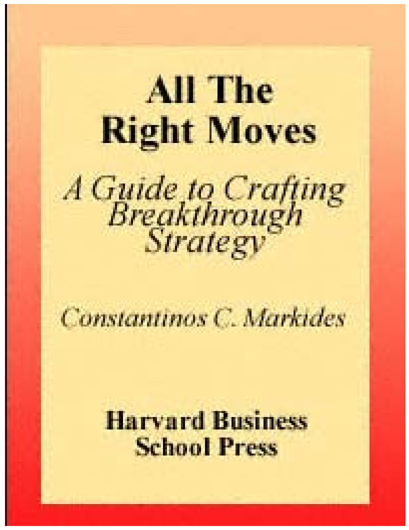

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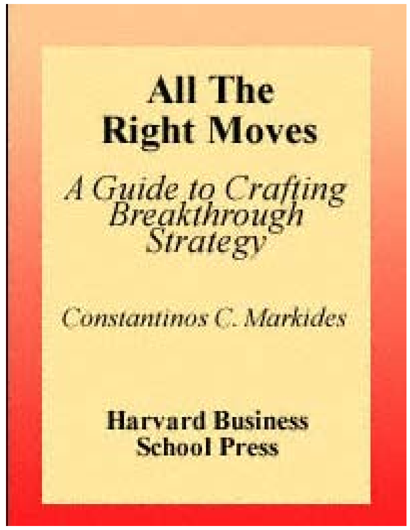
All The Right Moves

A Guide to Crafting Breakthrough Strategy

Constantinos C. Markides

HARVARD BUSINESS SCHOOL PRESS Boston, Massachusetts



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PREFACE

In early 1988, the newly appointed CEO of the small Danish bank Lan & Spar was under pressure to rejuvenate his financially troubled organization. Peter Schou had taken over as CEO at a particularly bad time: deregulation of the Danish banking industry in the mid-1980s had led to mergers, consolidations, and turbulence in the industry. Despite being more than one hundred years old, Lan & Spar was hit hard by the changes in its environment and was in danger of going bankrupt.

Schou had been working in the industry since the age of sixteen. All those years in banking, however, did not make the job he had to do any easier. He knew that the bank's current strategy was not working. He also knew that it was up to him to develop a new one. But what, exactly, should go into the new strategy? And how should he go about developing it?

If Schou had turned to an academic for help, it is unlikely that he would have received much useful guidance. Despite the obvious importance of a superior strategy to the success of an organization, and despite decades of academic research on the subject, there is little agreement among academics as to what strategy really is. Nor could Schou have expected too much help from other CEOs or managers. If asked, most practicing executives would have defined strategy as "the actions you take to achieve your company's objectives." Although technically correct, this definition is so general as to be virtually meaningless.

Needless to say, this state of affairs is unfortunate. Undoubtedly, part of the confusion is self-inflicted. But a major portion of the problem results from a genuine lack of understanding among managers and academics about the content of strategy. We simply do not know what strategy really is or how to develop a good one.

This book is concerned with the art and craft of creating strategy. It takes the perspective of a senior manager who is about to develop a new strategy for his or her organization and explores the thinking process that this manager should go through to create an innovative new strategy. It therefore asks the twofold question, "What issues should this manager address in thinking about a new strategy, and how should he or she think about them?"

Despite the seeming simplicity of this question, it addresses one of the most controversial issues in management today. People seem to disagree about almost every aspect of strategy making that this question raises: they disagree about which issues to address in developing strategy, they disagree about the process of developing strategy, and they even disagree as to whether one can "think" about strategy at all.

In this book, I propose an answer to this question that is based on my research of the past three years. A variety of companies have been the focus of this research, all of them strategic innovators in their industries. These are companies whose strategies have not only been fundamentally different from those of their competitors but have also turned out to be tremendously successful. By studying these successful innovators, I believe we can develop a deeper understanding of what accounts for the making of innovative strategies.

I've observed that there are certain simple but fundamental principles underlying every successful strategy. When one goes beyond the surface differences in such strategies and probes deeper into their roots, one cannot fail but notice that all successful strategies share the same underlying principles. Thus, the principles of Microsoft's successful strategy are essentially the same as those which propelled Sears to industry leadership one hundred years ago. My argument is that by understanding these basic principles, any manager can use them to design a successful strategy.

Still, designing a successful strategy is not a scienceit is an art. It is the art of asking intelligent questions, of exploring possible answers, of experimenting with possible solutions, and of starting the thinking process all over again by questioning the answers arrived at a year or two before. Effective strategic thinking is the process of continually asking questions and thinking through the issues in a creative way. Thus, correctly formulating the questions is often more important than finding a "solution," thinking through an issue from a variety of angles is often more productive than collecting and analyzing unlimited data, and actually experimenting with new ideas is often more productive than conducting extensive analysis and discussion.

Designing a successful strategy is also a never-ending quest. Just because companies like Dell or Wal-Mart have superior strategies and are successful *today* is no guarantee that they will be successful tomorrow. To be successful tomorrow, they will need to develop a strategy that will be superior in *tomorrow's* market; and to do that, they must understand the underlying principles of their successful strategy of today. Thus, even successful companies need to understand the logic of successful strategies. This is especially so if they arrived at their strategy by means of intuition, trial and error, or luck. It is highly unlikely that the same company will be "lucky" twice. But if its managers understand the principles of successful strategy making, they will be more likely to craft yet another superior strategy once their current strategy has run its course.

Structure of the Book

The basic premise of this book is that *superior strategy is all about finding and exploiting a unique strategic position in the company's business while at the same time searching for new strategic positions on a continuing basis.* From a managerial perspective, this raises several thorny issues, such as:

- What, exactly, is a strategic position and how can a company create a unique one in its business?
- How can an established company discover a new strategic position, especially at a time when its existing operations are quite profitable? How can an established company shift its attention away from improving its existing position to discovering a new one?
- How can a company know if a newly discovered position will turn out to be a profitable one?

• Even if a company discovers a new strategic position, can it manage two positions (the old and the new) at the same time? Is this even possible, or should the company focus on one of the two?

My aim in this book is to provide answers to these questions. After an introductory chapter, Part I (Chapters 2-7) explores the question "What is a strategic position and how can a company create a unique position in its industry? " Part II (Chapters 8-10) examines the consequences of introducing strategic innovation to the firm and explains how established companies can discover new strategic positions and then serve the old as well as the new at the same timeif that's the best course to take. Part II also explores the ways in which a company can phase out a strategy whose effectiveness is in decline while phasing in a new one to replace it.

While the ideas I present here are based on my research on a number of companies from a variety of countries and industries, I focus on a few instructive cases to highlight my points. In particular, I refer repeatedly to Edward Jones (Unites States), Nespresso (Switzerland), Lan & Spar Bank (Denmark), Canon (Japan), Boddington Group (United Kingdom), Hewitt Associates (United States), and Leclerc (France). These detailed case examples will be interspersed with material from several other companies as well as publicly available information.

Acknowledgments

I started writing this book three years ago. But the ideas in it first saw daylight as far back as 1990 and have matured and evolved over the years, aided by the contributions of the remarkable colleagues and senior executives with whom I have been privileged to work.

My first thanks go to my intellectual family at the London Business School and in particular to Sumantra Ghoshal and John Stopford. They have protected and nurtured me through the years, and in return I stole their ideas! Thank you.

A special thank you also to Booz • Allen & Hamilton and especially to Chuck Lucier and Bruce Pasternack for providing me and my colleagues in the strategy department of the London Business School with the financial resources to carry out our research. This book would not have been possible without their support. Thank you also to Harbir Singh and Ian MacMillan at Wharton, Orjan Solvell and Julian Birkinshaw at the Stockholm School of Economics, and Vassilis Papadakis at the Athens University of Economics and Business, all of whom provided me with an academic home during my sabbatical in 1996-97.

I am also grateful for the comments and advice of several other colleagues who read portions of this manuscript. Thank you to Harry Korine, Aya Chacar, Kim Warren, Don Sull, Dominic Houlder, Matthew Hayward, and Paul Geroski. I am particularly indebted to by brother Angelos, who tested many of the ideas in this book and gave me feedback on what worked and what didn't. My ideas have also benefited enormously from discussions and cooperative work with Peter Williamson, Gary Hamel, Paul Mang, Jose Santos, and Daniel Oyon. But above all, a special thank you to Costas Charitou. As my Ph.D. student over the past four years, he has been subjected to endless discussions on the subject of strategic innovation and has contributed enormously to the development of my ideas.

The ideas in this book derive from and have been test-run on several companies. A few of these companies and their executives prefer to remain anonymous. To all of themyou know who you arethank you. I hope you recognize a part of yourselves in this book. A heartfelt thanks to Peter Schou at Lan & Spar and John Bachmann and Doug Hill at Edward Jones: your companies are the birthplace of most of the ideas in this book. Thank you also to Jean-Paul Gaillard at Nespresso, Denis Cassidy at Boddington, Dale Gifford and Jack Bruner at Hewitt Associates, Jacques van Dijk and Henk de Back at Douwe Egberts, Robert Davis at Schlumberger, Olof Stenhammar and Nils-Robert Persson at OM Group, JeanClaude Biver at Blancpain, Peter Tillotson at Royal & SunAlliance, Graham Picken at First Direct, Pierre-Andre Steim at Migros, Peter Woods at Direct Line, Philip Twyman at CGU, and Haydan Leshel and Dr. Ulrich Hackenberg at Audi. Without your willingness to share your thoughts, it would have been impossible for me to write this book.

I have discussed most of the ideas in these pages with hundreds of executives around the globe. They have challenged me and

helped me structure my thoughts in far better ways than I could have done on my own. I'd like to thank, in particular, executives at Honeywell, Warner Lambert, Pirelli, Gartmore, Bowthorpe, Novartis, Barings, Standard Chartered, Energizer, Tibbett & Britten, Unilever, Bass, Schroder, Hill & Knowlton, Rea Brothers, BP, Polygram, Abbey National, MAM, Threadneedle, and British Aerospace.

What you now hold in your hands is the fourth draft of this book. It has been a long and laborious journey, but throughout I have been fortunate to have the help, support, and insights of Marjorie Williams at the Harvard Business School Press. She has singlehandedly shaped the structure and contents of this book. A special thanks to you Marjorie: without your help and guidance, this book would probably have been finished two years agobut its quality is another matter! I am also grateful to the superb editorial assistance of Barbara Roth and India Koopman at HBS Press. I gave them an ugly duckling and they transformed it into a beautiful swan. A million thanks!

The only person who has read this manuscript from beginning to end in each of its four different drafts and has unfailingly provided comments and suggestions every time is my brother George. All this because I promised him a free copy when it was published! Here's to you Georgeyou can have two free copies if you want.

LONDON

1
Put Innovation Back into Strategy

The strategist's method is very simply to challenge the prevailing assumptions with a single question: why? and to put the same question relentlessly to those responsible for the current way of doing things until they are sick of it.
Kenichi Ohmae, *The Mind of the Strategist: The Art of Japanese Business*

We've done some good work, but all of these products become obsolete so fast. . . It will be some finite number of years, and I don't know the numberbefore our doom comes.
Bill Gates, in *Daniel Gross, Forbes Greatest Business Stories of All Time*

In every industry, there are several viable positions that a company can occupy. The essence of strategy therefore is to choose the *one* position that your company will claim as its own. A strategic position is simply the sum of a company's answers to these three questions: *Who* should I target as customers? *What* products or services should I offer them? *How* should I do this? 1 Strategy is all about making tough choices in these three dimensions: the customers you will target and, just as important, the customers you will not target; the products or services you will offer and those you will not offer; and the activities you will engage in to sell your selected product to your selected customer and those you will not engage in. Ultimately, strategy is all about making choices, and a company will be successful if it chooses a *distinctive* strategic positionthat is, a position different from that of each of its competitors. The most common source of strategic failure is the failure to make clear and explicit choices in each of these three dimensions.

Two Companies That Chose Wisely and Chose Well

The value of making smart choices along the who/what/how continuum is probably best shown by example. Here are the brief strategic histories of two companies that chose well.

The Case of Edward Jones

The St. Louis, Missouri-based partnership of Edward Jones, with 1996 capital of $465 million, is not the largest brokerage firm in the United States. In fact, it is only the thirty-fourth largest. But it is one of the most profitable in the volatile securities industry, and it's growing like wildfire. Since 1981, Edward Jones has expanded its broker force at an annual rate of 15 percent, without making any acquisitions. It now boasts more than 2,500 partnersup from a total of 8 in 1981.

As described by many outside observers, including Peter Drucker, 2 the firm is a federation of highly autonomous entrepreneurial units bound together by a strong set of values and beliefs. The entrepreneurial units are the brokers themselves, who operate out of one-person offices located in small communities all across America. They make their living by selling financial products to the people who live in those communities. Foremost among the values and beliefs these brokers have in common is this: their job is to offer sound, long-term financial advice to customers, even if that advice does not generate short-term fees for the brokers. The "customer-first" value is ingrained in every single broker working in the Jones system.

It wasn't always that way. During the past fifty years, the firm has gone through three evolutionary stages. It was originally set up by Edward Jones, Sr., as a financial department storeone-stop shopping to satisfy all of a customer's financial needs. In the 1960s the department store concept slowly evolved into a financial services delivery system for rural America. This change was due to Ted Jones, son of Mr. Jones, Sr., who grew the firm into a network of 200 offices across the country. No longer traveling salesmen who passed through town every week or two, the brokers became more a part of the community. The idea was to convert Edward Jones into a distribution network to sell mutual funds in rural America.

The third stage in the evolution of Edward Jones began in 1970, after the arrival of John Bachmann, who is today the firm's managing partner. In what he describes as a "defining moment" for the firm, Bachmann set about to convert Jones into a "merchant"that is, an informed buyer for the end-customer. According to Bachmann, the difference between being a distributor and being a merchant is crucial:

> A distributor is structured around the product and tries to sell only profitable products. A merchant, on the other hand, is structured around the end-consumer. He acts as an informed buyer for the investor, selecting only the products that are good for the investor, as opposed to products that generate fees for the brokers. Most investment firms look at brokers as their customers. We don't. For us, the customer is the individual investor that signs the checks.

This vision of being a merchant for the individual investor has guided the company's every move since 1980. It has also shaped its current successful strategy, the main elements of which are the following:

• Unlike its major competitors (Merrill Lynch and Smith Barney, for instance), which sell their own in-house mutual funds, Edward Jones does not manufacture the products it sells. Instead, it acts as a distributor for the products of a few selected manufacturers, such as Capital Research, Putnam, and Morgan Stanley.

• Unlike most of its competitors, the company targets and sells its products only to individual investors, never to institutional investors.

• The firm sets up offices in selected areas, usually small towns or specific areas within cities where there is a "sense of community." In nearly all casesand contrary to traditional wisdom, which favors the exploitation of economies of scalethe Jones office is a one-person operation. That person has extraordinary autonomy, managing the office as if it were his or her own business. Every branch is a profit center. Brokers are tied to the home office through a satellite communications network that broadcasts homemade TV programming.

• The firm sells only selected productsoften transparent, longterm products such as large-cap equities and highly rated bonds. It avoids selling risky initial public offerings, options, and commodity futures.

• The firm remains a partnership so that people feel and think like owners, not employees.

• The glue that binds everything together is the company culture: everyone behaves like a member of a family whose mission is to help ordinary people invest their money wisely.

The company has obviously made explicit choices as to who to target, what to sell, and how to do this (see Exhibit 1-1). Bachmann likes to point out that the adoption of every one of these important components of the company's very successful strategy involved some kind of trade-off:

> We target individual investors, not institutional ones. We buy good securities and keep them a long time instead of trying to maximize transaction fees. Rather than have big offices in large cities, our offices are small and are placed in small communities to be convenient to the customer. Our offices are one-person operations. . .. We do not manufacture our products, and we showcase the products of a limited number of leading houses. We do not sell all productswe select transparent and safe products to promote. We remain a partnership rather than try to go public.

These choices were not easy to make. But they were made. And the company has remained faithful to them for more than twenty years. As Bachmann says, "These principles are cast in stone. We don't debate these things."

The Case of Nespresso

Another example of a company that has built its success on developing and exploiting a unique strategic position is the Nestlé subsidiary Nespresso. Nespresso represents one of the most innovative products developed by Swiss giant Nestlé. The product is basically a system that allows the consumer to produce a fresh cup

Exhibit 1-1 Strategic Choices Made at Edward Jones

The Who	"Who should I target as customers?"	• Target individual investors rather than institutional investors. • Target individuals who live in areas where "there is a sense of community."
The What	"What products or services should I offer?"	• Offer transparent, long-term products such as la bonds. Never sell risky initial large-cap equities and highly rated public offerings or commodity futures.
The How	"How can I best deliver these services to these customers?"	• Never manufacture my own productsact only as distributor. • Buy only from a few reputable suppliers (such as Capital Research and Morgan Stanley). • Operate as one-person offices located in the community. • Remain a partnership. * Focus on the end-customer, not the broker.

of espresso coffee at home. Though simple in appearance and use, Nestlé spent more than ten years developing it.

The system consists of two parts: a coffee capsule and a machine. The coffee capsule is hermetically sealed in aluminum and contains 5 grams (about one teaspoon) of roasted and ground coffee. The machine has four partsa handle, a water container, a pump, and an electrical heating system.

The use of the Nespresso system is straightforward. The coffee capsule is placed in the handle, which is then inserted into the body of the machine. The act of inserting the handle into the machine pierces the coffee capsule at the top. At the press of a button, pressurized, steamed water is passed through the capsule. The result is a creamy, foamy, high-quality cup of espresso coffee.

Nespresso was introduced in 1986, and the strategy behind it was the following. Nestlé was to set up a joint venture between Nespresso and a Swiss-based distributor called Sobal. The new venture, Sobal-Nespresso, was to purchase the coffee-making machines from another Swiss company, Turmix, and the coffee capsules from Nestlé. Sobal-Nespresso would then distribute and sell everything as a systemone product, one price. Offices and restaurants were targeted as the customers, and a separate unit, called Nespresso S.A., was set up within Nestlé to support the joint venture's sales and marketing efforts and to service and maintain the machines.

By 1988, the whole thing was an acknowledged nonstarter, and headquarters was considering freezing the operation. That's when Jean-Paul Gaillard arrived on the scene, first as commercial director of Nespresso S.A. and then as CEO of Nestlé Coffee Specialties S.A.the new name for the former Nespresso S.A. unit. The strategy he introduced in 1988-89 turned the operation around and established the unit as a profitable and growing enterprise within Nestlé.

Gaillard introduced several changes, but the logic that drove all his actions was the belief that the coffee side of the operation had to be separated from the machine side. Since Nestlé was not in the machine business, he felt he had to focus on coffee.

On the machine side, he assigned the manufacture of the Nespresso machine to a Swiss-based original equipment manufacturer, which then supplied a variety of carefully selected manufacturers, such as Krups, National, Turmix, and Philips. These companies, in turn, sold the Nespresso machine to prestigious retailers such as Harrods, Galeries Lafayette, and Bloomingdale's. It was the responsibility of these retailersunder the guidance and control of Nespressoto promote, demonstrate, and finally sell the machine to the end-consumer. It was also the responsibility of the machine partnerssuch as Krups, National, and Philipsto service and maintain the machines.

On the coffee side, the Sobal partnership was terminated and the whole operation placed under Nespresso S.A. (later Nestlé Coffee

Specialties S.A.). The target customer was changed from offices to households and the distribution of coffee capsules was organized through a "club." Once a customer bought a machine, he or she became a member of the Nespresso Club. Orders of capsules were made over the phone or by fax direct to the club, and the capsules were shipped to the customer's home within twenty-four hours. The club currently takes 7,000 orders per day.

The company has ambitious plans for the future. Prominent among these is the creation of two new products to target two new customer segments: small offices and young Internet users. Eventually, the objective is to have a Nespresso machine in every kitchen in the world. (See Exhibit 1-2 for a description of Nestlé's strategic choices in terms of "who," "what," and "how.")

Exhibit 1-2 Strategic Choices Made at Nespresso

The Who	"Who should I target as customers?"	• Target individuals and households, *not* restaurants or offices.
The What	"What products or services should I offer?"	• Sell coffee, *not* coffee machines. • Educate retailers so that they can teach the end-consumer how to use the machine.
The How	"How can I best deliver this product to these customers?"	• Subcontract the manufacture of the Nespresso machine to a prestigious OEM. • Focus on the manufacture of high-quality coffee capsules. • Sell the Nespresso machine through prestigious retailers, such as Harrods, Galeries Lafayette, and Bloomingdale's. • Sell the coffee capsules direct through the "Nespresso Club."

As was the case with Edward Jones, Nespresso has made clear and explicit choices concerning who to target, what to sell, and how to do this. It turns out that the original choices made did not produce the desired results. However, the new choices made by Jean-Paul Gaillard in 1988-89 have rejuvenated Nespresso and turned it into a profitable unit within Nestlé.

Unfortunately, No Position Remains Unique Forever

Nespresso and Edward Jones built their success on finding and exploiting unique strategic positions in their industries. They did not try to imitate the strategic positions of their competitors. Nor did they try to do their competitors one better by competing with them directly. Instead, these companies created unique positions for themselves that allowed them to play entirely different games. Of course, no position can be totally different from all others, but the idea is to create as much differentiation as possible.

There is no question that *success stems from the exploitation of a unique strategic position.* Unfortunately, no position can remain unique or attractive forever. The firm lucky enough to be in one will be imitated by aggressive competitors, and, perhaps more important, supplanted by even more aggressive competitors, those which develop new strategic positions in the market.

New strategic positions keep emerging all the time. A new strategic position is simply a new viable who/what/how combinationperhaps a new customer segment (a new *who),* a new value proposition (a new *what),* or a new way of distributing or manufacturing a product (a new *how).* Over time, the players with the new positions will rise to challenge the status quothe firms that have grown too comfortable in what once were their unique positions.

This cycle occurs in one industry after another. Once-formidable companies that built their success on what seemed to be unassailable strategic positions find themselves humbled by relative unknowns that base their attacks on creating and exploiting new strategic positions in the industry. The rise and fall of Xerox in the period 1960-90 exemplifies this simple but powerful point.

In the 1960s, Xerox put a lock on the copier market by deploying a well-defined and successful strategy. The main elements of this strategy were as follows. Having segmented the market by volume, Xerox decided to go after the corporate reproduction market by concentrating on copiers designed for high-speed, high-volume needs. This inevitably defined Xerox's customers as big corporations, which in turn determined its distribution method: the direct sales force. At the same time, Xerox decided to lease rather than sell its machines, a strategic choice that had worked well in the company's earlier battles with 3M.

The Xerox strategy was clear and precise, with sharp boundaries. Critical choices were made as to who to target (big corporations), what product features to emphasize (high speed), and how to deliver them (direct sales force and leasing). These were not easy choices, and there were no doubt lively debates and disagreements within Xerox about whether these decisions were the correct ones. Yet, at the end of the day, hard choices were made. And, at the time, they were good ones. Xerox prospered because it developed a distinctive strategic position in its industry, based on a well-defined customer base, well-defined products, and a well-defined system of delivering those products to those customers. Throughout the 1960s and early 1970s, Xerox maintained a return on equity (ROE) of around 20 percent.

Xerox's strategy proved to be so successful that several new competitors, among them IBM and Kodak, tried to enter this huge market, essentially by adopting the same or similar strategies. Fundamentally, their strategy was to grab market share by being *better* than Xeroxby offering better products or better service at lower prices. For example, IBM entered the market in 1970 with its first model, the IBM Copier I, which was clearly aimed at the medium and high-volume segments and was marketed by IBM's sales force on a rental basis. Similarly, Kodak entered the market in 1975 with the Ektaprint 100 copier/duplicator, also aimed at the high-volume end of the market and sold as a high-quality, low-price substitute for the Xerox machines.

Neither of these corporate giants managed to make substantial inroads in the copier business. While there are many possible reasons for their failure, one was undoubtedly their inability to create a distinctive position for themselves. Instead, they tried to "colonize" Xerox's position. Given the first-mover advantages that Xerox enjoyed in its own strategic position, it is no surprise that IBM and Kodak failed.