What Is Strategy?

A summary prepared by Qafila for founder applicants

Relevant to Questions 47 to 55 of the Qafila Founder Application (Section 7, Strategy). Also useful for Question 40 on competition.

About this summary

This is a summary written by Qafila of the following work:

> Michael E. Porter, "What Is Strategy?", Harvard Business Review, November to December 1996, pages 61 to 78, reprint number 96608. Porter was at the time the C. Roland Christensen Professor of Business Administration at the Harvard Business School.

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The article is nearly thirty years old and its examples are drawn from American and Japanese companies of the 1980s and 1990s. Some of those companies no longer exist in the form described. The argument, however, is the clearest account anyone has written of what strategy is and what it is not, and it is the framework Qafila uses when reading applications. Read it for the reasoning, not for the companies.

Porter organises the article in five parts. This summary follows the same order.

Part One. Operational Effectiveness Is Not Strategy

Porter opens with a complaint about how managers had come to think. For almost two decades they had been taught to be flexible, to benchmark continuously against best practice, to outsource aggressively for efficiency, and to nurture a few core competencies in a race to stay ahead of rivals. Positioning, which had once been the heart of strategy, was dismissed as too static for dynamic markets: rivals could copy any market position quickly, so competitive advantage was at best temporary.

He calls these beliefs dangerous half truths, and says they were leading companies into mutually destructive competition. Some barriers to competition were indeed falling. But in many industries what people called hypercompetition was a self inflicted wound rather than an inevitable change in how competition works. The root of the problem was a failure to distinguish operational effectiveness from strategy.

The distinction

Operational effectiveness means performing similar activities better than rivals perform them. It includes efficiency but is broader: any practice that lets a company make better use of its inputs, such as reducing defects or developing better products faster.

Strategic positioning means performing different activities from rivals, or performing similar activities in different ways.

Both matter, and both are essential to superior performance, but they work in entirely different ways. A company can outperform rivals only if it can establish a difference that it can preserve. It must deliver greater value to customers, or create comparable value at lower cost, or both. Delivering greater value lets a company charge higher average prices; greater efficiency results in lower average costs.

Activities are the basic units of competitive advantage

This is the sentence in the article that matters most for anyone filling in an application. All differences between companies in cost or price derive from the hundreds of activities required to create, produce, sell and deliver their products or services: calling on customers, assembling final products, training employees. Cost is generated by performing activities, and cost advantage arises from performing particular activities more efficiently than competitors. Differentiation arises from both the choice of activities and how they are performed.

Activities, then, are the basic units of competitive advantage. Overall advantage or disadvantage results from all of a company's activities, not only a few. A strategy is not a statement of ambition. It is a set of activities.

The productivity frontier

Porter asks the reader to imagine a productivity frontier: the sum of all existing best practices at any given time, or the maximum value a company delivering a particular product can create at a given cost, using the best available technologies, skills, management techniques and purchased inputs. When a company improves its operational effectiveness it moves toward that frontier. The frontier itself constantly shifts outward as new technologies and approaches appear.

Constant improvement in operational effectiveness is necessary to achieve superior profitability, but it is not sufficient, and few companies have competed successfully on that basis over an extended period. The reason is the rapid diffusion of best practice. Competitors can quickly imitate management techniques, new technologies, input improvements and superior ways of meeting customer needs. The most generic solutions, those usable in many settings, diffuse fastest, and consultants accelerate the spread.

Competitive convergence

Competition on operational effectiveness shifts the frontier outward and raises the bar for everyone, but produces relative improvement for no one. In the United States commercial printing industry, then worth over five billion dollars, the major players competed head to head, serving all types of customer, offering the same technologies, investing in the same equipment, running presses faster and cutting crew sizes. The productivity gains were captured by customers and equipment suppliers, not retained as profit, and Donnelley, the industry leader, saw its margin fall from consistently above seven percent in the 1980s to under four and six tenths percent in 1995.

The second and more insidious reason improved operational effectiveness is insufficient is competitive convergence. The more companies benchmark, the more they look alike. The more rivals outsource activities to efficient third parties, often the same ones, the more generic those activities become. As rivals imitate one another's improvements in quality, cycle times or supplier partnerships, strategies converge and competition becomes a series of races down identical paths that no one can win.

Porter is blunt about the consequence: competition based on operational effectiveness alone is mutually destructive, leading to wars of attrition that can be arrested only by limiting competition. He reads the merger wave of the period in this light. Driven by performance pressure but lacking strategic vision, company after company had no better idea than to buy up its rivals, and the competitors left standing were often those that outlasted others rather than companies with real advantage.

The box on Japanese companies

Porter adds a short discussion of Japan, drawn from research with Hirotaka Takeuchi. The Japanese triggered a global revolution in operational effectiveness in the 1970s and 1980s and enjoyed substantial cost and quality advantages for years. But they rarely developed distinct strategic positions. Sony, Canon and Sega were exceptions; most imitated one another, offering all product varieties, features and services, employing all channels and matching each other's plant configurations. As the operational gap narrowed they were caught in a trap of their own making. Escaping it meant overcoming cultural barriers: Japan is consensus oriented and tends to mediate differences rather than accentuate them, whereas strategy requires hard choices, and a deeply ingrained service tradition predisposes firms to satisfy any need a customer expresses, which blurs positioning and makes a company all things to all customers.

Part Two. Strategy Rests on Unique Activities (Questions 47 and 48)

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

Southwest Airlines

Southwest offered short haul, low cost, point to point service between midsize cities and secondary airports in large cities. It avoided large airports and did not fly great distances. Its customers included business travellers, families and students. Frequent departures and low fares attracted price sensitive customers who would otherwise travel by bus or car, and convenience oriented travellers who would choose a full service airline on other routes.

The contrast with a full service airline is instructive. Those airlines are configured to get passengers from almost any point A to any point B, so they use hub and spoke systems centred on major airports, offer first or business class for passengers who want comfort, coordinate schedules and transfer baggage for those changing planes, and serve meals on long journeys.

Southwest instead tailored all its activities to deliver low cost, convenient service on its particular type of route. Fast gate turnarounds of only fifteen minutes let it keep planes flying longer than rivals and provide frequent departures with fewer aircraft. It did not offer meals, assigned seats, interline baggage checking or premium classes of service. Automated ticketing at the gate encouraged customers to bypass travel agents, letting Southwest avoid their commissions. A standardised fleet of 737 aircraft boosted maintenance efficiency.

Porter's point is that most managers describe positioning in terms of their customers, saying something like "Southwest serves price and convenience sensitive travellers." But the essence of strategy is in the activities: choosing to perform activities differently or to perform different activities than rivals. Otherwise a strategy is nothing more than a marketing slogan that will not withstand competition.

Ikea

Ikea targets young furniture buyers who want style at low cost. What turns that marketing concept into a strategic position is the tailored set of activities that make it work.

Consider the typical furniture store. Showrooms display samples, with books of fabric swatches offering thousands of varieties. Salespeople escort customers through the store and help them navigate the maze. Once a customer selects, the order goes to a third party manufacturer, and with luck the furniture arrives within six to eight weeks. This value chain maximises customisation and service, at high cost.

Ikea serves customers happy to trade service for cost. Instead of a sales associate trailing customers, it uses self service based on clear in store displays. Rather than rely on third party manufacturers, it designs its own low cost, modular, ready to assemble furniture. In huge stores it displays every product in room like settings, so customers do not need a decorator to imagine how the pieces go together. Adjacent is a warehouse section with products in boxes on pallets. Customers do their own pickup and delivery, and Ikea will even sell a roof rack for the car that you can return for a refund next visit.

Although much of its low cost position comes from having customers do it themselves, Ikea offers extra services that its competitors do not. In store child care is one. Extended hours are another. Those services are uniquely aligned with the needs of its customers, who are young, not wealthy, likely to have children but no nanny, and who work for a living and therefore shop at odd hours.

The three origins of strategic positions

Positions come from three distinct sources, which are not mutually exclusive and often overlap.

Variety based positioning. Producing a subset of an industry's products or services, based on the choice of varieties rather than customer segments. It makes economic sense when a company can best produce particular products using distinctive sets of activities. Jiffy Lube specialises in automotive lubricants and offers no other repair or maintenance; its value chain produces faster service at lower cost than broader line shops, so attractive that many customers split their purchases, buying oil changes there and going to rivals for everything else. Vanguard offers common stock, bond and money market funds with predictable performance and rock bottom expenses, deliberately sacrificing extraordinary performance in any one year for good relative performance in every year. This positioning can serve a wide array of customers, but for most will meet only a subset of their needs.

Needs based positioning. Serving most or all the needs of a particular group of customers. This comes closer to traditional thinking about targeting a segment. It arises when there are groups of customers with differing needs, and when a tailored set of activities can serve those needs best. Some customers are more price sensitive than others, demand different product features, and need varying amounts of information, support and services. Ikea's customers are such a group: Ikea seeks to meet all the home furnishing needs of its target customers, not just a subset.

A variant arises when the same customer has different needs on different occasions, as a person travelling on business does from the same person travelling with the family.

Porter then makes the point most often overlooked. It is intuitive to think of a business in terms of the customer needs it meets. But a critical element of needs based positioning is not intuitive at all: differences in needs will not translate into meaningful positions unless the best set of

activities to satisfy them also differs. Otherwise every competitor could meet those same needs, and there would be nothing unique or valuable about the positioning.

His private banking example makes this concrete. Bessemer Trust targets families with at least five million dollars in investable assets who want capital preservation with wealth accumulation. Assigning one sophisticated account officer for every fourteen families, it configured its activities for personalised service: meetings are more likely at a client's ranch or yacht than in the office, and it offers customised investment management, estate administration, oversight of oil and gas investments, and accounting for racehorses and aircraft. Loans, a staple of most private banks, are rarely needed. Despite the most generous compensation of account officers and the highest personnel cost as a share of operating expenses, its differentiation produces a return on equity estimated as the highest of any private banking competitor.

Citibank's private bank serves clients with minimum assets of about two hundred and fifty thousand dollars who want convenient access to loans. Its account managers are primarily lenders and refer clients to specialists handling prepackaged products. The system is less customised and allows a manager to client ratio of one to one hundred and twenty five. Both banks tailored activities to different groups, and the same value chain cannot profitably meet the needs of both.

Access based positioning. Segmenting customers who are accessible in different ways. Their needs may be similar to those of other customers, but the best configuration of activities to reach them is different. Access can be a function of customer geography or customer scale, or of anything requiring a different set of activities to reach customers in the best way.

Carmike Cinemas operates movie theatres exclusively in towns under two hundred thousand people. It makes money in markets that will not support big city ticket prices through a lean cost structure: standardised, low cost complexes requiring fewer screens and less sophisticated projection; a proprietary information system that eliminates local administrative staff beyond a single manager; centralised purchasing; lower rent and payroll because of its locations; and corporate overhead of two percent against an industry average of five. Small communities also allow a highly personal marketing in which the manager knows patrons. By being the dominant if not the only theatre in its markets, where the main competition is often the high school football team, Carmike gets its pick of films and better terms from distributors.

Positioning is not the same as finding a niche

A position from any of these sources can be broad or narrow. A focused competitor such as Ikea targets the special needs of a subset of customers and designs its activities accordingly, thriving on groups who are overserved and hence overpriced by broader competitors, or underserved and hence underpriced. A broadly targeted competitor such as Vanguard serves a wide array of customers, meeting their common needs but only partially meeting the idiosyncratic needs of particular groups.

The definition, first version

Whatever the basis, positioning requires a tailored set of activities, because it is always a function of differences in activities, though not always of differences on the customer side. Having defined positioning, Porter gives his first answer to the title question. Strategy is 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, and companies would face a simple imperative: win the race to discover and preempt it.

The box on new entrants (Question 44)

Porter includes a passage that speaks directly to founders. Strategic competition can be thought of as the process of perceiving new positions that woo customers from established positions or draw new customers into the market. In principle, incumbents and entrepreneurs face the same challenges in finding new strategic positions. In practice, new entrants often have the edge.

Strategic positionings are often not obvious, and finding them requires creativity and insight. New entrants often discover unique positions that have been available but simply overlooked by established competitors. Ikea recognised a customer group that had been ignored or served poorly. Circuit City's entry into used cars, CarMax, was based on a new way of performing activities: extensive refurbishing of cars, product guarantees, no haggle pricing, and sophisticated use of in house customer financing, all of which had long been open to incumbents.

New entrants can also prosper by occupying a position a competitor once held but ceded through years of imitation and straddling, or by importing distinctive activities from another industry. Most commonly, though, new positions open up because of change: new customer groups or purchase occasions arise, new needs emerge as societies evolve, new distribution channels appear, new technologies or information systems become available. When such changes happen, new entrants unencumbered by a long history can more easily perceive the potential for a new way of competing, and they are more flexible because they face no trade offs with existing activities.

Part Three. A Sustainable Position Requires Trade-offs (Question 51)

Choosing a unique position is not enough to guarantee a sustainable advantage. A valuable position attracts imitation by incumbents, who are likely to copy it in one of two ways.

First, a competitor can reposition itself to match the superior performer. Second, and far more common, is straddling. The straddler seeks to match the benefits of a successful position while maintaining its existing position, grafting new features, services or technologies onto the activities it already performs.

Continental Lite

For those who argue that competitors can copy any market position, Porter says the airline industry is a perfect test case. It would seem that nearly any competitor could imitate any other airline's activities: buy the same planes, lease the gates, match the menus, ticketing and baggage handling.

Continental Airlines saw how well Southwest was doing and decided to straddle. While maintaining its position as a full service airline, it also set out to match Southwest on a number of point to point routes. It called the new service Continental Lite, eliminated meals and first class service, increased departure frequency, lowered fares and shortened turnaround time at the gate. Because Continental remained a full service airline on other routes, it continued to use travel agents and its mixed fleet of planes, and to provide baggage checking and seat assignments.

Trade offs grounded it. The airline lost hundreds of millions of dollars and the chief executive lost his job. Planes were delayed leaving congested hubs or slowed at the gate by baggage

transfers, and late flights generated a thousand complaints a day. Continental Lite could not compete on price and still pay standard travel agent commissions, but could not do without agents for its full service business, so it cut commissions across all Continental flights. It could not offer the same frequent flier benefits to travellers paying much lower fares, so it lowered the rewards of the entire programme. The results were angry travel agents and angry full service customers.

Continental tried to compete in two ways at once and paid an enormous straddling penalty. If there were no trade offs between the two positions, it could have succeeded. But the absence of trade offs is a dangerous half truth that managers must unlearn.

Neutrogena

Neutrogena soap shows trade offs made deliberately. Its positioning is built on a kind to the skin, residue free soap formulated for pH balance. With a large detail force calling on dermatologists, its marketing looks more like a drug company's than a soap maker's: advertising in medical journals, direct mail to doctors, medical conferences, research at its own Skincare Institute. It originally focused distribution on drugstores, avoided price promotions, and used a slow, more expensive process to mould its fragile soap.

In choosing this position Neutrogena said no to the deodorants and skin softeners many customers desire in their soap. It gave up the large volume potential of selling through supermarkets and using price promotions. It sacrificed manufacturing efficiencies to achieve the soap's desired attributes. In its original positioning, Neutrogena made a whole raft of trade offs, and those trade offs protected the company from imitators.

Why trade-offs arise

Porter identifies three reasons.

Inconsistencies in image or reputation. A company known for delivering one kind of value may lack credibility and confuse customers, or even undermine its reputation, if it delivers another kind at the same time. Ivory soap, positioned as a basic, inexpensive everyday soap, would have a hard time reshaping its image to match Neutrogena's premium medical reputation. Efforts to create a new image typically cost tens or even hundreds of millions of dollars in a major industry, which is itself a powerful barrier to imitation.

The activities themselves. This is the more important reason. Different positions, with their tailored activities, require different product configurations, different equipment, different employee behaviour, different skills, and different management systems. Many trade offs reflect inflexibilities in machinery, people or systems. The more Ikea configures its activities to lower costs by having customers do their own assembly and delivery, the less able it is to satisfy customers who require higher levels of service. Trade offs can be even more basic: value is destroyed if an activity is overdesigned or underdesigned for its use. Even if a salesperson were capable of providing a high level of assistance to one customer and none to another, that talent, and some of the cost, would be wasted on the second customer. Productivity can also improve when variation in an activity is limited, since providing a high level of assistance all the time lets the salesperson and the entire sales activity achieve efficiencies of learning and scale.

Limits on internal coordination and control. By clearly choosing to compete in one way and not another, senior management makes organisational priorities clear. Companies that try to be

all things to all customers risk confusion in the trenches as employees attempt to make day to day operating decisions without a clear framework.

False trade-offs

Porter is careful here. In general, false trade offs between cost and quality occur primarily when there is redundant or wasted effort, poor control or accuracy, or weak coordination. Simultaneous improvement of cost and differentiation is possible only when a company begins far behind the productivity frontier or when the frontier shifts outward. At the frontier, where companies have achieved current best practice, the trade off between cost and differentiation is very real indeed.

Honda and Toyota illustrate this. After a decade of productivity advantages they bumped against the frontier. In 1995, facing resistance to higher prices, Honda found the only way to make a cheaper car was to skimp on features, replacing the Civic's rear disc brakes with drum brakes and using cheaper back seat fabric, hoping customers would not notice. Toyota sold a Corolla in Japan with unpainted bumpers and cheaper seats; customers rebelled and the model was dropped.

Quality is not always free, Porter adds. Southwest's particular kind of quality, convenience, happens to be consistent with low costs because frequent departures are enabled by fast turnarounds and automated ticketing. Other dimensions of airline quality, an assigned seat, a meal, baggage transfer, cost money to provide.

The definition, second version

Trade offs add a new dimension to the answer. 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, and performance would once again depend wholly on operational effectiveness.

Part Four. Fit Drives Both Competitive Advantage and Sustainability (Question 52)

Positioning choices determine not only which activities a company will perform and how it will configure them, 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.

Southwest's rapid gate turnaround, which allows frequent departures and greater aircraft use, is essential to its positioning. How does it achieve it? Part of the answer is well paid gate and ground crews whose productivity is enhanced by flexible union rules. The bigger part is how Southwest performs other activities. With no meals, no seat assignment and no interline baggage transfers, it avoids activities that slow other airlines down. It selects airports and routes to avoid congestion. Its strict limits on route type and length make a standardised fleet possible: every aircraft it turns is a Boeing 737.

Porter then asks what Southwest's core competence is, and what its key success factors are. The correct answer, he says, is that everything matters. Its strategy is a whole system of activities, not a collection of parts, and its advantage comes from the way those activities fit and reinforce one another.

Fit locks out imitators by creating a chain that is as strong as its strongest link. In most companies with good strategies, activities complement one another in ways that create real economic value. One activity's cost is lowered because of the way other activities are performed.

Similarly, one activity's value to customers can be enhanced by a company's other activities. That is how strategic fit creates competitive advantage and superior profitability.

The three types of fit

The importance of fit among functional policies is one of the oldest ideas in strategy, but Porter argues it had been gradually supplanted on the management agenda by talk of core competencies, critical resources and key success factors. He says it is a far more central component of competitive advantage than most realise. The three types are not mutually exclusive.

First order fit is simple consistency between each activity, or function, and the overall strategy. Vanguard aligns all activities with its low cost strategy. It minimises portfolio turnover and does not need highly compensated money managers. It distributes funds directly, avoiding commissions to brokers. It limits advertising, relying instead on public relations and word of mouth. It ties employee bonuses to cost savings. Consistency ensures that the competitive advantages of activities cumulate and do not erode or cancel themselves out. It makes the strategy easier to communicate to customers, employees and shareholders, and improves implementation through single mindedness.

Second order fit occurs when activities are reinforcing. Neutrogena markets to upscale hotels eager to offer guests a soap recommended by dermatologists. Hotels grant it the privilege of using its customary packaging while requiring other soaps to carry the hotel's name. Once guests have tried Neutrogena in a luxury hotel they are more likely to buy it at the drugstore or ask their doctor about it, so the medical and hotel marketing activities reinforce one another and lower total marketing costs. Bic Corporation is a second example: it sells a narrow line of standard, low priced pens to all major customer markets through all available channels, gaining consistency across product design, low cost plants and aggressive purchasing. But it goes beyond consistency, because point of sale displays, frequent packaging changes, heavy television advertising and a large sales force to handle point of sale tasks together yield far more impulse buying than any of those activities in isolation could.

Third order fit is optimisation of effort. The Gap treats product availability as critical, and could achieve it either by holding store inventory or by restocking from warehouses. It optimised across the two by restocking basic clothing almost daily out of three warehouses, minimising in store inventory. The emphasis on restocking works because its merchandising sticks to basic items in few colours. Comparable retailers achieved inventory turns of three to four times a year; the Gap turned seven and a half times. Rapid restocking also lowers the cost of its short six to eight week model cycle.

Coordination and information exchange across activities to eliminate redundancy and minimise wasted effort are the most basic types of effort optimisation, but there are higher levels. Product design choices can eliminate the need for after sale service or make it possible for customers to perform service activities themselves. Coordination with suppliers or distribution channels can eliminate the need for some in house activities, such as end user training.

The whole matters more than the parts

In all three types of fit, the whole matters more than any individual part. Competitive advantage grows out of the entire system, and the competitive value of individual activities, or the associated skills, competencies and resources, cannot be decoupled from the system or the strategy. So it can be misleading to explain success by naming individual strengths, core

competencies or critical resources. The list of strengths cuts across functions and one strength blends into another. It is more useful to think in terms of themes that pervade many activities, such as low cost or a particular conception of the value delivered, embodied in nests of tightly linked activities.

Fit and sustainability

Strategic fit among many activities is fundamental not only to competitive advantage but to the sustainability of that advantage. It is harder for a rival to match an array of interlocked activities than merely to imitate a particular sales force approach, match a process technology, or replicate a set of product features. Positions built on systems of activities are far more sustainable than those built on individual activities.

Porter offers a simple piece of arithmetic. The probability that competitors can match any individual activity is often less than one. The probabilities then quickly compound to make matching the entire system highly unlikely: nine tenths times nine tenths is eighty one hundredths; nine tenths to the fourth power is sixty six hundredths, and so on. Existing companies that try to reposition or straddle will be forced to reconfigure many activities. And even new entrants, though they do not confront the trade offs facing established rivals, still face formidable barriers to imitation.

The more a company's positioning rests on activity systems with second and third order fit, the more sustainable its advantage. Such systems are difficult to untangle from outside and hard to imitate, and even rivals who identify the interconnections struggle to replicate them, because achieving fit requires integrating decisions across many independent subunits. A competitor who imitates only some activities gains little: performance does not improve, and it can decline, as Continental Lite showed.

Fit also creates pressure to improve operational effectiveness, which makes imitation harder still. Poor performance in one activity degrades performance in others, so weaknesses are exposed and get attention, while improvements pay dividends elsewhere. Companies with strong fit are rarely inviting targets.

When activities complement one another, rivals get little benefit from imitation unless they successfully match the whole system. Such situations tend to promote winner take all competition. The company that builds the best activity system wins, while rivals with similar strategies fall behind. Porter's example is Toys R Us prevailing while Child World and Lionel Leisure fell behind. Thus finding a new strategic position is often preferable to being the second or third imitator of an occupied position.

The most viable positions are those whose activity systems are incompatible because of trade offs. Strategic positioning sets the trade off rules that define how individual activities will be configured and integrated.

Continuity

One implication is that strategic positions should have a horizon of a decade or more, not of a single planning cycle. Continuity fosters improvements in individual activities and the fit across activities, allowing an organisation to build unique capabilities and skills tailored to its strategy. Continuity also reinforces a company's identity.

Conversely, frequent shifts in positioning are costly. Not only must a company reconfigure individual activities, it must realign entire systems, and some activities may never catch up to the

vacillating strategy. The inevitable result of frequent shifts in strategy, or of failure to choose a distinct position in the first place, is a me-too or hedged activity configuration, inconsistencies across functions, and organisational dissonance.

The definition, third version

Porter now completes the answer. Strategy is creating fit among a company's activities. The success of a strategy depends on doing many things well, not just a few, and integrating among them. If there is no fit among activities, there is no distinctive strategy and little sustainability. Management reverts to the simpler task of overseeing independent functions, and operational effectiveness determines relative performance.

Activity system maps

The article includes maps of the activity systems of Ikea, Vanguard and Southwest, drawn as networks in which a small number of higher order strategic themes are implemented through clusters of tightly linked activities. Porter suggests a set of questions to guide the exercise, and they are worth borrowing when answering Question 48.

Is each activity consistent with the overall positioning: the varieties produced, the needs served, the type of customers accessed?

Ask those responsible for each activity to identify how other activities within the company improve or detract from their performance.

Are there ways to strengthen how activities and groups of activities reinforce one another?

Could changes in one activity eliminate the need to perform others?

Part Five. Rediscovering Strategy (Questions 53 and 55)

The failure to choose

Why do so many companies fail to have a strategy? Porter argues that although external changes can be the problem, the greater threat to strategy often comes from within. A sound strategy is undermined by a misguided view of competition, by organisational failures, and especially by the desire to grow.

Managers have become confused about the necessity of choice. When many companies operate far from the frontier, trade offs appear unnecessary, and it can seem a well run company should beat ineffective rivals on all dimensions at once. Taught by popular management thinkers that they need not make trade offs, managers acquired a macho sense that doing so is a sign of weakness.

Unnerved by forecasts of hypercompetition, managers increase its likelihood by imitating everything about their competitors, and chase every new technology for its own sake. The pursuit of operational effectiveness is seductive because it is concrete and actionable, producing reassuring progress even while superior profitability remains elusive. Business publications and consultants flood the market with information about what other companies are doing, reinforcing the best practice mentality. Caught in that race, many managers simply do not understand the need to have a strategy.

Companies also blur strategic choices for other reasons. Conventional wisdom within an industry is often strong, homogenising competition. Some managers mistake customer focus to mean they

must serve all customer needs or respond to every request from distribution channels. Others cite the desire to preserve flexibility.

Organisational realities work against strategy too. Trade offs are frightening, and making no choice is sometimes preferred to risking blame for a bad one. Companies imitate one another in a type of herd behaviour, each assuming rivals know something they do not. Newly empowered employees, urged to seek every possible source of improvement, often lack a vision of the whole and the perspective to recognise trade offs. The failure to choose sometimes comes down to the reluctance to disappoint valued managers or employees.

The growth trap (Question 51)

Among all other influences, the desire to grow has perhaps the most perverse effect on strategy. Trade offs and limits appear to constrain growth. Serving one group of customers and excluding others places a real or imagined limit on revenue growth. Broadly targeted strategies emphasising low price result in lost sales with customers sensitive to features or service. Differentiators lose sales to price sensitive customers.

Managers are constantly tempted to take incremental steps that surpass those limits but blur a company's strategic position. Eventually, pressures to grow or apparent saturation of the target market lead managers to broaden the position by extending product lines, adding new features, imitating competitors' popular services, matching processes, and even making acquisitions.

Maytag is his example. Its success rested on focus: reliable, durable washers and dryers, later dishwashers. But industry wisdom supported selling a full line. Pressured by dealers and worried about slow growth, Maytag expanded into refrigerators and cooking products and acquired brands with disparate positions, including Jenn-Air, Hoover, Admiral and Magic Chef. It grew from six hundred and eighty four million dollars in 1985 to a peak of three and four tenths billion in 1994, but return on sales fell from eight to twelve percent in the 1970s and 1980s to an average of less than one percent between 1989 and 1995. Laundry and dishwasher products still anchored its profitability.

Neutrogena may have fallen into the same trap. In the early 1990s its distribution broadened to mass merchandisers such as Wal-Mart, and it expanded into products such as eye makeup remover and shampoo in which it was not unique, diluting its image and turning to price promotions.

Compromises and inconsistencies in the pursuit of growth will erode the competitive advantage a company had with its original varieties or target customers. Attempts to compete in several ways at once create confusion and undermine organisational motivation and focus. Profits fall, but more revenue is seen as the answer. Managers are unable to make choices, so the company embarks on a new round of broadening and compromises. Often, rivals continue to match each other until desperation breaks the cycle, resulting in a merger or downsizing to the original positioning.

Profitable growth

What approaches to growth preserve and reinforce strategy? Broadly, the prescription is to concentrate on deepening a strategic position rather than broadening and compromising it.

One approach is to look for extensions of the strategy that leverage the existing activity system by offering features or services that rivals would find impossible or costly to match on a stand alone basis. In other words, managers can ask themselves which activities, features or forms of

competition are feasible or less costly to them because of complementary activities that their company performs.

Deepening a position means making activities more distinctive, strengthening fit, and communicating the strategy better to the customers who should value it. Many companies instead chase easy growth by adding hot features without adapting them to the strategy, or target markets in which they have little special to offer.

Porter states the point plainly: a company can often grow faster, and far more profitably, by better penetrating needs and varieties where it is distinctive than by slugging it out in potentially higher growth arenas in which the company lacks uniqueness. Carmike, then the largest theatre chain in the United States, owed its rapid growth to its disciplined concentration on small markets, quickly selling off any big city theatres that came to it as part of an acquisition.

Globalisation often allows growth that is consistent with strategy, opening larger markets for a focused strategy. Unlike broadening domestically, expanding globally is likely to leverage and reinforce a company's unique position and identity.

Companies seeking growth through broadening within their industry can best contain the risks by creating stand alone units, each with its own brand name and tailored activities. Maytag struggled with this: it organised its premium and value brands into separate units with different strategic positions, but also created an umbrella appliance company for all its brands to gain critical mass, and with shared design, manufacturing, distribution and customer service it will be hard to avoid homogenisation. If a given business unit attempts to compete with different positions for different products or customers, avoiding compromise is nearly impossible.

The role of leadership

The challenge of developing or reestablishing a clear strategy is often primarily an organisational one and depends on leadership. With so many forces at work against making choices and trade offs, a clear intellectual framework to guide strategy is a necessary counterweight, and strong leaders willing to make choices are essential.

In many companies leadership has degenerated into orchestrating operational improvements and making deals. But general management is more than the stewardship of individual functions. Its core is strategy: defining and communicating the unique position, making trade offs, and forging fit among activities. The leader must decide which industry changes and customer needs the company will respond to while maintaining its distinctiveness, because managers at lower levels lack the perspective and confidence to hold a strategy against constant pressure to compromise and emulate rivals.

One of the leader's jobs is to teach others about strategy, and to say no. Deciding which customers, varieties and needs to serve is fundamental, but so is deciding not to serve others and not to offer certain features. One of the most important functions of an explicit, communicated strategy is to guide employees through the trade offs that arise in their own day to day decisions.

Reconnecting with strategy

Porter includes a box on companies that have lost their way. Most owe their initial success to a unique position involving clear trade offs, with activities aligned to it. Time and the pressures of growth led to compromises that were at first almost imperceptible, and through a succession of incremental changes that each seemed sensible, many established companies compromised their way to homogeneity with rivals.

The first approach to reconnecting is a careful look at what the company already does, because within most established companies there is a core of uniqueness. It is identified by answering questions like these, which founders will recognise as a useful checklist even at an early stage.

Which of our product or service varieties are the most distinctive?

Which of our product or service varieties are the most profitable?

Which of our customers are the most satisfied?

Which customers, channels or purchase occasions are the most profitable?

Which of the activities in our value chain are the most different and effective?

Around this core are encrustations added incrementally over time. Like barnacles, they must be removed to reveal the underlying position. A small percentage of varieties or customers may account for most of a company's sales and especially its profits, and the challenge is to refocus on that core and realign activities with it, letting peripheral customers and varieties be sold or fade away. A company's history is also instructive: what was the founder's vision, and what products and customers made the company? Reexamining the original strategy may show it is still valid and can be implemented in a modern way, which can instil the confidence to make the needed trade offs.

The box on emerging industries

This passage is worth attention for anyone building something new. Developing a strategy in a newly emerging industry, or in a business undergoing revolutionary technological change, is a daunting proposition. Managers face high uncertainty about the needs of customers, the products and services that will prove most desirable, and the best configuration of activities and technologies to deliver them. Because of this uncertainty, imitation and hedging are rampant: unable to risk being wrong or left behind, companies match all features, offer all new services and explore all technologies.

During such periods the industry's productivity frontier is being established. Explosive growth can make these times profitable, but the profits are temporary, because imitation and strategic convergence will ultimately destroy industry profitability. The enduringly successful companies are those that begin as early as possible to define and embody in their activities a unique competitive position. A period of imitation may be inevitable, but it reflects uncertainty rather than a desired state of affairs.

In high technology industries this phase often continues far longer than it should. Enraptured by technological change, companies pack in more features, most never used, while slashing prices across the board, and trade offs are rarely even considered. A few companies with fundamental advantages prosper; the majority are doomed to a rat race no one can win. Porter adds that the popular business press, focused on hot emerging industries, presents these special cases as proof that we have entered a new era in which none of the old rules are valid. In fact, he says, the opposite is true.

The closing argument

Improving operational effectiveness is a necessary part of management, but it is not strategy. In confusing the two, managers have backed into a way of thinking about competition that drives industries toward convergence, which is in no one's interest and is not inevitable.

Both agendas are essential, but they are different. The operational agenda involves continual improvement everywhere there are no trade offs, and is the proper place for constant change, flexibility and relentless pursuit of best practice. The strategic agenda is the place for defining a unique position, making clear trade offs and tightening fit, and for the continual search for ways to reinforce and extend that position. It demands discipline and continuity; its enemies are distraction and compromise.

Continuity does not imply a static view of competition. A company must keep improving operationally and try to shift the frontier, while extending its uniqueness and strengthening fit. A company may have to change strategy if there are major structural changes in its industry, and new positions often arise that way, with new entrants exploiting them most easily. But the choice of a new position must be driven by the ability to find new trade offs and build a new system of complementary activities into a sustainable advantage.

The two views set side by side

Porter closes with a comparison, which is a useful test to run against your own answers.

The implicit strategy model of the preceding decade held that there is one ideal competitive position in the industry; that all activities should be benchmarked to achieve best practice; that a company should outsource and partner aggressively to gain efficiencies; that advantages rest on a few key success factors, critical resources and core competencies; and that flexibility and rapid response to all competitive and market changes are what matter.

The sustainable competitive advantage model holds that there is a unique competitive position for the company; that activities are tailored to strategy; that there are clear trade offs and choices in relation to competitors; that competitive advantage arises from fit across activities; that sustainability comes from the activity system rather than from the parts; and that operational effectiveness is a given.

Prepared by Qafila. Summary only. Not the original work.