



"turning data into dollars"

Tom's Ten Data Tips – October 2008

Corporate Strategy

Strategy is one of those elusive concepts that everybody 'knows' but few people can define. Freedman: "... strategy is the *framework of choices that determine the nature and direction of an organization*. The choices in the framework relate to what products and services will be offered and not offered, what markets will be served and not served, and what capabilities are needed to take products to markets."

Note how this definition is much more fundamental than a "game plan." No CEO can take hold of an organization without a clear shared vision of the future, and a means to communicate this across layers of the enterprise.

1. Strategy Is *Not* About "Doing What Customers Want", Nor About "Core Competencies"

In spite of Michael Porter's (mostly unreadable, btw) tomes, strategy formulation is not about defining one's core competencies. Nor is it about finding "white space(s)" in the market. The internal focus has misled many companies. Of course the external view, or "voice of the customer" must be included in strategy formulation. But neither of them are sufficient. Strategy is about juxtaposing your capabilities and assets on existing and future market needs. At this *intersection* strategy formulation takes place.

Many so-called customer-centric companies have gone overboard by delivering what customers want. The reason that cannot work is because explicit consideration must be given to where a match between capabilities and market needs can be met, in a way that is *profitable and sustainable*. An "internal" focus on core competencies risks losing sight of future needs of (possibly altogether new) customers. It is actually not the trends, but rather the trends *in* trends that catch corporations off guard.

2. Strategy Is Your Bearing On The Horizon, Tactics Is How To Get There

There is a lot of confusion in the literature about strategy and tactics, worsened by the fact that strategy is not necessarily long-term, nor is

tactics always short-term. Strategy guides corporate decision making like a magnet is attracted to poles: when off-course, it gets pulled back northbound. A solid strategy pulls harder than a weak one. Think of strategy as your bearing on the horizon, tactics provide the means to get there.

Note that this definition explicitly denies a relation between strategy and "short-term" and "long-term". Sometimes tactics are long-term, and for very nimble companies their strategy must be short-term!

3. There Is No Free Strategic Lunch

Although customers are getting more and more value every year for the same amount they pay, there are "natural" boundaries to where offerings can stretch. Michael Porter has labeled a continuum running from product differentiation to cost leadership. Although in different wordings, most other theorists are in general agreement with these principles. At the cost leadership end of this continuum (Wal-Mart, Toyota, etc.), companies *must* choose a tradeoff between desirable product (& service) features and the lowest possible price one can afford to offer (see also tip# 7).

As companies aim to offer more value to their customers they tap into essentially limited resources. It is possible for one manufacturer to overtake another, and this process can repeat itself. Yet at any point in time there are trade-offs that need to be made. For example, although combustion engines are getting better year by year, at any point in time there's a tradeoff between power and fuel economy.

4. "Pure" Strategies Are Riskier And More Profitable

In Porter's model, strategies can be positioned along the product differentiation – cost leadership dimension. One could make a case that Treacy & Wiersema's triad unfolds the product dimension into product leadership and customer intimacy (both would be mapped onto product differentiation in Porter's model). A "pure" strategy lies at either one of the extremes of this dimension.

It has been demonstrated empirically that firms at these extremes are *both* more profitable (on average), as well as more likely to go out of business (materially higher risk of bankruptcy). The latter happens when structural changes in the market like new technology, (de)regulations, etc. beat the velocity at which firms can adapt to new

circumstances. So although taking risks doesn't make you more profitable, more profitable strategies *are* riskier.

5. Adaptive Strategies Don't Work

Adapting one's strategy when market conditions change seems a given. Then why is this so hard? First of all, organizational change *is* difficult, and it needs to (at least) match the pace of change in the environment. 'Famous' are the "Good to Great" or "Built to Last" exemplar companies that find themselves struggling only a decade or so later... Secondly, different elements in the competitive environment tend to be changing at different rates, exacerbating the problem of 'the right' organizational response to change.

Finally, really fast change in the environment is simply too hard to respond to *competitively*. Disruptive technology change, (de)regulation, exogenous shocks (like a credit crisis), simply require new and fundamentally *different* capabilities than were required in "the old" market. A new entrant, or recombination of existing players (e.g.: AOL/Time Warner, Fox Newschannel, etc.) are better suited to leverage new dynamics in the market. Adapting then simply comes too slow because a vested interest in the "old" core competencies used to be the basis for previous success.

6. Product Development *Can Not* Be Led By Customers

Although it is imperative that companies keep "an ear to the ground", new (truly innovative) product development can never be led by customers. The most important reason for this is that customers are notoriously poor at dreaming up products that they haven't yet experienced. It is even harder to imagine a solution that will fulfill currently unmet (latent) needs.

Who could have imagined that text-messaging would break through? Cell phones are cumbersome to operate, and a phone keyboard is horribly unergonomical! Product concept testing remains in part an art, not science. This is because the further away from existing products we are testing, the more challenging it is to imagine what a product would "do" for you.

7. Innovations Are Never Universally Better

The difficult challenge in coming up with new innovative products is not to find something "better". That's because there are always needs

that could be better met. What is *really* difficult is where to make a tradeoff: the greatest innovations involved a tradeoff between some features that performed better, at the cost of others that deteriorated. But then the end result should lead to an *overall proposition* that meets some customer needs better than the best alternative currently available.

8. Strategy Determines The Place In The Value Chain

When an organization sets out to define its strategy, in essence it determines which aspirations it holds with regards to claims on the value chain. This is likely to be one of the defining competitive distinctions for corporations in crowded and mature market places.

Some of the recent corporate moves to refocus on “core competencies” are driven by the realization that many capabilities *can* be outsourced. Senior management may feel this allows them to focus more clearly on its superior contribution in the value chain. Pricing of these services is only part of the equation if you accept that management attention is a limited resource and should be allocated accordingly.

9. Portfolios Of Strategic Options Hedge Strategic Risks

Despite advances in forecasting and scenario planning nobody can predict the future with any degree of certainty. The board owes it to its shareholders to take multiple possible alternative futures into account and hedge accordingly.

Creating a portfolio of strategic options means allowing for multiple business *models* to compete “internally”. A corporation need not claim full ownership of all possible strategic options, as long as (re)gaining ownership remains a possibility if that option proves the most viable due to market developments.

10. Strategic Targets Need To Be Realistic

At the end of strategy formulation, targets need to be set. As Peter Drucker has said, stretch targets enable personal growth. However, these targets ought to be *ambitious*, but should be *realistic*. Although growth is important, the manner in which it is achieved is all important. Growth with a poor business design destroys value, instead of creating it. DEC, People Express, examples abound. Secondly, growth needs to be managed and brings its own set of risks with it like

estimating *how* fast you should grow. Thirdly, growth implies reaching out to new customers which invariably leads to some mismatches. These either need to be shed again, or served at less favorable conditions.

Growth is necessary, yet at the same time exceedingly difficult to plan 'just' right, sort of like Goldilock's porridge...