.
   6. No end to the game of changing the game.

10. Creating Competitive Advantage (Ghemawat)

Added Value

- Added value = - total industry value created <u>with</u> the firm in the game
  - total value created <u>without</u> the firm in the game

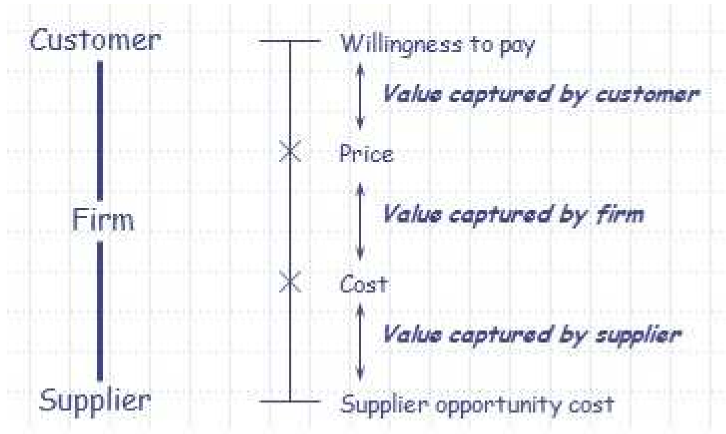
OR EQUIVALENTLY

- the value that would be lost to the industry if the firm disappeared

- Under unrestricted bargaining, a firm cannot capture more than its added value
  - If you (in your relationships with customers and suppliers) create no value, you can capture no value
- More generally, if a firm (in its relationships) creates no new value, it had better have some clever way of claiming value

Value Creation

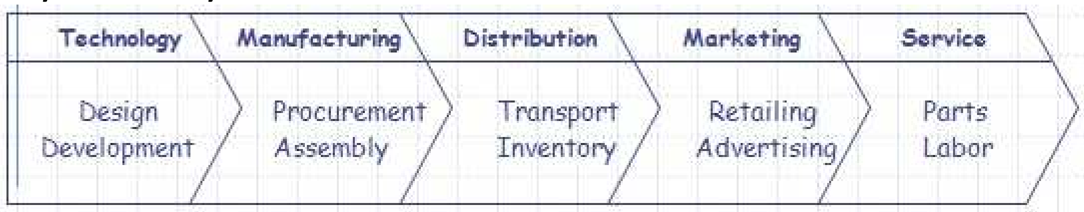
- Value is created by a business operating together with its customers and its suppliers
  - A firm does not create value in isolation
- Willingness to pay = the most that a customer will pay for a firm's product
- Supplier opportunity cost = willingness to receive = the least that a supplier will accept for the resources required to make a product
- The value created by a transaction is the difference between the customer's willingness to pay and the opportunity cost of the resources



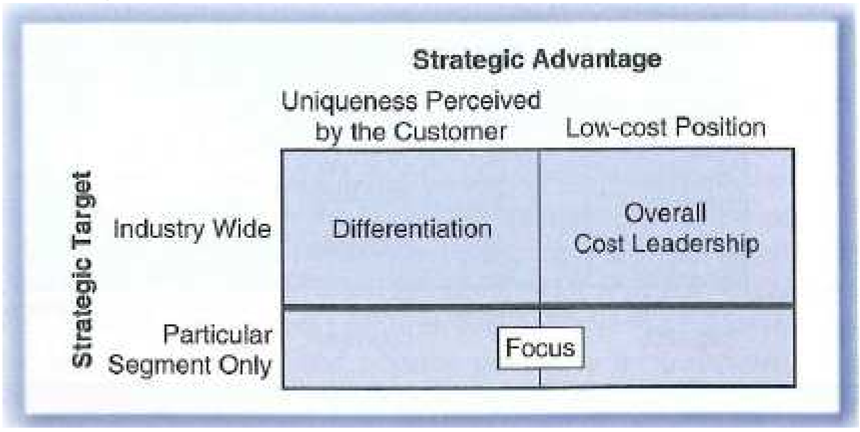
Activity Analysis of Competitive Advantage

- Added value => goal is to drive a wedge between willingness to pay and (supplier opportunity) cost
    - Indeed, a wider wedge than competitors achieve
- Problem: a firm must often incur higher costs to deliver a better product or service
- Partial solution: use activity analysis to spot opportunities to widen the wedge

McKinsey's Business System



Porter's Generic Strategies



- **Cost Leadership Strategy**
    - Deliver a GOOD product or service at the lowest possible cost
    - Open a significant and sustainable cost gap over all competitors
    - Create advantage through superior management of key cost drivers
    - Translates into above-average profits with industry-average prices

BUT

    - Cost leaders must maintain product parity or proximity in satisfying buyer needs
    - Cost leadership often requires making trade-offs with differentiation

- **Common Pitfalls in Cost Leadership**
  - Misunderstanding of actual costs
  - False perception of cost drivers
  - Focus on manufacturing
  - Failure to exploit linkages
  - Inadequate proximity to differentiators
  - Ignoring competitor behavior
  - Poor implementation
  - Acting incrementally
  - No cost management program

- **The Differentiation Strategy**
  - Select one or more needs that are valued by buyer
  - Achieve and sustain superior performance by meeting these needs uniquely
  - Selectively add costs if necessary to do so
  - Successful differentiation leads to premium prices
  - Differentiators must pick cost-effective forms of differentiation
  - Differentiation leads to above-average profitability provided the firm maintains -cost parity or proximity to competitors

- **Common Pitfalls in Differentiation**
  - Creating differentiation that buyers do not value
  - Over-fulfilling buyer needs
  - Looking too narrowly at the sources of differentiation
  - Charging an excessive price premium
  - Failing to understand costs of differentiation
  - Ignoring signals of value
  - Failing to recognize buyer segments
  - Creating differentiation that competitors can emulate quickly or cheaply

- **Focus Strategy**
  - Exploits the same fundamental types of competitive advantage
  - Selects narrow target segment(s) with unusual needs
  - Creates optimal strategy for the target

    ↓

    Narrowing of scope creates cost or differentiation advantage

- **Can business do more than one?**
  - **Overall Cost Leadership + Differentiation**
    - Sometimes consistent
    - But requires defense against a competitor achieving one or the other

      OR
  - **Focus**
    - Can have multiply-focused entities in one company

Stuck in the middle

- A company can be stuck in the middle if
  - A differentiator attempts to cut costs that are essential to its differentiation
  - A low cost leader incurs costs, above those which are essential to its low cost position, which do not differentiate the product
  - A focus company attempts to broaden its strategic target beyond the segments in which it has an advantage

- In other words, by incurring costs, or by cutting costs, or by pursuing markets that reduce the "wedge"

Main ideas:

- A successful firm does not simply participate in an attractive industry. It also strives to generate more economic profits than the typical firm in its industry.
- The ability to generate and capture profits in an industry derives from added value. A firm has added value when the network of customers, suppliers, and complementors in which it operates is better off with the firm than without it; the firm offers something that is unique and valuable in the marketplace.
- A firm usually can't claim any value unless it adds some value.
- To have added value, a firm must drive a wedge between customer willingness to pay and supplier opportunity cost –indeed a wider wedge than rivals achieve. A firm that attains a wider wedge is said to have a competitive advantage.
- To establish a competitive advantage, a firm has to do different things than its rivals on a day-to-day basis. These differences in activities, and their effects on relative cost and relative willingness to pay, can be analyzed in detail.
- A firm can use its analysis of activities to generate and asses options for creating competitive advantage. In doing so, the management team must decompose the firm into parts, but also craft a vision of an integrated whole.

11. The Core Competence of the Corporation (Prahalad & Hamel) Versie 1

1. Rethinking the corporation
2. The roots of competitive advantage
3. How not to think of think of competence
4. Identifying core competencies—and losing them
    1. 3 tests:
        1. i. Core competence provides potential access to a wide variety of markets
        2. ii. A core competence should make a significant contribution to the perceived customer benefits of the end product
        3. iii. A core competence should be difficult for competitors to imitate
5. From core competencies to core products
6. The tyranny of the SBU
    1. 3 planes of which battles for global leadership are waged:
        1. i. Core competence
        2. ii. Core products
        3. iii. End products
    2. Costs of distortion
        1. i. Underinvestment in developing core competencies and core products
        2. ii. Imprisoned resources
        3. iii. Bounded innovation
7. Developing strategic architecture

8. Redeploying to exploit competencies

- Is this article focused on the process of strategy or the content of strategy?
  - This article is focused on both. It talks about how the western way of strategizing is flawed and how they should implement a new way of thinking and planning. So it talks about the content of this new way of thinking and the process of how it will work.
- Is the article a conceptual/theoretical discussion or a practical discussion?
  - It is conceptual and theoretical because it talks about what it would look like if western companies adopted the eastern way of thinking when it comes to management.
- What definition of strategy (explicit or implicit) does the author use in the article?
  - Being open-minded to other plans that work. Using information from your competitors on what works and working with them.
- What statement of "the essence of strategy" does the author provide?
  - Core Competencies are the wellspring of new business development. They should constitute the focus for strategy at the corporate level.
- What are the three most important points the author makes?
  - Core competence provides potential access to a wide variety of markets
  - A core competence should make a significant contribution to the perceived customer benefits of the end product
  - A core competence should be difficult for competitors to imitate.
- What single statement (direct quote) from the article best captures the author's ideas?
  - You can miss the strength of competitors by looking only at their end products. In the same way you miss the strength of a tree if you look only at its leaves.

The Core Competence of the Corporation (Prahalad & Hamel) Versie 2

Roots of competitive advantage
The critical task of management is to create an organization capable of infusing products with irresistible functionality or, better yet, creating products that customers need but have not yet imagined.
In the short run, a company's competitiveness derives from the price/performance attributes of current products. However these are less important as sources of differential advantage. In the long run, competitiveness derives from an ability to build, at lower cost and more speedily than competitors, the core competencies that spawn unanticipated products. The real sources of advantage are to be found in management's ability to consolidate corporate-wide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities.

Characteristics of core competencies:

- Core competencies are the collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies.
- Core competency is also about the organization of work and the delivery of value.
- Core competence is communication, involvement and a deep commitment to working across organizational boundaries. It involves many levels of people and all functions.
- Core competence does not diminish with use: unlike physical assets, which do not deteriorate over time, competencies are enhanced as they are applied and shared. However they need to be nurtured and shared: it fades if it is not used.

- Cultivating core competence does not mean outspending rivals on research and development
- Core competence does not mean shared costs, as when two SBUs use a common facility.
- Building core competencies is more ambitious and different than integrating vertically.

Identifying core competencies

At least three tests can be applied to identify core competencies in a company:

- A core competence provides potential access to a wide variety of markets.
- A core competence should make a significant contribution to the perceived customer benefits of the end products.
- A core competence is a complex harmonization of individual technologies and productions skills: hence it is difficult to imitate.

It is unlikely that companies will build world leadership in more than five to six fundamental competencies. To identify core competencies, a good first step is to compile a list of 20 – 30 capabilities and to see aggregate capabilities as building blocks.

Losing core competencies

- Companies that judge competiveness primarily in terms of the price/performance of end products are in the danger of eroding the core competencies, or making too little effort to enhance them. Companies tend to surrender core competencies when they cut internal investment in what they mistakenly thought were just cost centers in favor of outside suppliers.
- In the short run, it is possible for companies to have a competitive product line up but be a laggard in developing core competencies. But when the fundamental technology is changed or if the supplier decides to enter the market directly and become a competitor, that company's product line, with all investments in marketing and distribution could be vulnerable. Outsourcing contributes little to building the people embodied skills that are needed to sustain product leadership.
- It is possible to lose core competencies when companies forgo opportunities in establishing competencies that are evolving in existing businesses. Often, companies exit from businesses which are considered as mature, only to miss out on whole streams of core competencies that emerge out of subsequent evolutions of those businesses.
- Costs of losing a Core competency can only be partly be calculated in advance.
- Since core companies are built through a long process of continuous improvement and enhancements, a company that has failed to invest in core competence building will find it very difficult to enter an emerging market, unless it is content simply to serve as a distribution channel.

From core competencies to core products

- The tangible link between identified core competencies and end products is called 'core products' – the physical embodiments of one or more core competencies.
- Core products are the components or subassemblies that actually contribute to the value of the end products. Thinking in terms of core products helps a company to distinguish between the brand share it achieves in end product markets vis-à-vis the manufacturing share it achieves in any particular core product.
- It is essential to make this distinction between core competencies, core products and end products, because global competition is played out by different rules and for different stakes at each level. To build or defend leadership over the long term, a corporation will probably have to be a winner at all levels.

- At the level of core competence, the goal is to build world leadership in design and development of a particular class of product functionality.
- To sustain leadership in the chosen core competence areas, these companies have to seek to maximize their world manufacturing share in core products. The manufacture of core products for a wide variety of external and internal customers yields the revenue and market feedback that, at least partly, determines the pace at which core competencies can be enhanced and extended.
- By focusing on competence and embedding it in core products, it is possible for companies to build up advantages in component market first and then leverage off their superior products to move downstream to build brand share.
- A dominant position in core products allows a company to shape the evolution of applications and end markets.
- Well targeted core products lead to economies of scale and scope.

Problems with the SBU view of organizations

Corporations can be conceptualized in two ways: SBU or core competence. Diversified corporations have a portfolio of products and a portfolio of businesses, but it is also required to view the company as a portfolio of competencies.

Problems with the SBU view of a corporation are as follows:

- Underinvestment in developing core competencies and core products: no single business may feel responsible for maintaining a viable position in core products, nor be able to justify the investment required to build world leadership in some core competence.
- Imprisoned resources: Typically, the people who embody the competences in an SBU are seen as the sole property of the business in which they grew up. They do not get assigned to the most exciting opportunities, and their skills begin to atrophy.
- Bounded innovation: if core competencies are not recognized, individual SBUs will only pursue those innovation opportunities that are close at hand – marginal product line extensions or geographic expansions. Hybrid opportunities will emerge only after the SBU concept is dismantled. Conceiving of the corporation in terms of core competencies widens the domain of innovation.

Developing Strategic architecture

To establish objectives of competence building, it is essential to develop a strategic architecture. A strategic architecture is a road map of the future that identifies which core competencies to build and their constituent technologies.

- Strategic architectures provide an impetus for learning from alliances and a focus for internal development efforts, and thereby can dramatically reduce the investment needed to secure future market leadership.
- The strategic architecture provides logic for product and market diversification.
- The strategic architecture should make resource allocation priorities transparent to the entire organization. It provides a template for allocation decisions by top management. It helps lower level managers understand the logic of allocation priorities and disciplines senior management to maintain consistency.
- The task of creating a strategic architecture forces the organization to identify and commit to the technical and production linkages across SBUs that will provide a distinct competitive advantage.
- It is consistency of resource allocation and the development of an administrative infrastructure appropriate to it that breathes life into a strategic architecture and creates a managerial culture,

teamwork, capacity to change and a willingness to share resources, to protect proprietary skills and to think long term.

- Strategic architecture is a tool for communicating with customers and other external constituents. It reveals the broad direction without giving away every step.

Redeploying to exploit competencies

- Core competencies are corporate resources and may be reallocated by corporate management. SBUs are entitled to the services of individual employees so long as SBU management can justify that the opportunity that it pursuing yields the highest possible payoffs on the investment in their skills.
- Reward systems that focus only on the product-line results and career paths that seldom cross SBU boundaries engender patterns of behavior amongst unit managers that are destructively competitive.
- Transfers for the sake of building core competence must be recorded and appreciated in the corporate memory: losses in performance due to surrendering of core skills should be acceptable in the short term.
- Employees should be weaned key employees off the idea of belongingness to any particular business.
  - Those who embody critical core competencies should know that their careers are tracked and guided by corporate resource professionals.
- Competence carriers should be regularly brought together to exchange ideas: the goal is to build loyalty to the integrity of the core competence area they represent and not just to particular businesses.

12. Competing on Resources (Collis & Montgomery)

1. Managers complain that strategic planning is too static and too slow.
   a. New waves of approaches have been proposed to address threats to premises of strategic planning
   b. Each compounded the confusion about strategy that besets managers

b. New approach
   a. grounded in economics,
   b. explains how a company's resources drive its performance
   c. builds on existing approaches

3. Forms of resources
   a. Physical
   b. Intangible
   c. Organizational capabilities
   d. Competitively distinct

4. Competitively valuable resources
   a. the test of inimitability: is the resource hard to copy
      1. physical uniqueness
      2. path dependency
      3. casual ambiguity

Economic deterrence

a. the test of durability: How quickly does this resource depreciate
    i. the longer it lasts the more valuable it is.
    ii. technical know-how in a fast-moving industry is a rapidly wasting asset.
b. the test of appropriability: Who captures the value that the resource creates
c. the test of substitutability: can a unique resource be trumped by a different resource?
d. the test of competitive superiority: whose resource is really better?

5. Strategic implications
    a. managers should build their strategies on resources that meet the 5 tests out lined above
    b. managers must continually invest in and upgrade their resources.

6. Investing in resources
7. upgrading resources
    a. moving beyond what the company is already good at
        i. adding new resources
        ii. upgrading to alternative resources
        iii. upgrade resources in order to move into a structurally more attractive industry.
8. Leveraging resources
    a. managers tend to overestimate the transferability of specific assets and capabilities
    b. managers overestimate their ability to compete in highly profitable industries.
    c. common diversification mistake is to assume that leveraging generic resources will be a major source of competitive advantage.

The authors say that strategy is being able to have resources that are inimitable, durable, appropriate, sustainable, and competitively superior. We think that the author's statement "Competitive advantage, whatever its source, ultimately can be attributed to the ownership of a valuable resource that enables the company to perform activities better or more cheaply than competitors" (p.120) provides the essence of strategy.

The three most important points that the authors make are understanding the importance of the resource-based view of the firm, the five tests that determine if a resource is qualified as an effective strategy, and managers should build their strategies on resources that are valuable. As a group, we raised the questions "Can strategy be based completely around resources or must a company have a wider scope to form a successful strategy?" and "if a company is competitive due to its culture, how do competitors find ways to duplicate that kind of resources?" This article connects with the "Strategic Intent" article.

The statement "Good corporate strategy, then, requires continual reassessment of the company's scope" captures the author's ideas. This article does have a "ring of truth" to it, as the author presents his ideas and also proves his points. The authors did make the case for the main points of the article. Great support was used, as numerous companies were used as examples as to how they have been able to strategize. The support and the simplicity of this article helped us to believe it.

After studying this article, we understand how businesses must arrange their strategies around the value of their resources. We think that this article fits well with the Learning School.
The major contribution that this article made is that it enhances other models. We think that the fast food industry could benefit from applying this article to their business model.

13. How To Design a Winning Business Model (Casadesus-Masanell & Ricart)

The article focuses on how companies might **compete more effectively** through business models
In a nutshell:

- Executives believe competing through business models is critical for success, few understand how best to do so.
- One common mistake: Focus on creating innovative models and evaluating their efficacy in standalone fashion –Akin to engineers testing new technologies or products.
- The success or failure depends on how it interacts with other players in the industry.
- Companies build them without considering competition –They routinely deploy doomed business models.
- Many companies ignore Dynamic Elements of Business Models.E.g. Microsoft, eBay, and Facebook

Business Models
What they are:

1. The story that explains how an enterprise works.
2. Answering the question:
    - Who is your customer,
    - What does the customer value, and
    - How do you deliver value at an appropriate cost.

Business Models
Why we need them NOW:

1. Deregulation, technological change, globalization, and sustainability have rekindled interest.
2. Pressure to crack open markets in developing nations.
3. Economic slowdown is forcing companies to modify or create new business models.
4. Rise of new technology based, low-cost rivals.

Business Models
Limitation and Challenges:

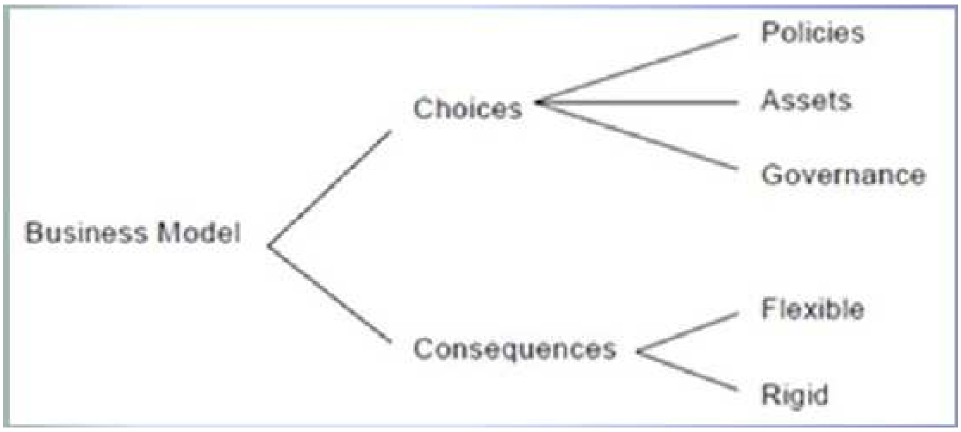
1. Companies' focus on creating innovative models, evaluating efficacy in a vacuum.
2. Propensity to ignore potential of dynamic business models. Undervaluing virtuous cycles.

Business Model
Characteristics of a ³Good´ Business Model:

1. Aligned with company goals.
2. Self-reinforcing.

3. Robustness.

Business Model
Choices VS Consequences:



Generating a Virtuous Cycle

- Competitive advantage of companies stems largely from their accumulated assets –They are consequences of BM choices.
- Favorable consequences enable further choices. Process generates Virtuous Cycles.
- As cycles spin, company stocks grow, enhancing competitive advantage.
- Virtuous cycles, over time, expand both value creation and capture.

E.g. Ryan Air, Irizar.

Generating a Virtuous Cycle
Beware the vicious cycle:

1. Virtuous Cycles reach a limit, triggering counterbalancing cycles.
2. VC slow down due to interaction with other BM's –When interrupted, synergies work in opposite direction, eroding competitive advantage.

E.g. Had Ryan Air's employees unionized/demanded higher wages.

Generating a Virtuous Cycle
Ryan Air VS Irizar:

1. Virtuous Cycles are not the birthright of low-cost, no-frills players. Differentiators may also create VC.
2. Focus on customer driven value and exploit innovation and empowered workforce.

Competing with Business Models

S Group VS Kesko:

1. To compete with rivals having similar BM, companies must quickly build rigid consequences; create and capture more value.
2. S Group, being a consumer cooperative may gain market share by offering customers bonuses on lowering prices BUT Kesko may increase profitability though its superior shopping experience.

Competing with Business Models
Strengthening your own:
Boeing VS Airbus

1. Boeing's 747 enjoyed monopoly until Airbus, afraid that the European subsidies currently keeping it afloat would soon dry up, took the bold step by introducing Airbus380.
2. Helped decelerate Boeing's VC.

Competing with Business Models
Weaken Competitor's cycles:

Microsoft VS Linux

1. Get ahead by using rigid consequences of choices to weaken new entrant's VC.
2. Microsoft used relationship with OEMs to preinstall Windows, keeping Linux customer base limited.
3. Spread fear and uncertainty about Linux

Competing with Business Models

Turn competitors into complements:
Betfair VS Ladbrokes and WilliamHill.

1. When a BM creates an environment conducive for the practices of its rivals without hampering its own market share.
2. Converts substitute goods into complementary ones.
3. Incumbents less likely torespond aggressively.

Then what is Strategy?
Business model refers to the logic of a company-

1. How it operates
2. How it creates value
3. How it captures value of stake holders in competitive market place

Whereas
Strategy is the plan to create a unique and valuable position involving a distinctive set of activities

And Tactics?
Strategy focuses essentially on deciding on <u>what</u> the organization is trying to do, what it is trying to become within its business environment. Changing strategy is difficult and often causes problems. *Tactic* is the implementation of the strategy. It is the set of management decisions focused on <u>how</u> to achieve the strategic objectives.

BM VS Strategy VS Tactics
Examples:

1. Once the organization decides that it wants to be a widget manufacturer, there are many decisions that must be made about how to profitably manufacture widgets.

2. Metro, the world's largest newspaper-Business Model: Ad sponsored free newspaper. Tactic: You cannot manipulate the price of the PRODUCT itself, only the ads.

14. Distance still matters (Ghemawat)

How to avoid entering a wrong foreign market—and select the right targets for your firm's global expansion? Look beyond a country's sales potential (as expressed by national wealth or propensity to consume)—and analyze the probable impact of distance. But don't focus only on distance's *geographical* dimension. Consider three other dimensions as well: *cultural factors* (religion, race, social norms, language); *administrative factors* (colony-colonizer links, currencies, trading arrangements); and *economic factors* (income, distribution-channel quality). The more two countries differ across these dimensions, the riskier the target foreign market. By contrast, similarities along these dimensions suggest great potential. Common currency, for example, boosts trade more than 300%. Also, types of distance affect industries differently. Religious differences, for instance, shape people's food preferences but not their choices of cement or other industrial materials. By analyzing the possible impact of distance— in all its dimensions—you sweeten the odds of investing in *profitable* foreign markets.

	Cultural Distance	**Administrative and Political Distance**	**Geographic Distance**	**Economic Distance**
Distance between two countries *increase* with...	- Different languages, ethnicities, religions, social norms - Lack of connective ethnic or social networks	- Absence of shared monetary or political association - Political hostilities - Weak legal and financial institutions	- Lack of common border, waterway access, adequate transportation or communication links - Physical remoteness - Different climates	- Different consumer incomes - Different costs and quality of natural, financial, and human resources - Different information or knowledge
Distance most affects industries or products...	- With high linguistic content (TV) - Related to national identity (foods) - Carrying country-specific quality associations (wines)	- That a foreign government views as staples (electricity), as building national reputations (aerospace), or as vital to national security (telecommunicati ons)	- With low value-to-weight ratio (cement) - That are fragile or perishable (glass, fruit) - In which communications are vital (financial services)	- For which demand varies by income (cars) - In which labor and other cost differences matter (garments)

Taking distance into account dramatically changes estimates of market opportunities. Managers must always be conscious of distance—in all its dimensions. The CAGE distance framework is intended to help managers meet that challenge. While it is necessarily subjective, it represents an important complement to the tools used by most companies seeking to build or rationalize their country market portfolios. Technology may indeed be making the world a smaller place, but it is not eliminating the very

15. Managing Differences: The Central Challenge of Global Strategy (Ghemawat)

Most business leaders and academics make two problematic assumptions with regard to global strategy, states Pankaj Ghemawat. They assume that:

- The central challenge is to strike the right balance between economies of scale and responsiveness to local conditions, and
- The more emphasis companies place on scale economies in their worldwide operations, the more global their strategies will be.

Any global strategy should instead revolve around managing the large differences that arise at the borders of markets, says Ghemawat. The two mistaken assumptions distract executives from exploiting market and production discrepancies—the response of *arbitrage*. In this article, Ghemawat maps out a framework—the AAA Triangle—intended to encompass all three effective responses to the challenges of globalization: Adaptation, Aggregation, and Arbitrage.

AAA Triangle

– Strategic map for managers aiming for globalization.
– 1 A or combine 2 A's
– Unlikely to use all 3 A's at the same time.
– Which will create most leverage?

Adaption

- Boost revenues and market share by maximizing a firm's local relevance
- Creating local units in each national market that do a pretty good job of carrying out all the steps in the supply chain

Companies that take the approach of Adaptation seek to boost revenues and market share by maximizing their local relevance. This might go as far as creating local units in each national market that do a satisfactory job of carrying out all the steps in the supply chain.

- Setting up mini branches of the company in target countries.
- Advertising intensity
- Local culture & presence
- Strategic levers include:
  - Decentralization
  - Flexibility
  - Partnership

Aggregation

- Attempts to deliver economies of scale by creating regional or sometimes global operations
- standardizing the product or service offering
- grouping together the development and production processes

The Aggregation approach involves attempting to deliver economies of scale by creating regional, or sometimes global, operations and standardizing the product or service offering and grouping together the development and production processes.

- Create regional or global operations
- R&D driven → large economies of scale
- Horizontal relationships
- Be cautious of homogenization
- Strategic levers include:
  - Regions or country groupings
  - Large platform

Arbitrage

- Exploitation of differences between national or regional markets
- Locating separate parts of the supply chain in different places, Ex: China, India

Finally, companies that take the Arbitrage approach exploit disparities between national or regional markets, often by locating different parts of the supply chain in different places.

- Separating supply chain in diverse countries
- Labor intensive organizations
- Outsourcing to reduce labor costs
- Vertical relationships
- Strategic levers include:
  - Taxes, regulations
  - Prices, knowledge, resources

The three strategic options are associated with different organizational types—country-centered; cross-border groupings such as global business units or product divisions, regional structures, global accounts; or by function with emphasis on vertical relationships. It's not advisable to give precedence to all three modes of organizing at the same time, and combining elements of more than one mode (as does matrix organization) increases managerial complexity. As Ghemawat shows, using several examples, organizations can draw from all three As to some extent. They should understand the trade-offs involved and how to balance the strategies. A summary scorecard based on the AAA Triangle helps executives to determine which of the three strategies, or which combination, is likely be optimal for them. Expense items in a company's income statements give strong clues about relative importance of the three A's.

From A to AA

- Two forms of AA strategies
  - Beats competitors in both dimensions at once
  - Manages tension between two A's better than competitors
- Must do more than allocate and monitor
- Hard and soft integrative devices
- Structural and algorithmic strategies

The Elusive Trifecta

- Organization's Constraints
    - Limited managerial bandwidth
    - "One culture organization" belief
    - Competitors can choose which strategy to beat them on
    - Effects on external relationships
- Tensions between the three A's must be weak

Broader Lessons

- Focus on only 1 or 2 of the "A's"
    - Easier to gain a competitive advantage.
    - Don't spread yourself too thin by going after all 3 at first.
- Make sure the new elements of a strategy are a good fit organizationally.
- Employ multiple integration mechanisms.
    - Pursuit of more than 1 "A" at a time leaves too much to chance.
- Think about externalizing integration.
    - Not all integration has to happen within a single organization.
    - Joint ventures in advanced semi-conductor research, development, manufacturing, etc.
- Know when NOT to integrate.
    - Tightly coupled systems.
    - Domain selection.
    - Keep activities that share a roof apart.

The article looks at the case of PMS, the smallest of the big three diagnostic-imaging firms, to show how a company could go about using the AAA Triangle to develop a globally competitive strategy. Ghemawat concludes by making explicit some of the main lessons brought into focus by the AAA Triangle. These include the advice to focus on one or two of the As; ensure the new elements of a strategy are a good fit organizationally; employ multiple integration mechanisms; think about externalizing integration; and to know when not to integrate. In a supplemental note (available only in the online version), Ghemawat compares and differentiates his model from those of well-known global strategy theorists such as C.K. Prahalad and Yves Doz, and Chris Bartlett and Sumantra Ghoshal.

16. Creating Project Plans To Focus Product Development (Wheelwright & Clark)

The long-term competitiveness of any manufacturing company depends ultimately on the success of its product development capabilities. New product development holds hope for improving market position and financial performance, creating new industry standards and new niche markets, and even renewing the organization. Much goes wrong during development. Mostly because companies lack an "aggregate project plan". They have too many projects going on at once and spend more time on short-term pressure than on the strategic mission of product development.

To create an aggregate project plan, management categorizes projects based on the amount of resources they consume and how they will contribute to the company's product line. Then, by mapping the project types, management can see where gaps exist in the development strategy and make more informed decisions about what types of projects to add and when to add them.

Sequencing projects carefully, in turn, gives management greater control of resource allocation and utilization. The project map also reveals where development capabilities need to be strong. Over time, companies can focus on adding critical resources and on developing the skills of individual contributors, project leaders, and teams. Finally, an aggregate plan will enable management to improve the way it manages the development function. Dimply adding projects to the active list –a common practice at many companies –endangers the long-term health of the development process.

- Create a set of projects that is consistent with the company's development strategies rather than selecting individual projects from a long list of ad hoc proposals.
- Get involved in the development process before projects get started, even before they are fully defined.

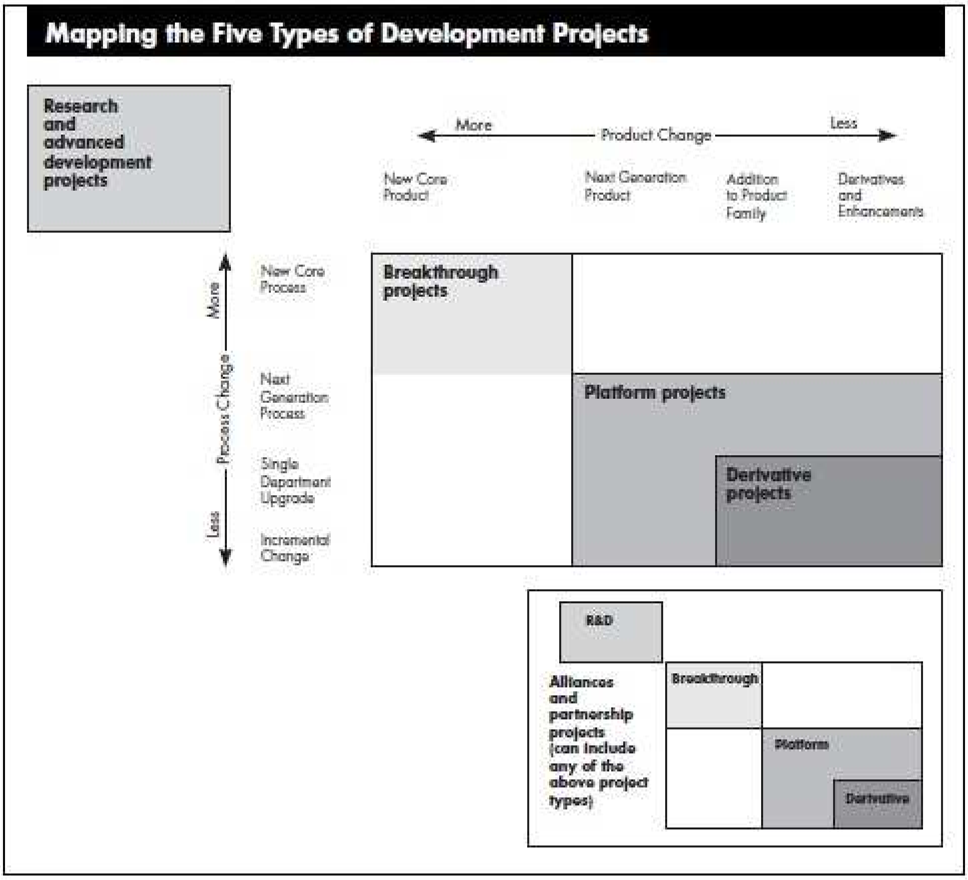
How to map projects

1. Define and map the different types of development projects; defining projects by type provides useful information about how resources should be allocated.
    a. Dimensions: Degree of change in the product
       Degree of change in the manufacturing process
       The greater the change along either dimension, the more resources are needed.

<u>Five types of projects</u>

1. Derivative projects
    I. Cost-reduced versions of existing products to add-ons or enhancements for an existing production process (product change/process change/material change).
2. Breakthrough projects
    I. Significant changes to products and processes.
3. Platform projects

I. In between derivative- and breakthrough projects

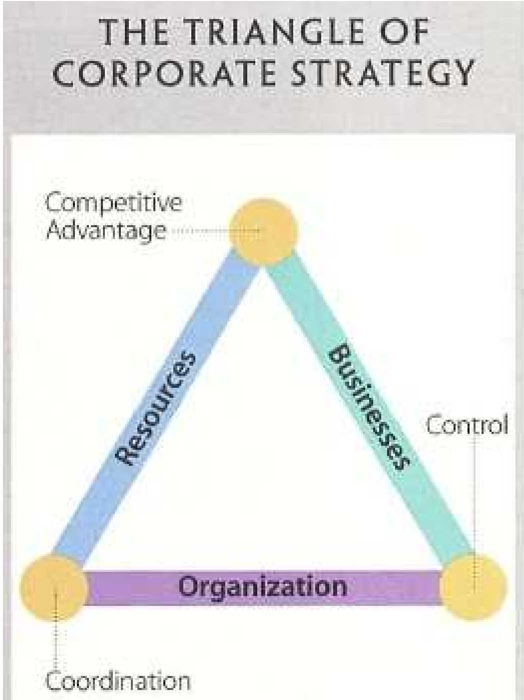


4. Research & (5) Development projects (no commercial development)
   I. The creation of the know-how and know-why of new materials and technologies that eventually translate into commercial development.

R&D projects compete with commercial development projects for resources. Because R&D is a creative, high-risk process, companies have different expectations about results and different strategies for funding and managing it than they do for commercial development. These differences can be great, but a close relationship between R&D and commercial development is essential to ensure an appropriate balance and a smooth conversion of ideas into products.

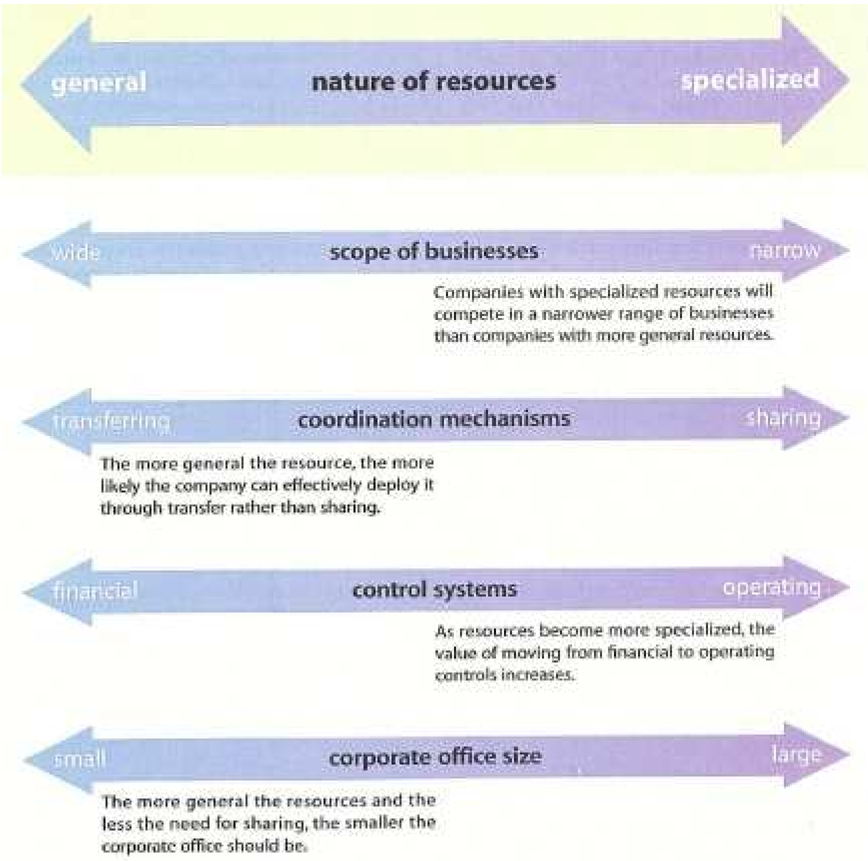
17. Creating Corporate Advantage (Collis & Montgomery)

Corporate advantage: the way a company creates value through the configuration and coordination of its multi business activities. The reason for the failure of creating value lies in focusing on the individual elements of corporate strategy (resources, business or organization) instead of focusing on the integrated whole of these elements. An outstanding corporate strategy actively directs executives' decisions about the resources the corporation will develop, the businesses the corporation will compete in, and the organization that will make it all come to life. But there's more to it than that: in a great corporate strategy, all of these elements are aligned with one another. That alignment is driven by the nature of the firm's resources –its special assets, skills, and capabilities. The firm's resources are the unifying thread, the element that ultimately determines the others.



The resource continuum

The resources that provide the basis for corporate advantage range along a continuum –from the highly specialized at one end to the very general at the other. A corporation's location of the continuum constrains the set of businesses it should compete in and limits its choices about the design of its organization along the other dimensions below.



The continuum of strategic resources is important because a corporation's location on the continuum constrains the set of businesses it should compete it and limits its choices about the design of its organization. Executives mistakenly enter businesses based on similarities in products rather than similarities in the resources that contribute to competitive advantage in each business. Example: The relatedness across its businesses comes not from similarities in the products themselves but from the common resources they draw on Newell's relationships with discount retailers, its efficient high-volume manufacturing, and its superior service, including national coverage, on-time delivery, and program merchandising.

There are two fundamentally different methods for monitoring and controlling the performance of subordinates and business units. The first, *financial control* holds managers accountable for a limited number of objective output measures, such as return on assets or aggregate sales growth. The second, *operating control,* recognizes that all sorts of events outside managers' influence, such as the bankruptcy of a major customer, may affect their performance. Rather than measuring outputs, operating control is concerned with evaluating managers' decisions and actions.

The acid test for any corporate strategy is this: the company's businesses must not be worth more to another owner.

18. The Granularity of Growth (Baghai, Smit & Viguerie)

Averaging out the different growth rates in an industry's segments and sub segments can produce a misleading view of its growth prospects. That is why executives should 'de-average' their view of markets and develop a granular perspective on trends, future growth rates, and market structures.

Going beyond averages to adopt a granular perspective on the markets is essential for any company as it shifts its portfolio in search of strong growth.

Seeking growth is rarely about changing industries—a risky proposition at best for most companies. It is more about focusing time and resources on faster-growing segments where companies have the capabilities, assets, and market insights needed for profitable growth. To make granular choices when selecting markets, management teams must have a deep and similarly granular understanding of what drives the growth of large companies and, in particular, of their own company and its peers. They can use the resulting growth benchmarks when they plan their portfolio moves. One thing they are likely to learn from the benchmarks is to avoid making unrealistic assumptions about a company's chances of consistently gaining market share.

Disaggregating growth

The growth profiles of companies began to emerge when we broke down their growth into three main organic and inorganic elements that measure positive and negative growth.

- Portfolio momentum is the organic revenue growth (the biggest) that a company achieves through the market growth of the segments represented in its portfolio. The company can influence the momentum of its portfolio in several ways. One is to select acquisitions and divestments, which affect the company's exposure to underlying market growth. Another is to *create* market growth—for instance, by introducing a new product category. Portfolio momentum (including currency effects) is in a sense a measure of strategic performance.

- M&A is the inorganic growth a company achieves when it buys or sells revenues through acquisition or divestment.
- Market share performance is the organic growth a company records by gaining or losing a share of the market. We define market share by the company's weighted-average share of the segments in which it competes.

The key point is that averages can be deceptive. The growth of segments within industries correlates closely with the differing profiles that emerge when we disaggregate the growth of large companies. This suggests that executives should make granular choices when they approach portfolio decisions and allocate resources toward busi-nesses, countries, customers, and products that have plenty of headroom for growth.

19. The New Dynamics of Managing the Corporate Portfolio (Carlesi, Verster & Wenger)

As investors demand that companies actively manage their business portfolios, executives must increasingly balance investment opportunities against the capital that's available to finance them.

A Natural Owner is the corporate parent that can bring out the most value in a business unit. Companies can be natural owners in several ways, depending on how they add value to a business. Operational synergies, for instance, may let them use the same technology, produce in the same plants, or distribute to the same channels where, business systems overlap. In specific situations, such as emerging markets, natural ownership can include superior access to capital and talent –one of the reasons emerging markets still have conglomerates with a broader business mix than we find in more developed countries.

Corporate skills also can be a source of natural ownership. The skills of any company are the product of its culture and history. Finally, natural ownership can come from corporate skills that generate proprietary insights for insiders in certain sectors and geographies.

Even if a company is the most natural owner of all its businesses, managers must constantly examine a company's entire portfolio of businesses and opportunities as if they were planning to reinvest all its capital.

In analyzing the capital balance, managers should distinguish among three types of capital decisions:

1. Capital deployed in existing businesses
2. Capital deployed in larger investment opportunities
3. Capital gained by exiting existing businesses

In all situations, managers who understand the elements of capital balance can make better-informed decisions.

To allocate capital among various opportunities, management has to understand the future economic returns that potential investments will generate, but assessing future returns is challenging and often poorly executed.

The right approach

Given the complexity of portfolio decisions, how should managers go about defining a portfolio strategy? Four hints:

1. Understand the context and objectives
2. Manage agency issues: make an independent (regarding to the operating business) person within the company responsible for making all final portfolio decisions.
3. Apply analytical rigor
4. Keep capital discipline

20. Mastering the Management System (Kaplan & Norton)

Successful strategy execution has two basic rules: understand the management cycle that links strategy and operations, and know what tools to apply at each stage of the cycle.

Like Conner, all too many companies – including some well-established public corporations – have learned how Gresham's Law applies to their management meetings: Discussions about bad operations inevitably drive out discussions about good strategy implementation. When companies fall into this trap, they soon find themselves limping along, making or closely missing their numbers each quarter but never examining how to modify their strategy to generate better growth opportunities or how to break the pattern of short-term financial shortfalls. Analysts, investors, and board members start to question the imagination and commitment of the companies' management.

In our experience, however, breakdowns in a company's management system, not managers' lack of ability or effort, are what cause a company's underperformance. By *management system,* we're referring to the integrated set of processes and tools that a company uses to develop its strategy, translate it into operational actions, and monitor and improve the effectiveness of both.

By creating a closed-loop management system, companies can avoid such shortfalls.
The loop comprises 5 stages:

5. **Develop the strategy**

I. *What business are we in and why?*

- Mission: a brief statement, typically one or two sentences, that defines why the organization exists, especially what it offers to its customers and clients.
- Vision: a concise statement that defines the mid- to long-term (3- to 10-year) goals.
- Values: prescribe the attitude, behavior, and character of an organization. Value statements, which are often lengthy, describe the desirable attitudes and behavior the company wants to promote as well as the forbidden conduct, such as bribery, harassment, and conflicts of interest, that employees should definitely avoid.

II. *What are the key issues we face in our business?*

- Study industry economics: e.g. with Michael Porter's five forces model
- Assess the external environment: e.g. with the PESTEL model
- Assess the company's internal capabilities and performance: e.g. with Michael Porter's value chain model.
- Summarize the conclusion from the external and internal analyses in a classic SWOT matrix

III. How can we best compete?

- In this step managers decide on a course of action that will create a sustainable competitive advantage by distinguishing the company's offering from competitor's and, ultimately, will lead to superior performance. The strategy must respond, in some form, to the following questions:

1. Which customers or markets will we target?
2. What is the value proposition that distinguishes us?
3. What key processes give us competitive advantage?
4. What are the human capital capabilities required to excel at these key processes?
5. What are the technology enablers of the strategy?
6. What are the organizational enablers required for the strategy?

6. Translate the strategy

Once the strategy has been formulated, managers need to translate it into objectives and measures that can be clearly communicated to all units and employees.

- Develop a strategy map, chunk it into strategic themes and link it to a measurement tool (e.g. BSC). Identify strategic initiatives intended to help achieve the strategy's objectives. A strategic initiative is a discretionary project or program, of finite duration, designed to close a performance gap.
- A strategic theme consists of a distinct set of related strategic objectives
- Advantages of strategic themes: (1) Customize to local conditions, (2) taking different periods of time in to account (short-term – Long-term).

7. Plan operations

With strategic metrics, targets, and initiative portfolios in place, the company next develops an operational plan that lays out the actions that will accomplish its strategic objectives.

I. Process improvements

The goal is to align near-term process improvements with long-term strategic priorities. Managers need to deconstruct each strategic process to identify the critical success factors and metrics that employees can focus on in their daily activities.

II. Sales plan

Managers also must identify the resources required to implement their strategic plan. Before they can do that, they need to deconstruct their overall sales target into the expected quantity, mix, and nature of individual sales orders, production runs, and transactions.

III. Resource capacity plan

Armed with data about productivity from process improvements and likely sales numbers, companies can now estimate what resources they will need in the year ahead to execute on their strategic goals.

IV. Dynamics operating and capital budgets

Once managers have determined the authorized level of resources for the future period, the financial implications become easy to calculate.

The company now has finished the integrated planning of strategy and operations, which encompasses the following steps: Formulate the strategy; translate it into linked objectives, measures, and targets; develop and fund the portfolio of strategic initiatives; identify the process improvement priorities; forecast sales consistent with the strategic plan; estimate the resource capacities required for those sales; authorize the spending on resources; and produce next period's pro forma income and detailed P&L statements. From here on, it is up to the managers to execute, learn, and adapt, moving the management cycle into its fourth stage.

8. Monitor and learn

As companies implement their strategic and operational plans, they need to hold three types of meetings to monitor and learn from their results.

I. Operational review meetings

II. Strategy review meetings

9. Test and adapt the strategy (meeting type 3)

From time to time managers will discover that some of the assumptions underlying their strategy are fl awed or obsolete. When that happens, managers need to rigorously reexamine their strategy and adapt it, deciding whether incremental improvements will suffice or whether they need a new, transformational strategy. This process closes the loop of the management system.

I. Cost and profitability reports

Anytime a company reviews its strategy, it should first understand the current economics of its existing strategy by examining activity-based costing reports that show the profit and loss of each product line, customer, market segment, channel, and region. Executives will then see where the existing strategy has succeeded and failed, and can formulate approaches to turning around loss operations and expanding the scope and scale of profitable operations.

II. Statistical analyses

Companies, especially those with large numbers of similar operating units, can use statistical analysis to estimate correlations among strategy performance numbers. Such analysis will usually validate and quantify links between investments in, for example, employee skills or IT support systems, and customer loyalty and financial performance.

III. Emergent strategies

The strategy offsite, beyond examining the performance of existing strategy, provides executives with a great opportunity to consider new strategy proposals that managers and employees throughout the enterprise may have suggested. Henry Mintzberg and Gary Hamel, in fact, argue against top-down strategy implementation, contending that the most innovative strategies emerge from within the organization.

Wrap up

Managers that carefully follow the recommendations we have laid out in this article will have a complete management system that helps them set clear strategic goals, allocate resources consistent with those goals, set priorities for operational action, quickly recognize the operational and strategic impact of those decisions, and, if necessary, update their strategic goals. The closed-loop management system enables executives to manage both strategy and operations, and to balance the tensions between them.