What Is Strategy?

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.

I. Operational Effectiveness Is Not Strategy

- For almost two decades, managers have been learning to play by a new set of rules. Companies must be flexible to respond rapidly to competitive and market changes. They must benchmark continuously to achieve best practice. They must outsource aggressively to gain efficiencies.
- Positioning -once the heart of strategy- is rejected as too static for today's dynamic markets and changing technologies. According to the new dogma, rivals can quickly copy any market position, and competitive advantage is, at best, temporary.

- The root of the problem is the failure to distinguish between operational effectiveness and strategy. The quest for productivity, quality, and speed has spawned a remarkable number of management tools and techniques: total quality management, benchmarking, time-based competition, outsourcing, partnering, reengineering, change management.

Operational Effectiveness: Necessary but Not Sufficient

- **Operational effectiveness and strategy are both essential to superior performance, which, after all, is the primary goal of any enterprise. But they work in very different ways.**
- **A company can outperform rivals only if it can establish a difference that it can preserve. It must deliver greater value to customers or create comparable value at a lower cost, or do both. The arithmetic of superior profitability then follows: delivering greater value allows a company to charge higher average unit prices; greater efficiency results in lower average unit costs.**

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

- Differences in operational effectiveness were at the heart of the Japanese challenge to Western companies in the 1980s.
- The Japanese were so far ahead of rivals in operational effectiveness that they could offer lower cost and superior quality at the same time.
- *productivity frontier* constitutes the sum of all existing best practices at any given time. Think of it as the maximum value that a company delivering a particular product or service can create at a given cost, using the best available technologies, skills, management techniques, and purchased inputs.
- The productivity frontier can apply to individual activities, to groups of linked activities such as order processing and manufacturing, and to an entire company's activities.
- When a company improves its operational effectiveness, it moves toward the frontier.

- The productivity frontier is constantly shifting outward as new technologies and management approaches are developed and as new inputs become available.
- For at least the past decade, managers have been preoccupied with improving operational effectiveness. Through programs such as TQM, time-based competition, and benchmarking, they have changed how they perform activities in order to eliminate inefficiencies, improve customer satisfaction, and achieve best practice.

- **Even industry leader Donnelley’s profit margin, consistently higher than 7% in the 1980s, fell to less than 4.6% in 1995. This pattern is playing itself out in industry after industry. Even the Japanese, pioneers of the new competition, suffer from persistently low profits.**

- They appeared unstoppable. But as the gap in operational effectiveness narrows, Japanese companies are increasingly caught in a trap of their own making. If they are to escape the mutually destructive battles now ravaging their performance, Japanese companies will have to learn strategy.
- To do so, they may have to overcome strong cultural barriers. Japan is notoriously consensus oriented, and companies have a strong tendency to mediate differences among individuals rather than accentuate them. Strategy, on the other hand, requires hard choices. The Japanese also have a deeply ingrained service tradition that predisposes them to go to great lengths to satisfy any need a customer expresses. Companies that compete in that way end up blurring their distinct positioning, becoming all things to all customers.

II. Strategy Rests on Unique Activities

- Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.
- Southwest Airlines Company, for example, offers short-haul, low-cost, point-to-point service between midsize cities and secondary airports in large cities. Southwest avoids large airports and does not fly great distances. Its customers include business travelers, families, and students. Southwest's frequent departures and low fares attract price-sensitive customers who otherwise would travel by bus or car, and convenience-oriented travelers who would choose a full-service airline on other routes.
- Most managers describe strategic positioning in terms of their customers: "Southwest Airlines serves price- and convenience-sensitive travelers,"for example. But **<u>the essence of strategy is in the activities – choosing to perform activities differently or to perform different activities than rivals</u>**.

- A full-service airline is configured to get passengers from almost any point A to any point B. To reach a large number of destinations and serve passengers with connecting flights, full-service airlines employ a hub-and-spoke system centered on major airports. To attract passengers who desire more comfort, they offer first-class or business-class service. To ccommodate passengers who must change planes, they coordinate schedules and check and transfer baggage. Because some passengers will be traveling for many hours, full-service airlines serve meals.

- Southwest, in contrast, tailors all its activities to deliver low-cost, convenient service on its particular type of route. Through fast turnarounds at the gate of only 15 minutes, Southwest is able to keep planes flying longer hours than rivals and provide frequent departures with fewer aircraft. Southwest does not offer meals, assigned seats, interline baggage checking, or premium classes of service.

- Automated ticketing at the gate encourages customers to bypass travel agents, allowing Southwest to avoid their commissions. A standardized fleet of 737 aircraft boosts the efficiency of maintenance.

- Southwest has staked out a unique and valuable strategic position based on a tailored set of activities. On the routes served by Southwest, a fullservice airline could never be as convenient or as low cost.

The Origins of Strategic Positions

- **Strategic positions emerge from three distinct sources, which are not mutually exclusive and often overlap.**
- **<u>First</u>, positioning can be based on producing a subset of an industry's products or services: *<u>variety-based positioning</u>* because it is based on the choice of product or service varieties rather than customer segments.**

- **Jiffy Lube International, specializes in automotive lubricants and does not offer other car repair or maintenance services. Its value chain produces faster service at a lower cost than broader line repair shops.**

- **A second basis for positioning is *needs-based positioning*, serving most or all the needs of a particular group of customers.**
- **It comes closer to traditional thinking about targeting a segment of customers.**
- **Some groups of customers are more price sensitive than others, demand different product features, and need varying amounts of information, support, and services.**
- **Ikea's customers are a good example of such a group. Ikea seeks to meet all the home furnishing needs of its target customers, not just a subset of them.**

- <u>The third basis</u> for positioning is that of segmenting customers who are accessible in different ways. Although their needs are similar to those of other customers, the best configuration of activities to reach them is different.
- This is called <u>*access-based positioning*</u>. Access can be a function of customer geography or customer scale or of anything that requires a different set of activities to reach customers in the best way.

- **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.**
- **New entrants can prosper by occupying a position that a competitor once held but has ceded through years of imitation and straddling.**
- **Most commonly, however, new positions open up because of change.**

III. A Sustainable Strategic Position Requires Trade-offs

- **Choosing a unique position, however, is not enough to guarantee a sustainable advantage. A valuable position will attract 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.**
- **A second and far more common type of imitation is straddling. The straddler seeks to match the benefits of a successful position while maintaining its existing position. It grafts new features, services, or technologies onto the activities it already performs.**

- **For those who argue that competitors can copy any market position, the airline industry is a perfect test case.**
- **Continental Airlines saw how well Southwest was doing and decided to straddle. Continental set out to match Southwest on a number of point-to-point routes. It 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.**

- **But a strategic position is not sustainable unless there are trade-offs with other positions.**
- **Trade-offs occur when activities are incompatible. A trade-off means that more of one thing necessitates less of another. An airline can choose to serve meals – adding cost and slowing turnaround time at the gate–or it can choose not to, but it cannot do both without bearing major inefficiencies.**

- **Trade-offs create the need for choice and protect against repositioners and straddlers.**

- Consider Neutrogena soap. Neutrogena Corporation’s variety-based positioning is built on a residuefree soap formulated for pH balance. With a large detail force calling on dermatologists, Neutrogena’s marketing strategy looks more like a drug company’s than a soap maker’s.
- It advertises in medical journals, sends direct mail to doctors, attends medical conferences, and performs research at its own Skincare Institute. To reinforce its positioning, Neutrogena originally focused its distribution on drugstores and avoided price promotions. Neutrogena uses a slow, more expensive manufacturing process to mold its fragile soap.

- **In choosing this position, Neutrogena said no to the deodorants and skin softeners that 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 like those, trade-offs that protected the company from imitators.**

Trade-offs arise for three reasons:

- **The first is inconsistencies in image or reputation.**
- **Second, and more important, trade-offs arise from activities, themselves.**
- **Finally, trade-offs arise from limits on internal coordination and control.**

- Continental tried to compete in two ways at once. In trying to be low cost on some routes and full service on others, Continental paid an enormous straddling penalty. If there were no trade-offs between the two positions, Continental could have succeeded.
- 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.

I V. Fit Drives Both Competitive Advantage and Sustainability

Positioning choices determine not only which activities a company will perform 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 use of aircraft, is essential to its high-convenience, low-cost positioning. But how does Southwest achieve it? Part of the answer lies in the company’s well-paid gate and ground crews, whose productivity in turnarounds is enhanced by flexible union rules. But the bigger part of the answer lies in how Southwest performs other activities. With no meals, no seat assignment, and no interline baggage transfers, Southwest avoids having to perform activities that slow down other airlines. It selects airports and routes to avoid congestion that introduces delays. Southwest’s strict limits on the type and length of routes make standardized aircraft possible: every aircraft Southwest turns is a Boeing 737.

Types of Fit

Fit is important because discrete activities often affect one another.

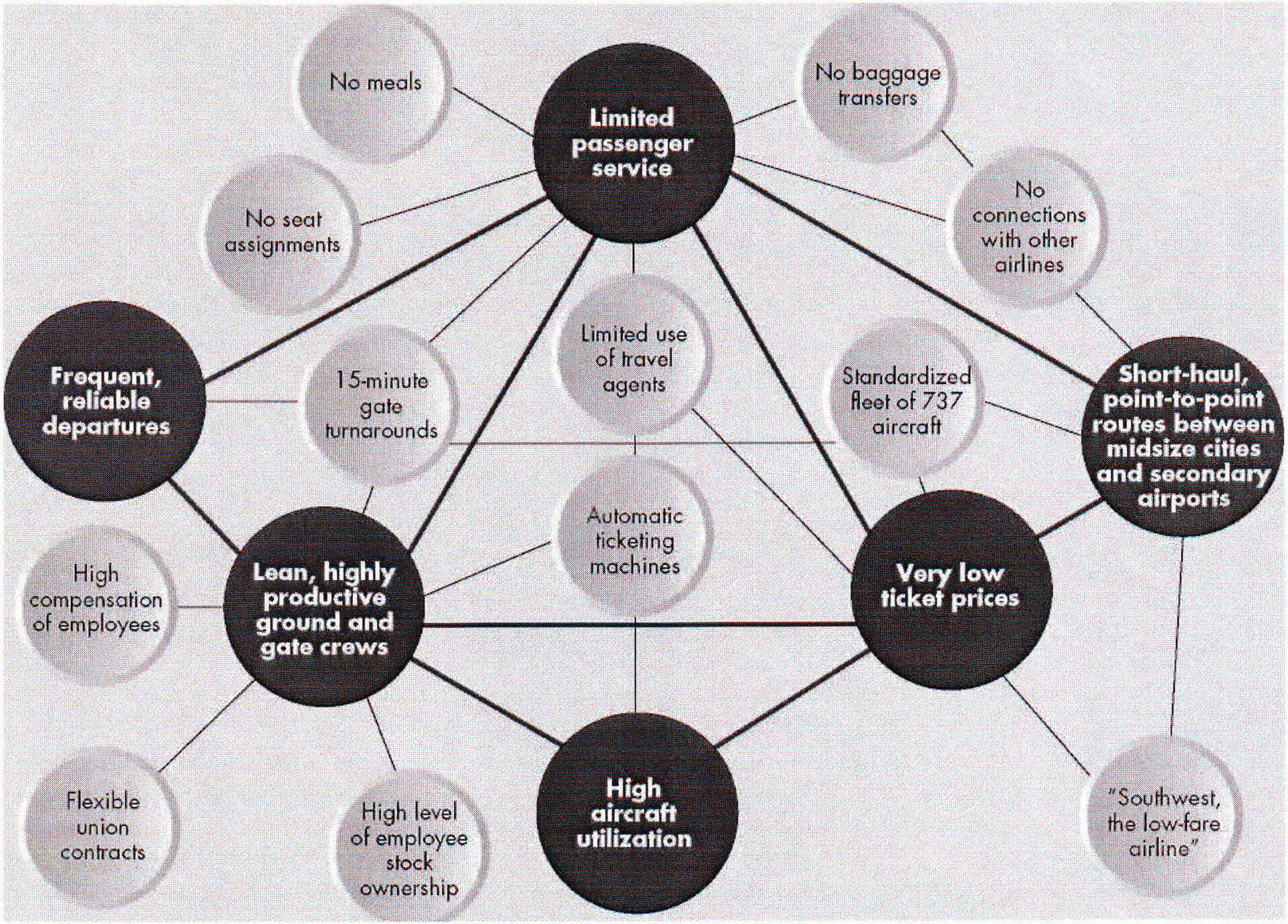
- **First-order fit is *simple consistency* between each activity (function) and the overall strategy.**
- **Consistency ensures that the competitive advantages of activities cumulate and do not erode or cancel themselves out. It makes the strategy easier to communicate to customers, employees, and share-holders, and improves implementation through single-mindedness in the corporation.**

- **Second-order fit occurs when *activities are reinforcing.***
- **Neutrogena markets to upscale hotels eager to offer their guests a soap recommended by dermatologists. Hotels grant Neutrogena the privilege of using its customary packaging while requiring other soaps to feature the hotel's name. Once guests have tried Neutrogena in a luxury hotel, they are more likely to purchase it at the drugstore or ask their doctor about it. Thus Neutrogena's medical and hotel marketing activities reinforce one another, lowering total marketing costs.**

- Third-order fit goes beyond activity reinforcement to what I call *optimization of effort*.
- The Gap,a retailer of casual clothes, considers product availability in its stores a critical element of its strategy.The Gap could keep products either by holding store inventory or by restocking from warehouses. The Gap has optimized its effort across these activities by restocking its selection of basic clothing almost daily out of three warehouses, there by minimizing the need to carry large in-store inventories. The emphasis is on restocking because the Gap's merchandising strategy sticks to basic items in relatively few colors. While comparable retailers achieve turns of three to four times per year, the Gap turns its inventory seven and a half times per year. Rapid restocking, moreover, reduces the cost of implementingthe Gap's short model cycle, which is six to eight weeks long.

- **Coordination and information exchange across activities** to eliminate redundancy and minimize wasted effort are the most basic types of effort optimization. But there are higher levels as well.
- Product design choices, for example, can eliminate the need for after-sale service or make it possible for customers to perform service activities themselves. Similarly, coordination with suppliers or distribution channels can eliminate the need for some in-house activities, such as enduser training.
- In all three types of fit, the whole matters more than any individual part. Competitive advantage grows out of the *entire system* of activities. The fit among activities substantially reduces cost or increases differentiation .

Southwest Airlines' Activity System



Fit and Sustainability

- **Strategic fit among many activities is fundamental not only to competitive advantage but also to the sustainability of that advantage. Positions built on systems of activities are far more sustainable than those built on individual activities.**

- **The probability that competitors can match any activity is often less than one. The probabilities then quickly compound to make matching the entire system highly unlikely (.9X.9= .81; .9X.9X.9X.9= .66, and so on). Existing companies that try to reposition or straddle will be forced to reconfigure many activities.**

- **The more a company’s positioning rests on activity systems with second- and third-order fit, the more sustainable its advantage will be. Such systems.**
- **And even if rivals can identify the relevant interconnections, they will have difficulty replicating them. Achieving fit is difficult because it requires the integration of decisions and actions across many independent subunits.**

- **A competitor seeking to match an activity system gains little by imitating only some activities and not matching the whole. Performance does not improve; it can decline. Recall Continental Lite's disastrous attempt to imitate Southwest.**
- **Finally, fit among a company's activities creates pressures and incentives to improve operational effectiveness, which makes imitation even harder. Fit means that poor performance in one activity will degrade the performance in others, so that weaknesses are exposed and more prone to get attention.**