Business Strategy:
New Thinking for the '90s

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Strategy is what determines the framework of a firm's business activities and provides guidelines for coordinating activities so that a firm can cope with and influence the changing environment. Strategy articulates the firm's preferred relationships with its environment and the type of organization it is striving to become.

Hiroyuki Itami, Mobilizing Invisible Assets

Strategy: what an overworked word!

Today we have „strategic" customers, launch „strategic" marketing campaigns, and make „strategic" facilities investments. We „strategize" about the best way to find and retain key employees, handle our shareholders, and manage our technology. We assess the strategic value of our information and the fit between our corporate culture and our strategy. We link strategy to vision.

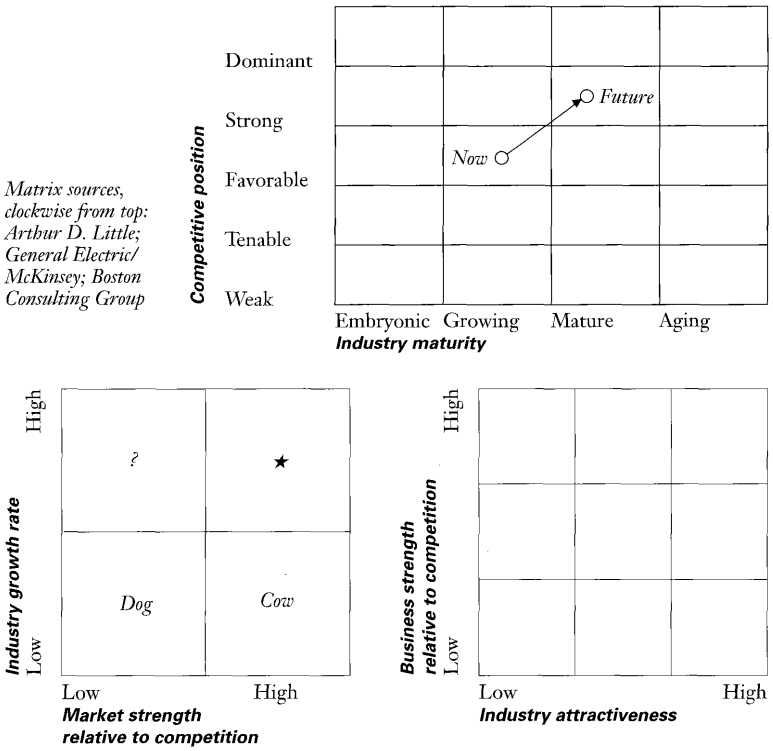
Let's rethink. What is strategy? To many, strategy once meant selecting the most attractive product/ market segments and determining the appropriate level of investment in each. Many useful tools and concepts, developed largely during the 1970s, gave managers important insights into the comparative attractiveness of the business options they faced (Exhibit 1). These constructs, which characterize business segments in terms of some variant of industry maturity and competitive position, have proven to be useful reflections of the levels of profitability – and hence the attractiveness – of a business at a given time. They remain valuable aids in addressing questions about expansion into new markets or businesses and in facing challenges of divestiture, business restructuring, or retrenchment.

But today fewer companies are wrestling with questions about which business to be in. There's a growing sense of „we're in this for the duration"; and with this sense has come a requirement for strategy that is both broader and more dynamic than the product/market variety.

Key strategic questions today are not just where to compete but to which end, how, with what, and with whom. Strategy helps not only the portfolio manager but also the operating head, who must devise ways to improve the performance of the business. In this broader sense, „strategy" deserves the breadth of application it has acquired.

Exhibit 1

Strategy is Formulated Relative to Competition

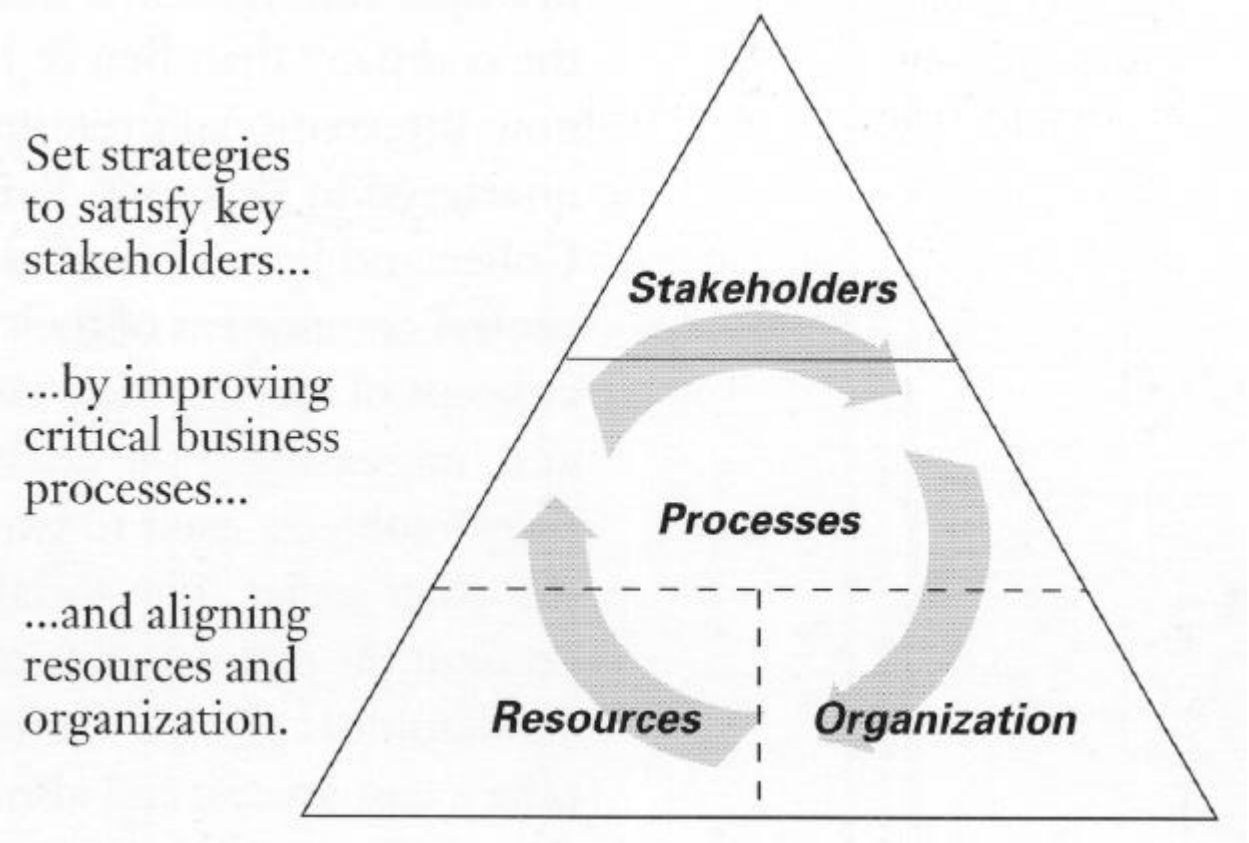


Strategy: A Stakeholder Definition

Today, a successful business strategy must be a holistic integration of decisions made at each level of the business, as diagrammed in our High Performance Business pyramid (Exhibit 2).[1] At the top, the strategy must reflect a detailed understanding of all the business's stakeholders – not simply its customers – and the ways the business will meet each group's needs. Even more, it must make the investment trade-offs necessary to balance all those needs – in ways that provide the firm with a unique advantage over its competitors.

Exhibit 2

The High Performance Business



At this level, the firm addresses the questions: What business are we in, and why? It makes strategic decisions to move into new markets or offer new products or services. It also makes decisions to evolve toward a different employee population – more or less risk-averse, more or less flexible – and to change a business's ownership profile, its relationship with its community, and so on. These questions are strategic in the broadest sense. They link strategy with vision.

Answering the question „What business are we in?" has always been the first step in strategic planning. But the traditional product/market response to this question falls far short of the complexity reflected in a true stakeholder-based strategy. In fact, each business is uniquely defined by both the stakeholders it serves and the ways it goes about satisfying them.

Many firms today articulate, as part of their mission statements, a commitment to multiple stakeholders – employees and owners, for example, as well as customers. Few provide a more vivid example of using these multiple commitments to define the very essence of the company than Ben & Jerry's – the once-regional, now-international premium ice cream maker headquartered in Vermont. Ben & Jerry's founders, Ben Cohen and Jerry Greenfield, have always held as a central component of their business definition the concept of serving their employees, their community, and, increasingly, the environment. Each year, Ben & Jerry's subjects itself to two audits, one financial and the other social. The social audit takes into qualitative account the company's contributions to such traditional stakeholders groups as shareholders, customers, suppliers, employees, and also to community members for whom the company has an active social outreach mandate. Examples of programs include voter registration drives (linked with ice cream give-aways), support (in the form of paid time) for employees doing community service work, environmental programs focusing on the decline of tropical rain

forests, and the investment of company funds in socially responsible financial vehicles.

According to Ben Cohen, the company's sponsorship programs and other community-based activities are not simply charity; they are the root of Ben & Jerry's' past, present, and future success. By intertwining financial and social performance, the company both generates media attention for itself and its products and makes its social vision an integral part of its day-to-day business activities.

Importantly, stakeholder-based strategy – as distinct from the product/market business strategy of old – encompasses conscious trade-offs and reinforcements among investments in various stakeholder groups:

• Employees, through direct compensation, benefits, training, security, and less tangible rewards such as pride in being associated with the firm

• Owners, via retained earnings, dividends, investments for long-term growth, and less tangible benefits such as satisfaction in contributing to employee contentment, excellent products, and valuable social programs

• Customers, in the form of investments in new products or services, lower prices, improved ancillary service features, and less tangible benefits such as a sense of virtue for purchasing environmentally sound products

• Other groups, via social investment, environmental excellence, or other factors

Just as there have never been iron-clad ways to define businesses in product-market terms, there are no *a priori* rules for balancing the needs of stakeholders. Although various tools can provide perspective, arriving at the appropriate stakeholder definition for a particular business is, in the end, the creative challenge for each company's leadership.

Operational Excellence

The second level of strategy deals with the firm's selection of what it does. Here one decides issues of scope: Which activities in the flow of operations or value chain of the business will be performed internally? Where will this particular firm begin and end? How far back will manufacturing start? What will be purchased? How close to the end-customer will the stream of operations reach?

This level also determines issues of competence: How well – with what speed, what quality of outcome, what efficiency – will the company perform each critical process? What advantage will it gain from developing products faster than its competitors? Can the quality of its customer service provide a basis for differentiation? What about manufacturing? And so on.

This level of strategy is roughly analogous to the step in the traditional strategic planning process of identifying the business's „basis of competition" or „key success factors" – with at least one major difference. The traditional strategic logic assumed that one – and only one – set of factors made up the basis of competition in each industry. Each participant, therefore, was measured against the same yardstick. For example, if productive research and development was determined to be the key success factor in an industry, then every company would have a strategy of doing the best R&D in the industry.

Today, there are many patterns of operational excellence chosen by successful competitors within an industry. In the prescription pharmaceutical industry, for example, Pfizer selected an unusual pattern of operational excellence over the past decade. Unlike many of its competitors, Pfizer chose not to base its quest for preeminence principally on the productivity of its discovery research (identifying new, therapeutically useful compounds in its own laboratories) – a capability that was once viewed as the essence of any major pharmaceutical firm. Rather, Pfizer perfected the process of in-licensing – of finding firms or academic institutions that had developed interesting compounds and convincing them to grant Pfizer the rights to develop and market the compounds. Pfizer's process for in-licensing includes an extensive international organization focused on scouring the globe for candidate compounds, plus a separate development laboratory specifically dedicated to work on in-licensed compounds.

The power of the latter is two-fold. First, it ensures that in-licensed work has top priority within the technical organization, avoiding the „not-invented-here" syndrome that can cripple a firm's ability to develop externally generated compounds in a timely way. Second, perhaps even more important, it helps Pfizer persuade potential licensors that their compounds will receive high-priority treatment. This separate licensing department has been a critical element in Pfizer's ability to outperform almost all major pharmaceutical firms in licensing operations over the past decade.

Thus, the second level of strategy today involves grappling with questions of where to invest for operational excellence – perhaps by excelling at processes that are not part of the traditional pattern of competition in the industry.

Enabling Resources and Organization

The foundation layer of the High Performance Business pyramid consists of the firm's resources and the organization of those resources within the company. Correspondingly the underpinnings of successful strategy are the decisions made about investments in these critical areas: What are the firm's core strengths in technology? How can the employees provide sustained value? Can the firm leverage its information for strategic benefit? How do investments in hard assets – such as facilities and property – constrain or enhance the firm's options for the future?

The strategic perspective on organization asks: What are the organizational characteristics that give this company unique strength? Is its culture, for example, more flexible, more innovative than its competitors? Has it embedded critical integrating concepts, such as quality-based thinking or a sensitivity to international issues, more firmly in the company's policies and practices? What formal structure will best reinforce and farther the firm's strategy?

Many companies today recognize the important strategic value of resources and organization. Once relegated to the realm of tactics, the acquisition of exceptional talent, the development of strong technology the maintenance of cultures that are uniquely well-suited to the challenge of the time, and so on, are now seen as powerful components of strategy.

In fact, for some small, entrepreneurial technology companies in fields such as biotechnology or computer sciences, resources and organization are, in essence, strategy. Developing and exploiting a strong technology core is their *raison d'être*. Similarly, the quality of their people – typically, their key researchers – is part and parcel of their strategy. Important, too, is the type of organization that the firm forges out of those resources, with careful attention paid to creating and sustaining special organizational cultures that nourish the strategic resources.

On a larger scale, 3M provides an example of a firm whose strategy is deeply embedded in the nature of its organization and core resources, particularly in technology. The company's strategy focuses on maintaining, expanding, and exploiting core areas of technology, such as adhesives, polymers, and other areas of chemistry, by maintaining a corporate culture that values – indeed, clamors for – constant technical innovation. This bias toward innovation is reflected in all aspects of the 3M organization, from its formal policies governing reward and recognition and its institutionalized forums for collaboration and scientific exchange, to the triggers for new organizational structures (evidence of entrepreneurial development of a new business) and its constant efforts to reinforce innovation in the culture.

An Integrated Strategy

Strategy thus becomes the definition of a firm's choice of investments in its stakeholders, processes, resources, and organization. Publicly, companies often become known and respected for their excellence in one of these dimensions. For example, IBM's mainframe business for many years was renowned for its deep understanding of and ability to satisfy the needs of the data processing manager. In contrast, Dell Computer is defined largely in terms of the critical process that it executes so well: its effective mail order marketing and distribution of computer hardware and software. Digital Equipment Corporation historically built on its strength at the third level of strategy: its tremendous competencies in the technology-based resources associated with minicomputers.

Appealing though such single-dimension strengths may be, the real power of strategy lies in the successful integration of the whole – i.e., the linkage, balance, and support among all three levels of the pyramid. For example, Ben & Jerry's' philosophy of commitment to multiple stakeholders would mean little without the close and successful alignment of its processes, resources, and organization. Its manufacturing processes ensure products of sufficiently high quality to provide the platform for addressing broader stakeholder needs, while its organizational policies govern employee compensation for socially directed activities. Similarly, IBM's understanding of its customer stakeholder group at its peak was clearly supported and enhanced through excellence in its customer service processes, the quality of its people resources, and the cohesive „Big Blue" organizational culture that ensured a consistent commitment to serving that customer group well. Success lies not in excellence in the single defining feature of the corporation, but rather in the integration of the strategy among all levels.

Moving Forward

In setting a course of strategy, businesses face two broad issues: where are we starting from, and where do we hope to go? Where the company is today is the consequence of many past decisions, investments, and external events. Recent academic literature on strategy has provided important insights about understanding current situations and how they arose.[2]

The more exciting question is where a company should go. „Build on your strengths" is one common answer. But many companies have found that understanding their current core competencies and capabilities helps define

constraints but does not provide a road map for the future. Strategy practitioners have long found that robust strategies emerge from creative thought rather than from *a priori* analytical rules. Examples abound of successful companies following many different paths, often in violation of frequently espoused rules of differentiation, cost leadership, and the like.

Strategy involves selecting areas where the company will choose to build and maintain preeminence over time and balancing all the remaining elements to achieve a smooth, integrated whole. It is fundamentally a creative process more than an analytical one. Nonetheless, certain tools and approaches can prove useful in the quest.

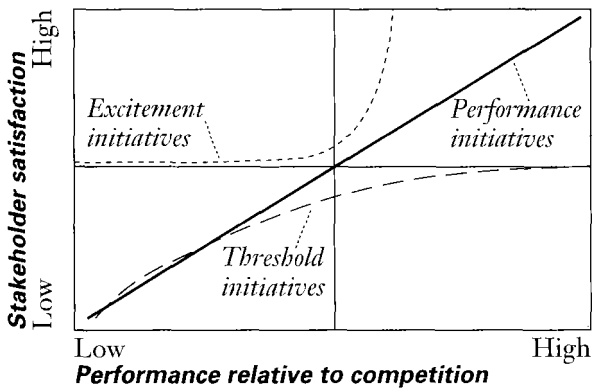
Tools for Today's Strategy

The tools and approaches that provide the greatest benefit to strategic thinking allow management to gain new perspectives, deeper understanding, and creative insight into the opportunities the company will face with respect to its stakeholders, processes, resources, and organization.

Stakeholders. In thinking about how to balance stakeholder needs, we built on a chart first developed by Professor Noriaki Kano in his work with quality to develop the Strategic Response Matrix (Exhibit 3).

Exhibit 3

The Strategic Response of Selected Initiatives



This matrix is enormously useful in exploring the „return on investment" (ROI) of various initiatives (including product features, services, and programs) under consideration for meeting the needs of a given stakeholder group. The ROI in this case is measured by the level of satisfaction that a proposed action would create, compared with the investment required. As shown in the exhibit, the satisfaction ROI curves for various options can differ significantly. We call options with high, accelerating satisfaction ROI excitement initiatives; those with steady incremental satisfaction ROI performance initiatives; and those with diminishing or negligible satisfaction ROI, threshold initiatives.

Since we began working with these tools several years ago, we have learned a lot about understanding stakeholder needs well enough to use this approach success-rally. For example, in a study to benchmark this process, one of our teams found that the approaches taken by major firms such as Ford, Hewlett-Packard, Johnson & Johnson, Merck, Motorola, and Procter and Gamble are similar in several respects:

• They do a good deal of market research in-house under the direction of senior people; often, those senior people do this research themselves.

• They use tools such as survey research to build knowledge of their customers that is broad but shallow. They also use tools such as ethnographic studies to acquire knowledge that is deep and strategic. The deep knowledge of the strategic segment of customers known as the „lead adopters," who have a powerful influence on the attitudes of other customers, provides the greatest pay-off.

• Because they acquire deep knowledge of strategic customers, they can develop much better questions to ask these customers and a much finer sense of the satisfaction ROI of given options. This understanding yields a level of insight into customer needs beyond the reach of conventional methods of market research.

Our work on stakeholder strategy over the last few years has also reinforced our belief in the importance of balanced investment among the various stakeholder groups. The approach we use follows a simple logic:

• Meet (but don't exceed) the threshold needs of all key stakeholder groups.

• Select a combination of performance options that draws from each group.

• Then consider a limited number of excitement options based on your overall ability to invest in those options.

The performance options selected represent, in a sense, your unique response to the current basis of competition in the industry; the excitement options become your creative investment in changing the basis of competition for the future.

Critical Processes. In helping many clients select critical processes for strategic advantage, we have made three basic observations that may be helpful during the strategy formulation process.

First, companies rarely have more than eight to ten broad strategic processes, and they rarely excel at more than two or three. Don't try to define your processes much more narrowly or you risk losing sight of broad, important themes.

Second, superior firms monitor their process strength through the continuous and rigorous application of benchmarking techniques. From a strategic perspective, significant understandings are often derived from intraindustry benchmarking, which compares your strength in critical processes against that of your competitors.

Finally, the most important strategic insights come from searching for the patterns among competitors' process strengths, rather than looking at isolated processes. Pfizer, in our earlier example, has two processes that work hand-in-glove to provide unique competitive advantage: its global searching for new compounds and its rapid and effective in-house development of those compounds. We suggest that you lay out the relative strengths in critical processes of the leading participants in your industry to highlight the combination of key capabilities each firm is using for successful strategic advantage.

Resources. Investments in resources should be based on satisfactory answers to five questions:

• How important is this resource to our strategy?

• How widespread or accessible is this resource in the world at large?

• How strong are we already in this resource area?

• How flexible is this resource?

• How adaptable is this resource?

Resource investments must reinforce and further develop areas of strength, or core competencies, but only if those strengths are both strategically important and at least somewhat differentiating (i.e., not widely or commonly available). Furthermore, resources must be flexible enough to do a variety of things and adaptable enough so that, as market conditions evolve, they remain useful over time. Toward the latter end, it is particularly important to strike a sensible balance among investments in the different types of resources available to the firm: technology, human resources, information, and capital assets.

During the early 1980s, colleagues at Arthur D. Little developed a series of concepts to understand technologies and help make differential investment decisions under the broad concept of the Strategic Management of Technology (SMT). More recently, we have found that this conceptual structure provides a foundation for exploring the full range of strategic resource issues. Basically, the SMT approach looks at each resource in terms of its competitive impact, maturity, and competitive strength.

• *Competitive impact.* Resources are categorized according to their ability to influence the execution of strategy. Base resources are necessary but non-differentiating and yield limited strategic benefit; key resources are the critical competitive assets for today; and pacing resources are expected to provide new advantage in the future.

• *Maturity.* Resources are assessed on the basis of their stage of development out in the world. Categorizations range from embryonic (very new, fairly rare, and rapidly evolving) through growing, maturing, and aging.

• *Competitive strength.* Resources are classified as weak, tenable, favorable, strong or dominant, reflecting their current market position.

By applying these three concepts together, companies can create multidimensional maps of various resources – an exercise we have found extremely useful in identifying the appropriate types and levels of make-or-buy and other strategic investment decisions for a broad range of resources.

Organization. By organization we mean the structure, policies, and culture of the company. How does management create an organization that supports its overall strategic orientation? Our recent experience helping develop cohesive organizations that promote change and performance improvement has led toa somewhat

contrarian view regarding the logic of organization design. We have found that the principal factor driving success is the organizational culture. Policies and procedures come second, and organizational structure follows as a supporting consequence of culture and policies.

The culture of a firm is shaped by its stated policies but also – significantly – by the unwritten rules of behavior that condition the way people really act.[3] In company after company, we find that these unwritten rules exert the most powerful – and often overlooked – influence on the linkage between organization and strategy. No amount of strategic vision and direction will have long-term impact if the people in the organization are not motivated to respond appropriately. Furthermore, although the unwritten rules that define a given culture appear intangible, we have found that they are in fact readily identifiable and easy to codify. And they can be „rewritten" so that people's authentic motivation aligns with the firm's strategic goals.

Organizational structure and formal policies are the tools management can use to implement real change in the desired strategic direction. But both must be based on a solid understanding of unwritten rules and their effects on operational actions.

Strategy formulation today is the exercise of building a coherent whole, a self-reinforcing business. The process begins with the recognition of the limitations dictated by history and then creatively defines the business in stakeholder terms. Once that focus is set, all the remaining aspects of a High Performance Business – its processes, resources, and organization – must be brought into balance. This activity is not inherently analytic but creative, not science but art. Nonetheless, there are many tools that can help ensure that the resulting work of art will be a masterpiece.

[1]*For a discussion of the High Performance Business, see* Prism, *first quarter 1992.*

[2] *Pankaj Ghemawat, in Commitment:* The Dynamic of Strategy, *compellingly illustrates that what a company does well at any time was determined long ago by day-to-day investments and operating choices. C. K. Prahalad, Gary Hammel, and George Stalk, in recent* Harvard Business Review *articles, discuss understanding competencies and capabilities as the foundation for competitive advantage.*

[3] *For further discussion, see „Removing the Barriers to Becoming a High Performance Business," by Peter B. Scott-Morgan,* Prism, *first quarter 1992.*

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