AFF9180
FINANCIAL INSTITUTION’S PLANNING AND STRATEGY
UNIT BOOK

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The Faculty of Business and Economics comprises the departments of Accounting and Finance, Business Law and Taxation, Econometrics and Business Statistics, Economics, Management, and Marketing, and it is represented on five of the University’s campuses in Victoria – Berwick, Caulfield, Clayton, Gippsland and Peninsula – at the Monash Malaysia campus in Kuala Lumpur, and at other overseas locations, particularly in Asia.

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The mission of the Faculty is to be an international leader in the pursuit, dissemination and analysis of knowledge in the field of business and economics.
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Copies of extracts made on 14 January 2001
The Concept of Planning and Strategy

Objectives

On completion of this topic you should be able to:

- distinguish the field of ‘planning and strategy’ from other study areas;
- define the notions of strategy, strategic thinking and strategic management and distinguish between each;
- explain the three main dimensions of strategic management: process, content and context;
- explain the concept of ‘strategic management’;
- distinguish the relationship between the hierarchy of strategic statements, namely mission statement, corporate, business and functional strategies;
- outline the need for strategic management and its relationship to growth;
- identify the challenges facing management leaders in dealing with change; and
- describe the basis for competitive success.
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The strategy-making, strategy-implementing process
Strategy: A summation
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Evaluation of strategy and performance
The strategic decision making and analysis model
Review questions

Reading

Prescribed reading:


The readings accompanying this week’s work are:


Introduction

Unless we change our direction we are likely to end up where we are headed (Ancient Chinese Proverb).

If we know where we are and something about how we got there, we might see where we are trending- and if the outcomes which lie naturally in our course are unacceptable, to make timely change (Abraham Lincoln).

There is no resting place for an enterprise in a competitive society (Alfred P. Sloan, Jnr).
The concept of strategy is one that is difficult to define, and many authors and thinkers on the topic address the concept in differing fashion. There is further blurring by the adoption of the term ‘strategy’ to a whole range of concepts and circumstances, particularly as it has become a ‘buzzword’ of management jargon.

The aim of these notes is not to confuse you with any further variation, but rather, in conjunction with the material presented in the Readings, provide scope for consideration of all manner of approaches taken with this topic as there is no best approach, no best definition, no best tool. Instead there should be considered a number of fundamental tools and concepts within the field of strategic management with management making best use of those which are most suited to their own circumstance.

Much of the material discussed in this topic is introductory and will be developed further in later topics.

The field of planning and strategy

What are the essential issues of strategic management and planning and how does this field of study differ from others you have completed?

The issues

The core issues (or questions) in strategic management include the following:

- Why do some firms outperform others?
- What are the characteristics of successful firms?
- What makes some industries more attractive than others?
- Is it a case of survival of the fittest or can managers make a difference to the performance of their organisations?
- Is there an optimum process of strategy making?
- Are strategic management practices and tools universal or do they only apply in certain circumstances?
- Does the context in which organisations operate matter?
You will be asked to consider these issues and others throughout the topics of this unit.

Strategic management and planning is a field of study that synthesises contributions from economics, finance, organisational theory, organisational behaviour and psychology. It requires an integration of perspectives and different discipline areas, so it is best is studied once you have an understanding of other components of organisational functions.

Essential to strategic management and planning is the notion that managers make a difference to the performance of organisations. If markets were perfect and all relevant factors were ‘knowable’, then the market mechanism would be the primary coordinating mechanism and industries would comprise many firms, none of which could achieve an advantage over others (other than in the very short term).

However, we know this is not the case. Imperfect markets and imperfect information exist. This leads to uncertainty and unpredictability in markets and creates an opportunity for well-managed firms to seek advantage over others. Further, strategic managers can seek to change the very nature of industries in which their firm operates by their political action, by the interfirm relationships they form, or by the technological breakthroughs they champion.

So, by their choice, implementation and evaluation of strategy, managers make a critical contribution to the firm.

Activity 1: Self quiz

Test yourself by indicating whether the following statements are true or false:

1. Strategic management and planning requires an action orientation. T / F

2. The emphasis in strategic management is on the understanding of theory. T / F

3. Management decision-making is central to strategic management. T / F
4. Strategic management and planning is concerned with factors both external and internal to an organisation. **T / F**

5. The activities of a firm are determined by the industries in which it operates. **T / F**

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**Reading**

Chapter 1 of your textbook provides a very good overview of the traditional field of strategic management.

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**Planning, strategy, strategic thinking, and strategic management**

**Definitions**

The terms ‘planning’, ‘strategy’, ‘strategic thinking’ and ‘strategic management’ are often used interchangeably, however for the purpose of these notes the following broad definitions are adopted.

**Planning** is the process of defining goals, establishing strategy, and developing plans to coordinate activities.

**Strategy** refers to the pattern of actions by which management aims to achieve its objectives. Kenichi Ohmae defines strategy as “the way in which a corporation endeavours to differentiate itself positively from its competitors, using its relative corporate strengths to better satisfy customer needs.”

So strategy is about taking action. Some of these actions are planned, some are the response to changing conditions within and outside the organisation. Further, the strategy of an organisation is rarely a single action but it is the consistent pattern that emerges from a number of actions taken by managers over time.

**Strategic thinking** brings us to the importance of strategic thinking. What ensures that the multitude of little decisions are consistent with the main objectives of the organisation; or that the organisation understands enough about itself and its environment that its big decisions will ensure its growth and success long into the future?
Hamel and Prahalad in their book *Competing for the Future* suggest that very few organisations are really into strategic thinking. Over the past few years we have seen many organisations pursuing operational efficiency and downsizing rather than pursuing growth and new businesses in order to create their own futures. Is this true of the organisation for which you work?

Strategic thinking, according to Hamel and Prahalad, is not about the ruthless pursuit of efficiency, shareholder value, or return on capital employed; nor is it about the analysis of present customer requirements, present competitor activities or the basis for competitive advantage. Rather, strategic thinking is about imagining what customers will demand in the future; who future competitors will be; and what future industries could emerge.

Think about a new industry such as pay TV. Are Bill Gates and Rupert Murdoch passively sitting back and letting the industry develop? Or, are they actively involved in moulding the industry to suit their own organisations? Of course the latter is true. This is strategic thinking.

In summary, today’s strategists must have:

1. an understanding of how competition for the future is different;
2. a process for finding and gaining insight into tomorrow’s opportunities;
3. an ability to energise the company top-to-bottom for what may be a long and arduous journey toward the future; and
4. the capacity to outrun competitors and get to the future first, without taking undue risks (Hamel and Prahalad 1994, p.23).

**Strategic management** in broad terms refers to three main activities: the crafting (developing), implementing and evaluation of strategy. It involves:

- analysing the organisation and its environment;
- developing a vision of the future for the organisation;
- taking decisions about the major issues facing the organisation;
ensuring that the chosen strategy is implemented;

making the necessary changes to structure, systems, technology etc within resource constraints; and

continuously evaluating strategy and the changes occurring in the industries in which it operates, and the industries that are emerging.

It is different from other aspects of management in that the issues are generally complex, ambiguous and non-routine. Strategic decisions impact on the whole organisation and may be associated with fundamental change.

For the purposes of this unit, Financial Institution’s Planning and Strategy, the term ‘Strategic Management’ will be used almost exclusively, and in as many examples as possible, financial institutions will be used. However as you will see in the textbook for this unit, case examples are not based on financial institutions, but rather a collection of other industries, mostly multi-nationals. It is important to understand that the principles that apply to strategic management may be applied to any industry.

Reading

Reading 1.1, Cummings (1994), “The First Strategists”. This article describes the origins of the notion of ‘strategy’ and illustrates some of the fundamental characteristics of strategists.

Activity 2

1. Select three principles of strategy mentioned in the above article and discuss in what ways they are applicable to managers today.

2. Suggest some ways that business strategy is different from military strategy

3. Select a manager, who in your opinion demonstrates some of the characteristics that the ancient Greeks identified and prepare a list of these characteristics.
Process, content and context of strategy

We have said that strategic management and planning is a process. This process takes place within a particular organisational, industry or national context, therefore the process will result in different content or outcomes for different organisations.

These three main dimensions of strategic management (process, content and context) are complementary. Figure 1.1 illustrates each of these dimensions of strategy.

Figure 1.1: Dimensions of strategy

The strategy process

We can look at strategy as a process. This refers to the way strategy forms. Is strategy planned or does it emerge? Should strategic change be revolutionary or incremental? Who should be involved in the process of strategy making? How does power and culture influence the process of strategic decision making? From this dimension we are concerned with the behaviour and choices made by managers. You will soon notice that the process dimension of strategy provides the framework of your textbook, Thompson and Strickland. We will seek answers to the above process questions during the course of this unit. A process model guides the discussion in each chapter of your textbook.
The content of strategy

A second dimension of strategy is content. Here our focus is on the output of the strategic process: the actions selected by managers to achieve the company’s long-term objectives (de Wit and Meyer, 1994). The important issues with content are:

- What types of strategies are there?
- In what circumstances are each appropriate?
- On what should strategy be based?
- What matters most: positioning or core competencies?
- How does strategy differ at the functional, business, corporate or intercompany level?

In this unit you will cover these issues of content in later chapters.

Clearly, process and content need to be considered together.

The context of strategy

Every organisation faces a unique set of circumstances; that is, context varies between organisations. By context we mean the industry structure faced by the organisation; the nature and degree of competitive rivalry; and the firm’s culture, history and structure.

Here the critical questions are:

- Can a particular strategic process be applied universally?
- Does the context of strategy matter?
- To what degree can the organisation change or choose its environment?

In your study of this unit we consider context in several ways. In Topic 3 we consider general environmental issues, that is, how to assess the properties of the environment.

Remember, strategic issues need to be considered from all three dimensions: process, content and context.
The strategy-making, strategy-implementing process

Reading

Read section 1.4, “Basic Model of Strategic Management” on pp.8-16, of your textbook. This section provides an overview of the strategy process. The diagrams on p.9 clearly show how this process is structured, and will be used as the building blocks for this unit.

Leaders of organisations are aware however that this process is not necessarily linear. When an organisation is in a rapidly changing industry, it is necessary to frequently revisit components of this process before outcomes can be reached.

Vision, mission and objectives

Some people like to combine the ideas of vision and mission, others like to consider them as two different concepts. We will define them separately. Vision refers to a future state for the organisation and describes what the organisation would like to become, whilst the mission statement promotes a sense of shared expectations in employees and communicates a public image to important stakeholder groups in the company’s external environment. It tells who we are and what we do as well as what we’d like to become. Don’t get too ‘hung up’ on the differences between them.

ANZ’s vision as written in their 1999 Annual Report, states:

ANZ is a vibrant financial services company that delivers:

- superior performance and value to our shareholders;
- an experience which delights our customers; and
- an environment where our people excel.

The following are two examples of mission that demonstrate the dynamic nature of environments and the necessity to change strategies and therefore strategic statements.

The former Syme Faculty of Business:

Our mission is to provide high quality relevant and applied education for the business professions.

We seek to achieve this through a process of continuous focus on our clients and their employers.
When the Chisholm Institute of Technology was taken over by Monash University and Syme became part of the Faculty of Business and Economics a new mission statement was developed as follows:

The Faculty of Business and Economics at Monash University will use its scale, scope and unique internal diversity to become an international leader in pursuit, dissemination and analysis of knowledge. By application of that knowledge to relevant disciplines its staff and students will contribute to the economic, social and commercial development of Australian and other communities.

Quite clearly the latter statement signals that to accommodate this mission a significant change in strategy will be required. However note the general nature of the mission statement. It is a statement of intention and does not describe how success will be achieved.

The following is an example of a financial organisation’s mission statement, namely Westpac’s.

Westpac’s mission is simple:

Through our affinity with customers, in chosen markets, we will consistently demonstrate superior ability to help each and every customer find the best solution to their financial needs.

Again, note the generalities of the mission statement, in that it asserts what it will strive to achieve rather than how it will gain a competitive advantage. For this we need to examine the next stage, the corporate strategy.

Corporate strategy

Corporate strategy can be described as:

The placement and the manner in which resources are employed to enable an organisation to exploit current and future products, market positions and opportunities in the pursuit of goals and objectives.

Corporate strategy tends to be more specific than a mission statement, although for a small business firm, mission, corporate and business strategy can be the same. Corporate strategy defines or describes the business or businesses in which an organisation will compete. The huge Australia mining conglomerate CRA has a number of separate businesses, each of which operates as an independent business unit.
These cover iron ore, coal, aluminium, base and precious metals and other operations. Although these are related activities, each has different markets and technologies. For an organisation such as CRA, its corporate strategy will be stated at a much more general level than each of its separate divisions.

CRA’s corporate strategy is:

- to improve the international competitiveness of its existing businesses;
- to create future opportunities by maintaining strong exploration and research and development programs where appropriate opportunities exist to do so; and to acquire economically first class assets in fields in which it has the strengths and which add to shareholder value.

It can be seen that this corporate strategic statement is very broad and in no way indicates how these strategic business units will achieve a competitive advantage. These business units will each be required to develop business strategies.

**Business strategy**

A *business strategy* describes how an individual firm or business unit will compete. This is the level at which most of our case studies are conducted.

A good strategic statement will indicate how a firm focuses its resources to turn a distinctive competence or a functional strength into a competitive edge. A prominent Australian conglomerate company, Southcorp, has a corporate strategy relating to general goals such as growth and shareholder rewards, whilst the individual business units of packaging, domestic appliances, hot water appliances and wine have quite distinctive business strategies:

1. because of different products and markets; and
2. because of different competitive situations.

In small organisations the corporate and business strategy will often be the same.
Westpac states its current strategy as follows:

- to improve the returns to proprietors by increasing the profitability of our retail business; we will do this by:
  - reducing costs substantially and by retaining and attracting valuable customer relationships through improved customer service;
  - reshaping our global institutional banking operations by changing our principal focus from corporate lending to a niche global financial markets business;
  - reducing the impact of the problem asset portfolio on the bank’s performance;
  - improving returns from, or exiting under-performing businesses;
  - reducing costs in and improving the productivity of, the Corporate Centre.

The italicised sections indicate particular ways in which Westpac will strive to gain a competitive edge.

**Functional strategies**

These are implemented at the level at which most people are employed.

The major functional areas include finance and accounting, marketing and logistics, production and operations, research and development, personnel and human resources employment and, over-seeing each of these, management and leadership.

The managers at these levels are the people who implement strategy.

Ajax Spurway Fasteners, (which itself was a strategic merger of two firms that were struggling to compete against imports), states in its marketing functional strategies that it will:

- enhance the Ajax brand;
- deliver on time in full;
- provide telemarketing;
- provide a quotation service; and
- undertake new product development.
Strategy: A summation

Strategic management determines the future direction of the organisation in the pursuit of goals and objectives and employs resources, operating systems, structures, rewards, controls, management and leadership to achieve these; that is planning, implementing and controlling strategy.

Frequently, the latter two are the hardest aspects of strategic management to undertake because they must be implemented through people, for example, for a bank, to determine that the basis of its strategy is to be a low cost operation is not difficult, but to have the managers and work-force adopt low cost behaviour can be extremely difficult.

The major challenge of strategic management, because it deals with future directions, is to anticipate and cope with change in a competitive environment; one has only to consider the strategic debacles of financial institutions attempting to cope with deregulation and new competitors between 1985 and 1990 to appreciate this challenge.

A second challenge is to convince and motivate the workers to implement the policies necessary to gain a competitive edge.

Since top management usually devises the strategies, a third challenge is to effectively communicate and have new strategies adopted.

Goals and objectives

Objectives are the end results of planned activity. They state what is to be accomplished by when and should be quantified if possible. The achievement of corporate objectives should result in the fulfilment of a corporation’s mission. An example might be:

1. to achieve 10% annual growth in earnings per share;
2. to achieve 20%-25% return on equity; or
3. to achieve 27% return on capital employed.
Private organisations have goals, for example Southcorp Ltd’s former CEO Ross Wilson, stated that his organisation’s goal was to increase shareholders’ wealth. Goals are usually general aims and depending upon the type of organisation, can cover an enormous area; for example to expand overseas, to diversify geographically.

Objectives are better viewed as quantifiable tasks or aims, for example 15% ROE, increase profits by 5%, increase sales by 10%, lower costs by 15%, reduce employment levels by 10%. Tony Berg, the former joint managing director of Macquarie Bank, shortly after his appointment as CEO of the large Australian building products and gas company Boral in 1994, stated that his objective was to raise share-holder wealth by 50% over the next five years. This is a clear objective by which share-holders can measure his performance.

The more an organisation can translate its goals into objectives, the easier it is to control activities, measure performance and reward accordingly.

National Australia Bank’s 1992 Annual Report, p.2, is an example of mission statement and so-called objectives.

*Group Mission*

To provide core banking and selected financial services professionally, efficiently and competitively to achieve a pre-eminent position in chosen markets.

*Objectives*

Develop and maintain a mutually beneficial customer relationship based on high quality service.

Quality earnings generated in core markets.

A diverse high quality business base.

Strong capitalisation.

Disciplined growth strategy.

Market leader in efficiency and productivity.

Create shareholder wealth.
Management style and practices that contribute to the well being and development of a fully responsible and accountable work-force.

High standard of business and corporate ethics.

Clearly these are not measurable objectives but rather goals. Good strategic plans will detail how these “objectives” will be achieved.

**Strategy implementation: The means to achieve competitive success**

The next stage in the strategic management process is essentially about putting the strategy into place; about establishing the right preconditions for strategy to be successfully implemented and about ensuring structure and systems support the strategy.

The usual rationale for strategic management is to increase shareholder wealth through increased profits. Often this means growth strategies are adopted and in turn firms try to fashion distinctive strategies that will provide competitive advantage.

Three items are needed for success in a competitive environment.

1. A good strategy that builds on a firm’s strengths and exploits market positions and opportunities where it has a competitive advantage. An example of this is Mazda with its niche car product approach, where by it attempts to avoid head-to-head competition with Toyota and Nissan in the large volume segments.

   Much of the subject Strategic Management is the expansion of how a firm crafts and implements a successful strategy.

2. Hard work. Seldom do good products and services come easily. A short rest to enjoy the fruits of success and a competitor, working harder and smarter can remove market share. Consider the way the Australian Fosters’ CUB Victorian Brewery with over 90% of the state market became careless and disrespectful of the new Lion Nathan competitor. Within a short time and without advertising Tooheys Blue had taken some 14% of the Victorian market.
CUB soon launched a strong counter-attack by hiring away Lion Nathan’s chief brewer and launching Fosters Special Bitter.

In 1989 Westpac was the largest bank (by total assets) in Australia and the NAB (National Australia Bank) was the smallest. By 1993 the positions had been reversed - the NAB was not only the largest by assets but by far the most profitable large bank in Australia; that is, its return on share-holders’ funds is significantly higher than its competitors.

3. A little luck, which should never be confused with good management, can be an important ingredient of success. Many a property developer in the mid to late eighties made a “killing” up to 1989. Many did not appreciate that the whole market was rising and most, if not all properties were rising in value. For many it was this environmental factor and not their competitive advantage that was delivering success. Those who did not recognise this and continued to purchase property found that their luck had run out. Some of the better property strategists, such as the managers of Hudson Conway, a listed company which controls Crown Casino, recognised the market was overheated and sold much of their property before the crash of 1990.

**Evaluation of strategy and performance**

The Strategic Management Process can be often thought of as beginning at the evaluation stage, particularly when senior management may be planning a new direction for the organisation. They will begin the process with a thorough evaluation of how well the organisation is performing and how well present strategy is meeting the objectives of the organisation and its stakeholders.

**Growth and strategic management**

The idea of growth is often the reason that strategies are crafted. So why do organisations pursue growth?

Shareholders want it. Funds flow away from declining organisations to growing organisations.

It is far easier to reward and motivate people in a growing profitable organisation.
Stagnation can open opportunities to competitors, where by the strong take over the weak and competitors are forced to take high risks to survive, for example The State Bank of Victoria’s disastrous take-over of Tricontinental.

Computer technology, research and development, manufacturing technology and so on, can be very expensive. Without growth and profitability it is difficult to generate the funds to take advantage of opportunities.

Growing organisations find it easier to attract and retain good staff and leaders.

It is easier to cope with change. Resources can be moved out of a declining sector into a growing one.

It provides a more vigorous and dynamic culture which can be more amenable to change.

The strategic decision making and analysis model

The model on the next page is a summary of the subject of strategic management. The first three boxes cover the external environment, the next two the internal environment. These five boxes are concerned with analysis and not descriptive information. The sixth box deals with the recommendations which grow out of the analysis. The seventh and final box looks at the issues involved in implementing your recommendations.

Most of the cases that will form part of the activities for this unit will not require all of these elements. It is your judgement that will determine what elements you develop and which you exclude. However if you feel lost with the detail in the cases, a review of the model will help you determine the context of the case.
Figure 1.2: Strategic decision making and analysis model

- Environmental Analysis
  - Conditions affecting the industry and its related markets
  - Significant trends in the industry

- Critical Success Factors
  - Identification of CSF's of any firm operating in that industry or market
  - Identification of any CSF's specific to only that firm

- Opportunities and Threats
  - To any industry
  - To this industry
  - In related markets
  - To the firm

- Internal Analysis
  - Direct assessment of the firm against the identified critical success factors
  - The firm's current strategy
  - Resources
  - Structure
  - Controls
  - Leadership
  - Culture

- SWOT Analysis
  - Strengths and Weaknesses
    - Relative to Critical Success Factors
    - Comparison with those of key competitors
  - Opportunities and Threats
    - Comparison of the firm's strengths and weaknesses with identified opportunities & threats

- Recommendations
  - Identify and evaluate major options
  - Make specific recommendations to take advantage of opportunities which align with major relative strengths & minimise the negative impacts of threats

- Implementation
  - Specific details of how the recommended/chosen strategies will be implemented
Review questions

To ensure you have an understanding of the key concepts of ‘Strategy’ and ‘Strategic Management’, there are two review activities to be completed. The first is to review the discussion questions at the end of Chapter 1 of your textbook (p.22.)

The second is to go to Reading 1.2 about “Strategic Intent” and answer these two questions.

*Hint:* Focus on the box: ‘Remaking strategy’ and take particular attention of the use of key terms.

**Question 1**

Is ‘competitive strategy’ a contradiction in terms? When is strategy not necessarily competitive?

**Question 2**

This article uses the term ‘competitive advantage’. What does this mean?

What are the key differences between Western and Far Eastern companies concerning the notion of competitive advantage?
The First Strategists
Cummings, S.

Origin of Strategy
The word strategy derives from the ancient Athenian position of strategos. The title was coined in conjunction with the democratic reforms of Kleisthenes (508-7 B.C.), who developed a new sociopolitical structure in Athens after leading a popular revolution against a Spartan-supported oligarchy. Kleisthenes instituted ten new tribal divisions, which acted as both military and political subunits of the district of Athens. At the head of each tribe was elected a strategos. Collectively, the ten incumbent strategoi formed the Athenian war council. This council and its individual members, by virtue of the kudos granted them, also largely controlled nonmilitary politics.

Strategos was a compound of stratos; which meant “anny,” or more properly an encamped anny spread out over ground (in this way stratos is also allied to stratum) and agein, “to lead.” The emergence of the term paralleled increasing military decision-making complexity. Warfare had evolved to a point where winning sides no longer relied on the deeds of heroic individuals, but on the coordination of many units of men each fighting in close formation. Also, the increasing significance of naval forces in this period multiplied the variables a commander must consider in planning action. Consequently, questions of coordination and synergy among the various emergent units of their organizations became imperative considerations for successful commanders.

Of what interest are the origins of strategy to those engaging in strategic activities and decision making in organizations today? In the words of Adlai Stevenson, we can see our future clearly and wisely only when we know the path that leads to the present. Most involved in corporate strategy have little knowledge of where that path began. A great deal of insight into strategy can be gained from examining those from whom we inherit the term. The first strategists, the Greek strategoi, perhaps practiced strategy in its purest sense.

Strategy and Strategist as Defined by Ancient Theorists
Aineias the Tactician, who wrote the earliest surviving Western volume on military strategy, How to Survive under Siege, in the mid-fourth century B.C., was primarily concerned with how to deploy available manpower and other resources to best advantage. The term strategy is defined in more detail by Frontinus in the first century A.D., as “everything achieved by a commander” be it characterized by foresight, advantage, enterprise, or resolution.”

Ancient Athenian theorists also had clear ideas about the characteristics that were necessary in an effective strategos. According to Xenophon, a commander “must be ingenious, energetic, careful, full of stamina and presence of mind, loving and tough, straightforward and crafty, alert and deceptive, ready to gamble everything and wishing to have everything, generous and greedy, trusting and suspicious.” These criteria for identifying an excellent strategist still ring true.

Xenophon goes on to describe the most important attribute for an aspiring strategos/statement as “knowing the business which you propose to carry out.” The Athenians in this period were very concerned that their leaders had an awareness of how things worked at the “coal-face.” Strategoi were publicly elected by their fellow members of the Athenian organization; and to be
considered a credible candidate, one had to have worked one's way into this position by demonstrating prowess at both individual combat and hands-on military leadership. Wisdom was considered to be a citizen’s ability to combine political acumen and practical intelligence, and strategoi should be the wisest of citizens. The organization’s future lay in the hands of these men and, ipso facto, the strategic leadership of the Athenian organization was not to consider itself immune from hardship when times were tough: “No man was fitted to give fair and honest advice in council if he has not, like his fellows, a family at stake in the hour of the city’s danger.”

To the ancient Athenians strategy was very much a line function. The formulation of strategy was a leadership task. The Athenian organization developed by Kleisthenes was extremely recursive. The new tribes, and the local communities that these tribes comprised, formed the units and subunits of the army, and were, in their sociopolitical structures, tantamount to the city-state in microcosm. Decision makers at all levels of the corporation were expected to think strategically, in accordance with the behaviour exhibited by those in leadership roles at higher levels of the Athenian system. Strategoi were expected both to direct and take part in the thick of battle, leading their troops into action. For a strategos not to play an active combat role would have resulted in a significant diminution in the morale of those fighting for his tribe.

Practical Lessons from the Strategoi

If military practice is identified as a metaphor for business competition, the strategic principles of the great strategoi still provide useful guides for those in the business of strategy formulation today. For Pericles, perhaps the greatest of the Athenian strategoi, the goal of military strategies was “to limit risk while holding fast to essential points and principles.” His often quoted maxims of “Opportunity waits for no man” and “Do not make any new conquests during the war” are still applicable advice in a modern, business environment.

Epaminondas of Thebes was said to have brought the two arms of his military corporation, infantry and cavalry, together in a “fruitful organizational blend.” The Theban’s strategic principles included economy of force coupled with overwhelming strength at the decisive point; close co-ordination between units and meticulous staff planning combined with speed of attack; and as the quickest and most economical way of winning a decision, defeat of the competition not at his weakest point but at his strongest. Epaminondas was Philip of Macedon’s mentor, and it was largely due to the application of the Theban’s innovations that the Macedonian army grew to an extent where it was able to realize Alexander the Great’s (Philip’s son) vast ambitions. The ‘close integration of all its individual units became the major strength of the Macedonian army organization.

Alexander himself is perhaps the most famous ancient exponent of a contingency approach to strategy. It is often told that as a young man he was asked by his tutor Aristotle what he would do in a given situation. Alexander replied that his answer would depend on the circumstances. Aristotle described
a hypothetical set of circumstances and asked his original question again. To this the student answered, “I cannot tell until the circumstances arise.” In practice Alexander was not often caught without a “plan B.” An example is related by Frontinus: “At Arbela, Alexander, fearing the numbers of the enemy, yet confident in the valour of his own troops, drew up a line of battle facing in all directions, in order that the men, if surrounded, might be able to fight from any side.”

Ancient Approaches to the Learning of Strategy

The ancient Greeks took great interest in both the practical and theoretical aspects of strategic leadership. They favoured the case method as the best means of passing this knowledge from one generation of strategists to the next. Frontinus argued that “in this way commanders will be furnished with specimens of wisdom and foresight, which will serve to foster their own power of conceiving and executing like deeds.” Aineias and Xenophon also used and championed such methods in ways that would please any Harvardophile. The best-crafted exposition of the case method, however, belongs to Plutarch, biographer to the ancient world’s greatest leaders:

It is true, of course, that our outward sense cannot avoid apprehending the various objects it encounters, merely by virtue of their impact and regardless of whether they are useful or not but a man’s conscious intellect is something which he may bring to bear or avert as he chooses, and can very easily transfer … to another object as he sees fit. For this reason, we ought to seek out virtue not merely to contemplate it, but to derive benefit from doing so. A colour, for example, is well suited to the eye if its bright and agreeable tones stimulate and refresh the vision, and in the same way we ought to apply our intellectual vision to those models which can inspire it to attain its own proper virtue through the sense of delight they arouse. … [Such a model is] no sooner seen than it rouses the spectator into action, and yet it does not form his character by mere imitation, but by promoting the understanding of virtuous deeds it provides him with a dominating purpose.

Now, as then, our strategic vision can be refreshed and stimulated through studying the character and deeds of the great strategic leaders of the past.
STRATEGIC INTENT

Gary Hamel, London Business School
C. K. Prahalad, University of Michigan

Today managers in many industries are working hard to match the competitive advantages of their new global rivals. They are moving manufacturing offshore in search of lower labor costs, rationalizing product lines to capture global scale economies, instituting quality circles and just-in-time production, and adopting Japanese human resource practices. When competitiveness still seems out of reach, they form strategic alliances—often with the very companies that upset the competitive balance in the first place.

Important as these initiatives are, few of them go beyond mere imitation. Too many companies are expending enormous energy simply to reproduce the cost and quality advantages their global competitors already enjoy. Imitation may be the sincerest form of flattery, but it will not lead to competitive revitalization. Strategies based on imitation are transparent to competitors who have already mastered them. Moreover, successful competitors rarely stand still. So it is not surprising that many executives feel trapped in a seemingly endless game of catch-up—regularly surprised by the new accomplishments of their rivals.

For these executives and their companies, regaining competitiveness will mean rethinking many of the basic concepts of strategy. As “strategy” has blossomed, the competitiveness of Western companies has withered. This may be coincidence, but we think not. We believe that the application of concepts such as “strategic fit” (between resources and opportunities), “generic strategies” (low cost versus differentiation versus focus), and the “strategy hierarchy” (goals, strategies, and tactics) has often abetted the process of competitive decline. The new global competitors


approach strategy from a perspective that is fundamentally different from that which underpins Western management thought. Against such competitors, marginal adjustments to current orthodoxies are no more likely to produce competitive revitalization than are marginal improvements in operating efficiency. (The box, “Remaking Strategy,” describes our research and summarizes the two contrasting approaches to strategy we see in large, multinational companies.)

Few Western companies have an enviable track record anticipating the moves of new global competitors. Why? The explanation begins with the way most companies have approached competitor analysis. Typically, competitor analysis focuses on the existing resources (human, technical, and financial) of present competitors. The only companies seen as threats are those with the resources to erode margins and market share in the next planning period. Resourcefulness, the pace at which new competitive advantages are being built, rarely enters in.

In this respect, traditional competitor analysis is like a snapshot of a moving car. By itself, the photograph yields little information about the car’s speed or direction—whether the driver is out for a quiet Sunday drive or warming up for the Grand Prix. Yet many managers have learned through painful experience that a business’s initial resource endowment (whether bountiful or meager) is an unreliable predictor of future global success.

Think back. In 1970, few Japanese companies possessed the resource base, manufacturing volume, or technical prowess of U.S. and European industry leaders. Komatsu was less than 35 percent as large as Caterpillar (measured by sales), was scarcely represented outside Japan, and relied on just one product line—small bulldozers—for most of its revenue. Honda was smaller than American Motors and had not yet begun to export cars to the United States. Canon’s first halting steps in the reprographics business looked pitifully small compared with the $4 billion Xerox powerhouse.

If Western managers had extended their competitor analysis to include these companies, it would merely have underlined how dramatic the resource discrepancies between them were. Yet by 1985, Komatsu was a $2.8 billion company with a product scope encompassing a broad range of earth-moving equipment, industrial robots, and semiconductors. Honda manufactured almost as many cars worldwide in 1987 as Chrysler. Canon had matched Xerox’s global unit market share.

The lesson is clear: assessing the current tactical advantages of known competitors will not help you understand the resolution, stamina, and inventiveness of potential competitors. Sun-tzu, a Chinese military strategist, made the point 3,000 years ago: “All men can see the tactics whereby I conquer,” he wrote, “but what none can see is the strategy out of which great victory is evolved.”

Companies that have risen to global leadership over the past 20 years invariably began with ambitions that were out of all proportion to their resources and capabilities. But they created an obsession with winning at all levels of the organization and then sustained that obsession over the 10- to 20-year quest for global leadership. We term this obsession “strategic intent.”

On the one hand, strategic intent envision's a desired leadership position and establishes the criterion the organization will use to chart its progress. Komatsu set out to “Encircle Caterpillar.” Canon sought to “Beat Xerox.” Honda strove to become a second Ford—an automotive pioneer. All are expressions of strategic intent.

At the same time, strategic intent is more than simply unfettered ambition. (Many companies possess an ambitious strategic intent yet fall short of their goals.) The concept also encompasses an active management process that includes focusing the
REMAKING STRATEGY

Over the last 10 years, our research on global competition, international alliances, and multinational management has brought us into close contact with senior managers in America, Europe, and Japan. As we tried to unravel the reasons for success and surrender in global markets, we became more and more suspicious that executives in Western and Far Eastern companies often operated with very different conceptions of competitive strategy. Understanding these differences, we thought, might help explain the conduct and outcome of competitive battles as well as supplement traditional explanations for Japan’s ascendance and the West’s decline.

We began by mapping the implicit strategy models of managers who had participated in our research. Then we built detailed histories of selected competitive battles. We searched for evidence of divergent views of strategy, competitive advantage, and the role of top management.

Two contrasting models of strategy emerged. One, which most Western managers will recognize, centers on the problem of maintaining strategic fit. The other centers on the problem of leveraging resources. The two are not mutually exclusive, but they represent a significant difference in emphasis—an emphasis that deeply affects how competitive battles get played out over time.

Both models recognize the problem of competing in a hostile environment with limited resources. But while the emphasis in the first is on trimming ambitions to match available resources, the emphasis in the second is on leveraging resources to reach seemingly unattainable goals.

Both models recognize that relative competitive advantage determines relative profitability. The first emphasizes the search for advantages that are inherently sustainable, the second emphasizes the need to accelerate organizational learning to outpace competitors in building new advantages.

Both models recognize the difficulty of competing against larger competitors. But while the first leads to a search for niches (or simply dissuades the company from challenging an entrenched competitor), the second produces a quest for new rules that can devalue the incumbent’s advantages.

Both models recognize that balance in the scope of an organization’s activities reduces risk. The first seeks to reduce financial risk by building a balanced portfolio of cash-generating and cash-consuming businesses. The second seeks to reduce competitive risk by ensuring a well-balanced and sufficiently broad portfolio of advantages.

Both models recognize the need to disaggregate the organization in a way that allows top management to differentiate among the investment needs of various planning units. In the first model, resources are allocated to product-market units in which relatedness is defined by common products, channels, and customers. Each business is assumed to own all the critical skills it needs to execute its strategy successfully. In the second, investments are made in core competencies (microprocessor controls or electronic imaging, for example) as well as in product-market units. By tracking these investments across business, top management works to assure that the plans of individual strategic units don’t undermine future developments by default.

Both models recognize the need for consistency in action across organizational levels. In the first, consistency between corporate and business levels is largely a matter of conforming to financial objectives. Consistency between business and functional levels comes by tightly restricting the means the business uses to achieve its strategy—establishing standard operating procedures, defining the served market, adhering to accepted industry practices. In the second model, business-corporate consistency comes from allegiance to a particular strategic intent. Business-functional consistency comes from allegiance to intermediate-term goals, or challenges, with lower-level employees encouraged to invent how these goals will be achieved.

organization’s attention on the essence of winning; motivating people by communicating the value of the target; leaving room for individual and team contributions; sustaining enthusiasm by providing new operational definitions as circumstances change; and using intent consistently to guide resource allocations.

Strategic intent captures the essence of winning. The Apollo program—landing a man on the moon ahead of the Soviets—was as competitively focused as Komatsu’s drive against Caterpillar. The space program became the scorecard for America’s technology race with the USSR. In the turbulent information technology industry, it was hard to pick a single competitor as a target, so NEC’s strategic intent, set in the
early 1970s, was to acquire the technologies that would put it in the best position to exploit the convergence of computing and telecommunications. Other industry observers foresaw this convergence, but only NEC made convergence the guiding theme for subsequent strategic decisions by adopting “computing and communications” as its intent. For Coca-Cola, strategic intent has been to put a Coke within “arm’s reach” of every consumer in the world.

Strategic intent is stable over time. In battles for global leadership, one of the most critical tasks is to lengthen the organization’s attention span. Strategic intent provides consistency to short-term action, while leaving room for reinterpretation as new opportunities emerge. At Komatsu, encircling Caterpillar encompassed a succession of medium-term programs aimed at exploiting specific weaknesses in Caterpillar or building particular competitive advantages. When Caterpillar threatened Komatsu in Japan, for example, Komatsu responded by first improving quality, then driving down costs, then cultivating export markets, and then underwriting new product development.

Strategic intent sets a target that deserves personal effort and commitment. Ask the chairmen of many American corporations how they measure their contributions to their companies’ success and you’re likely to get an answer expressed in terms of shareholder wealth. In a company that possesses a strategic intent, top management is more likely to talk in terms of global market leadership. Market share leadership typically yields shareholder wealth, to be sure. But the two goals do not have the same motivational impact. It is hard to imagine middle managers, let alone blue-collar employees, waking up each day with the sole thought of creating more shareholder wealth. But mightn’t they feel different given the challenge to “Beat Benz”—the rallying cry at one Japanese auto producer? Strategic intent gives employees the only goal that is worthy of commitment: to unseat the best or remain the best, worldwide.

Many companies are more familiar with strategic planning than they are with strategic intent. The planning process typically acts as a “feasibility sieve.” Strategies are accepted or rejected on the basis of whether managers can be precise about the “how” as well as the “what” of their plans. Are the milestones clear? Do we have the necessary skills and resources? How will competitors react? Has the market been thoroughly researched? In one form or another, the admonition “Be realistic!” is given to line managers at almost every turn.

But can you plan for global leadership? Did Komatsu, Canon, and Honda have detailed, 20-year “strategies” for attacking Western markets? Are Japanese and Korean managers better planners than their Western counterparts? No. As valuable as strategic planning is, global leadership is an objective that lies outside the range of planning. We know of few companies with highly developed planning systems that have managed to set a strategic intent. As tests of strategic fit become more stringent, goals that cannot be planned for fall by the wayside. Yet companies that are afraid to commit to goals that lie outside the range of planning are unlikely to become global leaders.

Although strategic planning is billed as a way of becoming more future oriented, most managers, when pressed, will admit that their strategic plans reveal more about today’s problems than tomorrow’s opportunities. With a fresh set of problems confronting managers at the beginning of every planning cycle, focus often shifts dramatically from year to year. And with the pace of change accelerating in most industries, the predictive horizon is becoming shorter and shorter. So plans do little more than project the present forward incrementally. The goal of strategic intent is to fold the future back into the present. The important question is not “How will next year be
different from this year?” but “What must we do differently next year to get closer to our strategic intent?” Only with a carefully articulated and adhered to strategic intent will a succession of year-on-year plans sum up to global leadership.

Just as you cannot plan a 10- to 20-year quest for global leadership, the chance of falling into a leadership position by accident is also remote. We don’t believe that global leadership comes from an undirected process of intrapreneurship. Nor is it the product of a skunkworks or other techniques for internal venturing. Behind such programs lies a nihilistic assumption: the organization is so hidebound, so orthodox that the only way to innovate is to put a few bright people in a dark room, pour in some money, and hope that something wonderful will happen. In this “Silicon Valley” approach to innovation, the only role for top managers is to retrofit their corporate strategy to the entrepreneurial successes that emerge from below. Here the value added of top management is low indeed.

Sadly, this view of innovation may be consistent with the reality in many large companies. On the one hand, top management lacks any particular point of view about desirable ends beyond satisfying shareholders and keeping raiders at bay. On the other, the planning format, reward criteria, definition of served market, and belief in accepted industry practice all work together to tightly constrain the range of available means. As a result, innovation is necessarily an isolated activity. Growth depends more on the inventive capacity of individuals and small teams than on the ability of top management to aggregate the efforts of multiple teams toward an ambitious strategic intent.

In companies that overcame resource constraints to build leadership positions, we see a different relationship between means and ends. While strategic intent is clear about ends, it is flexible as to means—it leaves room for improvisation. Achieving strategic intent requires enormous creativity with respect to means: witness Fujitsu’s use of strategic alliances in Europe to attack IBM. But this creativity comes in the service of a clearly prescribed end. Creativity is unbridled, but not uncorralled, because top management establishes the criterion against which employees can pretest the logic of their initiatives. Middle managers must do more than deliver on promised financial targets; they must also deliver on the broad direction implicit in their organization’s strategic intent.

Strategic intent implies a sizable stretch for an organization. Current capabilities and resources will not suffice. This forces the organization to be more inventive, to make the most of limited resources. Whereas the traditional view of strategy focuses on the degree of fit between existing resources and current opportunities, strategic intent creates an extreme misfit between resources and ambitions. Top management then challenges the organization to close the gap by systematically building new advantages. For Canon this meant first understanding Xerox’s patents, then licensing technology to create a product that would yield early market experience, then gearing up internal R&D efforts, then licensing its own technology to other manufacturers to fund further R&D, then entering market segments in Japan and Europe where Xerox was weak, and so on.

In this respect, strategic intent is like a marathon run in 400-meter sprints. No one knows what the terrain will look like at mile 26, so the role of top management is to focus the organization’s attention on the ground to be covered in the next 400 meters.

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In several companies, management did this by presenting the organization with a series of corporate challenges, each specifying the next hill in the race to achieve strategic intent. One year the challenge might be quality, the next total customer care, the next entry into new markets, the next a rejuvenated product line. As this example indicates, corporate challenges are a way to stage the acquisition of new competitive advantages, a way to identify the focal point for employees’ efforts in the near to medium term. As with strategic intent, top management is specific about the ends (reducing product development times by 75 percent for example) but less prescriptive about the means.

Like strategic intent, challenges stretch the organization. To preempt Xerox in the personal copier business, Canon set its engineers a target price of $1,000 for a home copier. At the time, Canon’s least expensive copier sold for several thousand dollars. Trying to reduce the cost of existing models would not have given Canon the radical price-performance improvement it needed to delay or deter Xerox’s entry into personal copiers. Instead, Canon engineers were challenged to reinvent the copier—a challenge they met by substituting a disposable cartridge for the complex image-transfer mechanism used in other copiers.

Corporate challenges come from analyzing competitors as well as from the foreseeable pattern of industry evolution. Together these reveal potential competitive openings and identify the new skills the organization will need to take the initiative away from better-positioned players. The box, “Building Competitive Advantage at Komatsu,” illustrates the way challenges helped that company achieve its intent.

For a challenge to be effective, individuals and teams throughout the organization must understand it and see its implications for their own jobs. Companies that set corporate challenges to create new competitive advantages (as Ford and IBM did with quality improvement) quickly discover that engaging the entire organization requires top management to:

Create a sense of urgency, or quasi-crisis, by amplifying weak signals in the environment that point up the need to improve, instead of allowing inaction to precipitate a real crisis. (Komatsu, for example, budgeted on the basis of worst case exchange rates that overvalued the yen.)

Develop a competitor focus at every level through widespread use of competitive intelligence. Every employee should be able to benchmark his or her efforts against best-in-class competitors so that the challenge becomes personal. (For example, Ford showed production-line workers videotapes of operations at Mazda’s most efficient plant.)

Provide employees with the skills they need to work effectively—training in statistical tools, problem solving, value engineering, and team building, for example.

Give the organization time to digest one challenge before launching another. When competing initiatives overload the organization, middle managers often try to protect their people from the whipsaw of shifting priorities. But this “wait and see if they’re serious this time” attitude ultimately destroys the credibility of corporate challenges.

Establish clear milestones and review mechanisms to track progress and ensure that internal recognition and rewards reinforce desired behavior. The goal is to make the challenge inescapable for everyone in the company.

It is important to distinguish between the process of managing corporate challenges and the advantages that the process creates. Whatever the actual challenge may be—quality, cost, value engineering, or something else—there is the same need to engage employees intellectually and emotionally in the development of new skills.
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<th>Corporate Challenge</th>
<th>Protect Komatsu’s Home Market Against Caterpillar</th>
<th>Reduce Costs While Maintaining Quality</th>
<th>Make Komatsu An International Enterprise And Build Export Markets</th>
<th>Respond To External Shocks That Threaten Markets</th>
<th>Create New Products And Markets</th>
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<td>Programs early 1960s</td>
<td>Licensing deals with Cummins Engine, international Harvester, and Bucyrus-Erie to acquire technology and establish benchmarks</td>
<td>1965 CD (Cost Down) program 1966 Total CD program</td>
<td>early 1960s Develop Eastern bloc countries 1967 Komatsu Europe marketing subsidiary established 1970 Komatsu America established</td>
<td>1975 ¥10 program to reduce costs by 10% while maintaining quality; reduce parts by 20%; rationalize manufacturing system 1977 ¥180 program to budget companywide for 180 yen to the dollar when exchange rate was 240</td>
<td>late 1970s Accelerate product development to expand line 1979 Future and Frontiers program to identify new businesses based on society’s needs and company’s know-how 1981 EPOCHS program to reconcile greater product variety with improved production efficiencies</td>
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<td>1961 Project A (for Ace) to advance the product quality of Komatsu’s small- and medium-size bulldozers above Caterpillar’s Quality Circles companywide to provide training for all employees</td>
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In each case, the challenge will take root only if senior executives and lower-level employees feel a reciprocal responsibility for competitiveness.

We believe workers in many companies have been asked to take a disproportionate share of the blame for competitive failure. In one U.S. company, for example, management had sought a 40 percent wage-package concession from hourly employees to bring labor costs into line with Far Eastern competitors. The result was a long strike and, ultimately, a 10 percent wage concession from employees on the line. However, direct labor costs in manufacturing accounted for less than 15 percent of total value-added. The company thus succeeded in demoralizing its entire blue-collar workforce for the sake of a 1.5 percent reduction in total costs. Ironically, further
analysis showed that their competitors’ most significant cost savings came not from lower hourly wages but from better work methods invented by employees. You can imagine how eager the U.S. workers were to make similar contributions after the strike and concessions. Contrast this situation with what happened at Nissan when the yen strengthened: top management took a big pay cut and then asked middle managers and line employees to sacrifice relatively less.

Reciprocal responsibility means shared gain and shared pain. In too many companies, the pain of revitalization falls almost exclusively on the employees least responsible for the enterprise’s decline. Too often, workers are asked to commit to corporate goals without any matching commitment from top management—be it employment security, gain sharing, or an ability to influence the direction of the business. This one-sided approach to regaining competitiveness keeps many companies from harnessing the intellectual horsepower of their employees.

Creating a sense of reciprocal responsibility is crucial because competitiveness ultimately depends on the pace at which a company embeds new advantages deep within its organization, not on its stock of advantages at any given time. Thus we need to expand the concept of competitive advantage beyond the scorecard many managers now use: Are my costs lower? Will my product command a price premium?

Few competitive advantages are long lasting. Uncovering a new competitive advantage is a bit like getting a hot tip on a stock: The first person to act on the insight makes more money than the last. When the experience curve was young, a company that built capacity ahead of competitors, dropped prices to fill plants, and reduced costs as volume rose went to the bank. The first mover traded on the fact that competitors undervalued market share—they didn’t price to capture additional market share because they didn’t understand how market share leadership could be translated into lower costs and better margins. But there is no more undervalued market share when each of 20 semiconductor companies builds enough capacity to serve 10 percent of the world market.

Keeping score of existing advantages is not the same as building new advantages. The essence of strategy lies in creating tomorrow’s competitive advantages faster than competitors mimic the ones you possess today. In the 1960s, Japanese producers relied on labor and capital cost advantages. As Western manufacturers began to move production offshore, Japanese companies accelerated their investment in process technology and created scale and quality advantages. Then as their U.S. and European competitors rationalized manufacturing, they added another string to their bow by accelerating the rate of product development. Then they built global brands. Then they deskilled competitors through alliances and outsourcing deals. The moral? An organization’s capacity to improve existing skills and learn new ones is the most defensible competitive advantage of all.

To achieve a strategic intent, a company must usually take on larger, better-financed competitors. That means carefully managing competitive engagements so that scarce resources are conserved. Managers cannot do that simply by playing the same game better—making marginal improvements to competitors’ technology and business practices. Instead, they must fundamentally change the game in ways that disadvantage incumbents—devising novel approaches to market entry, advantage building, and competitive warfare. For smart competitors, the goal is not competitive imitation but competitive innovation, the art of containing competitive risks within manageable proportions.
Four approaches to competitive innovation are evident in the global expansion of Japanese companies. These are building layers of advantage, searching for loose bricks, changing the terms of engagement, and competing through collaboration.

The wider a company’s portfolio of advantages, the less risk it faces in competitive battles. New global competitors have built such portfolios by steadily expanding their arsenals of competitive weapons. They have moved inexorably from less-defensible advantages such as low wage costs to more defensible advantages like global brands. The Japanese color television industry illustrates this layering process.

By 1967, Japan had become the largest producer of black-and-white television sets. By 1970, it was closing the gap in color televisions. Japanese manufacturers used their competitive advantage—at that time, primarily, low labor costs—to build a base in the private-label business, then moved quickly to establish world-scale plants. This investment gave them additional layers of advantage—quality and reliability—as well as further cost reductions from process improvements. At the same time, they recognized that these cost-based advantages were vulnerable to changes in labor costs, process and product technology, exchange rates, and trade policy. So throughout the 1970s, they also invested heavily in building channels and brands, thus creating another layer of advantage, a global franchise. In the late 1970s, they enlarged the scope of their products and businesses to amortize these grand investments, and by 1980 all the major players—Matsushita, Sharp, Toshiba, Hitachi, Sanyo—had established related sets of businesses that could support global marketing investments. More recently, they have been investing in regional manufacturing and design centers to tailor their products more closely to national markets.

These manufacturers thought of the various sources of competitive advantage as mutually desirable layers, not mutually exclusive choices. What some call competitive suicide—pursuing both cost and differentiation—is exactly what many competitors strive for.1 Using flexible manufacturing technologies and better marketing intelligence, they are moving away from standardized “world products” to products like Mazda’s minivan, developed in California expressly for the U.S. market.

Another approach to competitive innovation—searching for loose bricks—exploits the benefits of surprise, which is just as useful in business battles as it is in war. Particularly in the early stages of a war for global markets, successful new competitors work to stay below the response threshold of their larger, more powerful rivals. Staking out underdefended territory is one way to do this.

To find loose bricks, managers must have few orthodoxies about how to break into a market or challenge a competitor. For example, in one large U.S. multinational, we asked several country managers to describe what a Japanese competitor was doing in the local market. The first executive said, “They’re coming at us in the low end. Japanese companies always come in at the bottom.” The second speaker found the comment interesting but disagreed: “They don’t offer any low-end products in my market, but they have some exciting stuff at the top end. We really should reverse engineer that thing.” Another colleague told still another story. “They haven’t taken any business away from me,” he said, “but they’ve just made me a great offer to supply components.” In each country, their Japanese competitor had found a different loose brick.

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1For example, see Michael E. Porter, Competitive Strategy (New York: Free Press, 1980).
The search for loose bricks begins with a careful analysis of the competitor’s conventional wisdom: How does the company define its “served market”? What activities are most profitable? Which geographic markets are too troublesome to enter? The objective is not to find a corner of the industry (or niche) where larger competitors seldom tread but to build a base of attack just outside the market territory that industry leaders currently occupy. The goal is an uncontested profit sanctuary, which could be a particular product segment (the “low end” in motorcycles), a slice of the value chain (components in the computer industry), or a particular geographic market (Eastern Europe).

When Honda took on leaders in the motorcycle industry, for example, it began with products that were just outside the conventional definition of the leaders’ product-market domains. As a result, it could build a base of operations in underdefended territory and then use that base to launch an expanded attack. What many competitors failed to see was Honda’s strategic intent and its growing competence in engines and power trains. Yet even as Honda was selling 50cc motorcycles in the United States, it was already racing larger bikes in Europe— assembling the design skills and technology it would need for a systematic expansion across the entire spectrum of motor-related businesses.

Honda’s progress in creating a core competence in engines should have warned competitors that it might enter a series of seemingly unrelated industries—automobiles, lawn mowers, marine engines, generators. But with each company fixated on its own market, the threat of Honda’s horizontal diversification went unnoticed. Today companies like Matsushita and Toshiba are similarly poised to move in unexpected ways across industry boundaries. In protecting loose bricks, companies must extend their peripheral vision by tracking and anticipating the migration of global competitors across product segments, businesses, national markets, value-added stages, and distribution channels.

Changing the terms of engagement—refusing to accept the front-runner’s definition of industry and segment boundaries—represents still another form of competitive innovation. Canon’s entry into the copier business illustrates this approach.

During the 1970s, both Kodak and IBM tried to match Xerox’s business system in terms of segmentation, products, distribution, service, and pricing. As a result, Xerox had no trouble decoding the new entrants’ intentions and developing countermoves. IBM eventually withdrew from the copier business, while Kodak remains a distant second in the large copier market that Xerox still dominates.

Canon, on the other hand, changed the terms of competitive engagement. While Xerox built a wide range of copiers, Canon standardized machines and components to reduce costs. Canon chose to distribute through office-product dealers rather than try to match Xerox’s huge direct sales force. It also avoided the need to create a national service network by designing reliability and serviceability into its product and then delegating service responsibility to the dealers. Canon copiers were sold rather than leased, freeing Canon from the burden of financing the lease base. Finally, instead of selling to the heads of corporate duplicating departments, Canon appealed to secretaries and department managers who wanted distributed copying. At each stage, Canon neatly sidestepped a potential barrier to entry.

Canon’s experience suggests that there is an important distinction between barriers to entry and barriers to imitation. Competitors that tried to match Xerox’s business system had to pay the same entry costs—the barriers to imitation were high. But Canon dramatically reduced the barriers to entry by changing the rules of the game.
Changing the rules also short-circuited Xerox's ability to retaliate quickly against its new rival. Confronted with the need to rethink its business strategy and organization, Xerox was paralyzed for a time. Xerox managers realized that the faster they downsized the product line, developed new channels, and improved reliability, the faster they would erode the company's traditional profit base. What might have been seen as critical success factors—Xerox's national sales force and service network, its large installed base of leased machines, and its reliance on service revenues—instead became barriers to retaliation. In this sense, competitive innovation is like judo: The goal is to use a larger competitor's weight against it. And that happens not by matching the leader's capabilities but by developing contrasting capabilities of one's own.

Competitive innovation works on the premise that a successful competitor is likely to be wedded to a "recipe" for success. That's why the most effective weapon new competitors possess is probably a clean sheet of paper. And why an incumbent's greatest vulnerability is its belief in accepted practice.

Through licensing, outsourcing agreements, and joint ventures, it is sometimes possible to win without fighting. For example, Fujitsu's alliances in Europe with Siemens and STC (Britain's largest computer maker) and in the United States with Amdahl yield manufacturing volume and access to Western markets. In the early 1980s, Matsushita established a joint venture with Thorn (in the United Kingdom), Telefunken (in Germany), and Thomson (in France), which allowed it to quickly multiply the forces arrayed against Philips in the battle for leadership in the European VCR business. In fighting larger global rivals by proxy, Japanese companies have adopted a maxim as old as human conflict itself: My enemy's enemy is my friend.

Hijacking the development efforts of potential rivals is another goal of competitive collaboration. In the consumer electronics war, Japanese competitors attacked traditional businesses like TVs and hi-fis while volunteering to manufacture "next generation" products like VCRs, camcorders, and compact disk players for Western rivals. They hoped their rivals would ratchet down development spending, and in most cases that is precisely what happened. But companies that abandoned their own development efforts seldom reemerged as serious competitors in subsequent new product battles.

Collaboration can also be used to calibrate competitors' strengths and weaknesses. Toyota's joint venture with GM, and Mazda's with Ford, give these automakers an invaluable vantage point for assessing the progress their U.S. rivals have made in cost reduction, quality, and technology. They can also learn how GM and Ford compete—when they will fight and when they won't. Of course, the reverse is also true: Ford and GM have an equal opportunity to learn from their partner-competitors.

The route to competitive revitalization we have been mapping implies a new view of strategy. Strategic intent assures consistency in resource allocation over the long term. Clearly articulated corporate challenges focus the efforts of individuals in the medium term. Finally, competitive innovation helps reduce competitive risk in the short term. This consistency in the long term, focus in the medium term, and inventiveness and involvement in the short term provide the key to leveraging limited resources in pursuit of ambitious goals. But just as there is a process of winning, so there is a process of surrender. Revitalization requires understanding that process too.

Given their technological leadership and access to large regional markets, how did U.S. and European companies lose their apparent birthright to dominate global industries? There is no simple answer. Few companies recognize the value of documenting failure. Fewer still search their own managerial orthodoxies for the seeds for compet-
THE PROCESS OF SURRENDER

In the battles for global leadership that have taken place during the last two decades, we have seen a pattern of competitive attack and retrenchment that was remarkably similar across industries. We call this the process of surrender.

The process started with unseen intent. Not possessing long-term, competitor-focused goals themselves, Western companies did not ascribe such intentions to their rivals. They also calculated the threat posed by potential competitors in terms of their existing resources rather than their resourcefulness. This led to systematic underestimation of smaller rivals who were fast gaining technology through licensing arrangements, acquiring market understanding from downstream OEM partners, and improving product quality and manufacturing productivity through companywide employee involvement programs. Oblivious of the strategic intent and intangible advantages of their rivals, American and European businesses were caught off guard.

Adding to the competitive surprise was the fact that the new entrants typically attacked the periphery of a market (Honda in small motorcycles, Yamaha in grand pianos, Toshiba in small black-and-white televisions) before going head-to-head with incumbents. Incumbents often misread these attacks, seeing them as part of a niche strategy and not as a search for “loose bricks.” Unconventional market entry strategies (minority holdings in less developed countries, use of nontraditional channels, extensive corporate advertising) were ignored or dismissed as quirky. For example, managers we spoke with said Japanese companies’ position in the European computer industry was nonexistent. In terms of brand share that’s nearly true, but the Japanese control as much as one-third of the manufacturing value added in the hardware sales of European-based computer businesses. Similarly, German auto producers claimed to feel unconcerned over the proclivity of Japanese producers to move upmarket. But with its low-end models under tremendous pressure from Japanese producers, Porsche has now announced that it will no longer make “entry level” cars.

Western managers often misinterpreted their rivals’ tactics. They believed that Japanese and Korean companies were competing solely on the basis of cost and quality. This typically produced a partial response to those competitors’ initiatives: moving manufacturing offshore, outsourcing, or instituting a quality program. Seldom was the full extent of the competitive threat appreciated—the multiple layers of advantage, the expansion across related product segments, the development of global brand positions. Imitating the currently visible tactics of rivals put Western businesses into a perpetual catch-up trap. One by one, companies lost battles and came to see surrender as inevitable. Surrender was not inevitable, of course, but the attack was staged in a way that disguised ultimate intentions and sidestepped direct confrontation.

for selling businesses rather than defending them. They yield predictable strategies that rivals easily decode.

Strategy “recipes” limit opportunities for competitive innovation. A company may have 40 businesses and only four strategies—invest, hold, harvest, or divest. Too often strategy is seen as a positioning exercise in which options are tested by how they fit the existing industry structure. But current industry structure reflects the strengths of the industry leader, and playing by the leader’s rules is usually competitive suicide.

Armed with concepts like segmentation, the value chain, competitor benchmarking, strategic groups, and mobility barriers, many managers have become better and better at drawing industry maps. But while they have been busy mapmaking, their competitors have been moving entire continents. The strategist’s goal is not to find a niche within the existing industry space but to create new space that is uniquely suited to the company’s own strengths, space that is off the map.

This is particularly true now that industry boundaries are becoming more and more unstable. In industries such as financial services and communications, rapidly changing technology, deregulation, and globalization have undermined the value of traditional industry analysis. Mapmaking skills are worth little in the epicenter of an earthquake. But an industry in upheaval presents opportunities for ambitious companies to redraw the map in their favor, so long as they can think outside traditional industry boundaries.

Concepts like “mature” and “declining” are largely definitional. What most executives mean when they label a business mature is that sales growth has stagnated in their current geographic markets for existing products sold through existing channels. In such cases, it’s not the industry that is mature, but the executives’ conception of the industry. Asked if the piano business was mature, a senior executive at Yamaha replied, “Only if we can’t take any market share from anybody anywhere in the world and still make money. And anyway, we’re not in the ‘piano’ business, we’re in the ‘keyboard’ business.” Year after year, Sony has revitalized its radio and tape recorder businesses, despite the fact that other manufacturers long ago abandoned these businesses as mature.

A narrow concept of maturity can foreclose a company from a broad stream of future opportunities. In the 1970s, several U.S. companies thought that consumer electronics had become a mature industry. What could possibly top the color TV? they asked themselves. RCA and GE, distracted by opportunities in more “attractive” industries like mainframe computers, left Japanese products with a virtual monopoly in VCRs, camcorders, and compact disk players. Ironically, the TV business, once thought mature, is on the verge of a dramatic renaissance. A $20 billion-a-year business will be created when high-definition television is launched in the United States. But the pioneers of television may capture only a small part of this bonanza.

Most of the tools of strategic analysis are focused domestically. Few force managers to consider global opportunities and threats. For example, portfolio planning portrays top management’s investment options as an array of businesses rather than as an array of geographic markets. The result is predictable: As businesses come under attack from foreign competitors, the company attempts to abandon them and enter others in which the forces of global competition are not yet so strong. In the short term, this may be an appropriate response to waning competitiveness, but there are fewer and fewer businesses in which a domestic-oriented company can find refuge. We seldom hear such companies asking: Can we move into emerging markets overseas ahead of our global rivals and prolong the profitability of this business? Can
we counterattack in our global competitors’ home markets and slow the pace of their expansion? A senior executive in one successful global company made a telling comment: “We’re glad to find a competitor managing by the portfolio concept—we can almost predict how much share we’ll have to take away to put the business on the CEO’s ‘sell list.’”

Companies can also be overcommitted to organizational recipes, such as strategic business units and the decentralization an SBU structure implies. Decentralization is seductive because it places the responsibility for success or failure squarely on the shoulders of line managers. Each business is assumed to have all the resources it needs to execute its strategies successfully, and in this no-excuses environment, it is hard for top management to fail. But desirable as clear lines of responsibility and accountability are, competitive revitalization requires positive value added from top management.

Few companies with a strong SBU orientation have built successful global distribution and brand positions. Investments in a global brand franchise typically transcend the resources and risk propensity of a single business. While some Western companies have had global brand positions for 30 or 40 years or more (Heinz, Siemens, IBM, Ford, and Kodak, for example), it is hard to identify any American or European company that has created a new global brand franchise in the last 10 to 15 years. Yet Japanese companies have created a score or more—NEC, Fujitsu, Panasonic (Matsushita), Toshiba, Sony, Seiko, Epson, Canon, Minolta, and Honda, among them.

General Electric’s situation is typical. In many of its businesses, this American giant has been almost unknown in Europe and Asia. GE made no coordinated effort to build a global corporate franchise. Any GE business with international ambitions had to bear the burden of establishing its credibility and credentials in the new market alone. Not surprisingly, some once-strong GE businesses opted out of the difficult task of building a global brand position. In contrast, smaller Korean companies like Samsung, Daewoo, and Lucky Gold Star are busy building global-brand umbrellas that will ease market entry for a whole range of businesses. The underlying principle is simple: Economies of scope may be as important as economies of scale in entering global markets. But capturing economies of scope demands interbusiness coordination that only top management can provide.

We believe that inflexible SBU-type organizations have also contributed to the deskilling of some companies. For a single SBU, incapable of sustaining investment in a core competence such as semiconductors, optical media, or combustion engines, the only way to remain competitive is to purchase key components from potential (often Japanese or Korean) competitors. For an SBU defined in product-market terms, competitiveness means offering an end product that is competitive in price and performance. But that gives an SBU manager little incentive to distinguish between external sourcing that achieves “product embodied” competitiveness and internal development that yields deeply embedded organizational competences that can be exploited across multiple businesses. Where upstream component manufacturing activities are seen as cost centers with cost-plus transfer pricing, additional investment in the core activity may seem a less profitable use of capital than investment in downstream activities. To make matters worse, internal accounting data may not reflect the competitive value of retaining control over core competence.

Together a shared global corporate brand franchise and shared core competence act as mortar in many Japanese companies. Lacking this mortar, a company’s businesses are truly loose bricks—easily knocked out by global competitors that steadily
invest in core competences. Such competitors can co-opt domestically oriented companies into long-term sourcing dependence and capture the economies of scope of global brand investment through interbusiness coordination.

Last in decentralization’s list of dangers is the standard of managerial performance typically used in SBU organizations. In many companies, business unit managers are rewarded solely on the basis of their performance against return on investment targets. Unfortunately, that often leads to denominator management because executives soon discover that reductions in investment and head count—the denominator—“improve” the financial ratios by which they are measured more easily than growth in the numerator—revenues. It also fosters a hair-trigger sensitivity to industry downturns that can be very costly. Managers who are quick to reduce investment and dismiss workers find it takes much longer to regain lost skills and catch up on investment when the industry turns upward again. As a result, they lose market share in every business cycle. Particularly in industries where there is fierce competition for the best people and where competitors invest relentlessly, denominator management creates a retrenchment ratchet.

The concept of the general manager as a movable peg reinforces the problem of denominator management. Business schools are guilty here because they have perpetuated the notion that a manager with net present value calculations in one hand and portfolio planning in the other can manage any business anywhere.

In many diversified companies, top management evaluates line managers on numbers alone because no other basis for dialogue exists. Managers move so many times as part of their “career development” that they often do not understand the nuances of the businesses they are managing. At GE, for example, one fast-track manager heading an important new venture had moved across five businesses in five years. His series of quick successes finally came to an end when he confronted a Japanese competitor whose managers had been plodding along in the same business for more than a decade.

Regardless of ability and effort, fast-track managers are unlikely to develop the deep business knowledge they need to discuss technology options, competitors’ strategies, and global opportunities substantively. Invariably, therefore, discussions gravitate to “the numbers,” while the value added of managers is limited to the financial and planning savvy they carry from job to job. Knowledge of the company’s internal planning and accounting systems substitutes for substantive knowledge of the business, making competitive innovation unlikely.

When managers know that their assignments have a two-to three-year time frame, they feel great pressure to create a good track record fast. This pressure often takes one of two forms. Either the manager does not commit to goals whose time line extends beyond his or her expected tenure, or ambitious goals are adopted and squeezed into an unrealistically short time frame. Aiming to be number one in a business is the essence of strategic intent; but imposing a three- to four-year horizon on the effort simply invites disaster. Acquisitions are made with little attention to the problems of integration. The organization becomes overloaded with initiatives. Collaborative ventures are formed without adequate attention to competitive consequences.

Almost every strategic management theory and nearly every corporate planning system is premised on a strategy hierarchy in which corporate goals guide business unit strategies and business unit strategies guide functional tactics.\footnote{For example, see Peter Lorange and Richard E. Vancil, Strategic Planning Systems (Englewood Cliffs, N.J.: Prentice Hall, 1977).} In this hierarchy,
senior management makes strategy and lower levels execute it. The dichotomy between formulation and implementation is familiar and widely accepted. But the strategy hierarchy undermines competitiveness by fostering an elitist view of management that tends to disenfranchise most of the organization. Employees fail to identify with corporate goals or involve themselves deeply in the work of becoming more competitive.

The strategy hierarchy isn’t the only explanation for an elitist view of management, of course. The myths that grow up around successful top managers—“Lee Iacocca saved Chrysler,” “De Benedetti rescued Olivetti,” “John Sculley turned Apple around”—perpetuate it. So does the turbulent business environment. Middle managers buffeted by circumstances that seem to be beyond their control desperately want to believe that top management has all the answers. And top management, in turn, hesitates to admit it does not for fear of demoralizing lower-level employees.

The result of all this is often a code of silence in which the full extent of a company’s competitiveness problem is not widely shared. We interviewed business unit managers in one company, for example, who were extremely anxious because top management wasn’t talking openly about the competitive challenges the company faced. They assumed the lack of communication indicated a lack of awareness on their senior managers’ part. But when asked whether they were open with their own employees, these same managers replied that while they could face up to the problems, the people below them could not. Indeed, the only time the workforce heard about the company’s competitiveness problems was during wage negotiations when problems were used to extract concessions.

Unfortunately, a threat that everyone perceives but no one talks about creates more anxiety than a threat that has been clearly identified and made the focal point for the problem-solving efforts of the entire company. That is one reason honesty and humility on the part of top management may be the first prerequisite of revitalization. Another reason is the need to make participation more than a buzzword.

Programs such as quality circles and total customer service often fall short of expectations because management does not recognize that successful implementation requires more than administrative structures. Difficulties in embedding new capabilities are typically put down to “communication” problems, with the unstated assumption that if only downward communication were more effective—“if only middle management would get the message straight”—the new program would quickly take root. The need for upward communication is often ignored, or assumed to mean nothing more than feedback. In contrast, Japanese companies win, not because they have smarter managers, but because they have developed ways to harness the “wisdom of the ant hill.” They realize that top managers are a bit like the astronauts who circle the earth in the space shuttle. It may be the astronauts who get all the glory, but everyone knows that the real intelligence behind the mission is located firmly on the ground.

Where strategy formulation is an elitist activity it is also difficult to produce truly creative strategies. For one thing, there are not enough heads and points of view in divisional or corporate planning departments to challenge conventional wisdom. For another, creative strategies seldom emerge from the annual planning ritual. The starting point for next year’s strategy is almost always this year’s strategy. Improvements are incremental. The company sticks to the segments and territories it knows, even though the real opportunities may be elsewhere. The impetus for Canon’s pioneering entry into the personal copier business came from an overseas sales subsidiary—not from planners in Japan.

The goal of the strategy hierarchy remains valid—to ensure consistency up and
down the organization. But this consistency is better derived from a clearly articulated strategic intent than from inflexibly applied top-down plans. In the 1990s, the challenge will be to enfranchise employees to invent the means to accomplish ambitious ends.

We seldom found cautious administrators among the top managements of companies that came from behind to challenge incumbents for global leadership. But in studying organizations that had surrendered, we invariably found senior managers who, for whatever reason, lacked the courage to commit their companies to heroic goals—goals that lay beyond the reach of planning and existing resources. The conservative goals they set failed to generate pressure and enthusiasm for competitive innovation or give the organization much useful guidance. Financial targets and vague mission statements just cannot provide the consistent direction that is a prerequisite for winning a global competitive war.

This kind of conservativism is usually blamed on the financial markets. But we believe that in most cases investors’ so-called short-term orientation simply reflects their lack of confidence in the ability of senior managers to conceive and deliver stretch goals. The chairman of one company complained bitterly that even after improving return on capital employed to over 40 percent (by ruthlessly divesting lackluster businesses and downsizing others), the stock market held the company to an 8:1 price/earnings ratio. Of course the market’s message was clear: “We don’t trust you. You’ve shown no ability to achieve profitable growth. Just cut out the slack, manage the denominators, and perhaps you’ll be taken over by a company that can use your resources more creatively.” Very little in the track record of most large Western companies warrants the confidence of the stock market. Investors aren’t hopelessly short term, they’re justifiably skeptical.

We believe that top management’s caution reflects a lack of confidence in its own ability to involve the entire organization in revitalization—as opposed to simply raising financial targets. Developing faith in the organization’s ability to deliver on tough goals, motivating it to do so, focusing its attention long enough to internalize new capabilities—this is the real challenge for top management. Only by rising to this challenge will senior managers gain the courage they need to commit themselves and their companies to global leadership.