MODULE 4

Creating new strategies and initiatives
Strategic Planning
Common feelings about “The strategy planning process”

“Gives me a headache even thinking about it”

“Usually unproductive; a complete time sink”

“It’s March already???”

“Does anyone actually read all the slides we produce?”

“This has never really produced any new ideas; it’s only used to legitimize decisions already made.”

Dismay, disdain, despair…. because in most companies and at most times, strategic planning processes do not produce strategies
Key tests of effective competitive strategies: What is strategy?

A strategy is an integrated set of choices that positions a firm in an industry so as to generate superior financial returns over the long run.
Three core jobs of a strategist

A strategy is an integrated set of choices that positions a firm in an industry so as to generate superior financial returns over the long run.

**External environment**
Job 1: size up the external environment of a firm in its entirety

**Internal choices**
Job 2: configure all of a firm’s choices to attain a competitive advantage

**Competitive dynamics**
Job 3: sustain a firm’s competitive advantage over time
Key Tests of Effective Competitive Strategies

– **External consistency**: Does the strategy tap the opportunities and neutralize the threats posed by the outside world in a unique manner?

– **Internal consistency**: Do the parts of the strategy fit together to form a whole that is greater than the sum of the parts?

– **Dynamic consistency**: Does the strategy call on the company to do today what is necessary to succeed tomorrow?
Generating and Evaluating Strategy
Finding a new peak in rugged performance landscapes
Finally we found the peak!
Strategy generation & evaluation

- Many strategies and initiatives are incremental, refining our existing peak (and that’s ok), but how can we increase the likelihood of creating larger, systemic strategies, of finding a new peak?

- We have a lot of tools to evaluate strategies. The more data, the more exhaustive the analyses, the more “scientific” we feel. How can we make sure we run the relevant analyses, and not just “nice-to-know” analyses?
Strategy generation & evaluation

- Creative “jam sessions” to generate “out-of-the-box” ideas are fun, but these ideas are quite often impossible to implement. “There’s a reason we keep those ideas outside the box.”
Strategy generation & evaluation

- We suggest to use the scientific method: integral to the scientific method is the creation of novel hypotheses and the careful generation of custom-tailored tests for these hypotheses. ("Bringing Science to the Art of Strategy")
A possibilities-based approach to making strategic choices

1. Cross-functional team generates a set of truly distinct, integrated strategic possibilities
2. Team agrees on the “burden of proof” required to select one integrated possibility over the others
3. Team conducts required analyses
4. Team chooses a possibility based on the analyses
A Possibilities-Based Approach to Making Strategic Choices
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What is a possibility?

– Each possibility is essentially a happy story that describes how the firm might succeed in the marketplace
  • Where does the firm play and how might it succeed

– At this point, each possibility should be internally consistent, but not required to be proven “valid”

– Each possibility needs to be told with some detail (not just a motto, “Go global” or a goal “Be number one”)
  • What’s the competitive advantage?
  • What’s the scope of the strategy?
  • What activities are involved?
Strategy-making processes: Elements of a strategic possibility

Type of Advantage
• Basic logic of how you make money (e.g., low cost, differentiation on X)

Scope of Advantage
• Customer scope:
  – Segments targeted

• Product scope:
  – Breadth of product line

• Geographic scope:
  – Locations served

• Vertical scope:
  – Make vs. buy

Activities
Firm infrastructure
Human resources
Technology development
Procurement
Inbound logistics
Operations
Outbound logistics
Marketing & sales
After-sales service
Example: Procter & Gamble’s Olay

- In 1999 P&G had only a small business in beauty
- Stronger position in shampoo with Head & Shoulders and Pantene
- Much weaker position in skin-care with Oil of Olay (1985 acquisition of Richardson-Vicks)
- To become a credible player in the beauty segment, P&G felt they had to build a consequential skin care business, the biggest beauty business with approximately $50 billion in industry sales globally
- Oil of Olay, $250 million brand sold only through mass channels with a low price point (about $5)
Proctor & Gamble’s initial choice

Buy a major skin care brand  OR  Grow Olay into something more substantial
Idea Generation
Process for creating strategic possibilities

- It is useful to include the status quo as one of the possibilities

- Who should be involved?
  - Diverse group (specialties, backgrounds, experience)
  - Include individuals who did not create the status quo
  - Include operating managers, not just staff (build early commitment)
Process for creating strategic possibilities

- The group needs to commit to separate possibility generation from evaluation
- This is not the time (yet) to shoot down ideas
- Leadership is important at this point
Process for creating strategic possibilities

- Start with each individual generating ideas (30 minutes)
  - Overcome production blocking; evaluative pressures; free-riding (2-3x more ideas)
- If the group is large, then form subgroups (4-5 people) to flesh out ideas
- One-day off-site, or spread out to reflect and build on ideas
Idea generation

– *Inside-out* questions: What does our company do especially well that parts of the market might value, that might produce a superior wedge between costs and buyer value?

– *Outside-in* questions: What are the underserved needs, what are the over-served needs, what are the needs that customers find hard to express, and what gaps have competitors left open?

– *Far-outside-in* questions employ analogical reasoning: What would it take to be the Google, the Apple, or the Wal-Mart of this market?
Proctor and Gamble’s Idea-Generation Process
Idea generation for P&G

*Inside-out*: make sure to take into account P&G’s corporate strengths in consumer understanding, product innovation, and brand building.

*Outside-in*: worked with dermatologists to uncover new insights, e.g., seven signs of aging: not just lines and wrinkles, but rough skin texture, dullness of skin’s appearance, larger appearance of pores, blotchiness, dry skin, age spots.
When are we done with this step?

You will know that you have a good set of possibilities for further work if the following is true:

- First, the status quo doesn’t look like a brilliant idea: At least one other possibility is quite intriguing to the group, enough to make the group start to really question the status quo.
- Second, at least one of the possibilities makes most of the group nervous: At least one possibility is sufficiently far from the status quo that it makes the group question whether it would be at all doable or safe.

Important shift in mindset:

“What should we do?” → “What might we do?”
Possibilities for Olay

1. Abandon Olay and acquire a new brand
2. Take Olay into the prestige distribution channel, department stores and specialty beauty shops, as an upscale brand competing with Estée Lauder, Clarins, La Prairie.
3. Continue focusing on the 50+ year old female consumer and provide breakthrough wrinkle reduction
4. Aim for a younger customer segment, women 35-50, who were experiencing some of the 7 signs of aging and who weren’t targeted by the prestige channel or the brands that targeted the older, wrinkle-focused segment. Target traditional mass channel, but try to get special display sections in retailers. Pricing in the $15-20 range.
5. Extend the successful existing Cover Girl brand into skin care and build a global brand on that platform
Burden of Proof
A possibilities-based approach to making strategic choices

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Burden of proof

– Reverse-engineer each possibility: What must be true for the possibility to be a terrific choice?

– Important: This step is decidedly not for arguing about what is true.

– By focusing on “What would have to be true?” it fleshes out the underlying logic and makes more concrete the sources of skepticism.

– Lastly, it identifies the critical analyses to be done in the next step.
Setting the burden of proof

1. What would one have to believe about the external world?
   o What would one have to believe about customers? E.g.,
     about what they want and are willing to pay for, about how
     they buy, about how many there are, about what segments
     exist
   o What would one have to believe about competitors? E.g.,
     about their capabilities
   o What would one have to believe about suppliers,
     complementors, channels, regulators, etc.?

2. What would one have to believe about the internal world = the
   company itself?
   o E.g., about cost position, capabilities, culture

3. What would one have to believe about dynamics = the future?
   o E.g., about competitor reaction, entrants, development of
     technology and substitutes
Burden of proof for 4\textsuperscript{th} option for Olay

4. Aim for a younger customer segment, women 35-50, who were experiencing some of the 7 signs of aging and who weren’t targeted by the prestige channel or the brands that targeted the older, wrinkle-focused segment. Target traditional mass channel, but try to get special display sections in retailers. Pricing in the $15-20 range.
Burden of proof for 4th option for Olay

**Segmentation:** There is a big enough segment of women in their 30s and 40s who would fight ‘the seven signs of aging’ if given a compelling product offering.

**Channel Value:** The mass channel will partner with P&G to create a ‘masstige’ experience because P&G can give them sufficient growth – new segment growth and growth from consumers shifting from specialty and department stores to mass.

**Consumer Value:** Consumers will switch from department and specialty stores to buy skincare in the mass channel. Consumers will value the benefits enough to pay a premium more than current but still less than Clinique (with opening prices of $25 to $50+)
Burden of proof for 4th option for Olay

**P&G Capabilities:** P&G can create a product that delivers on the ‘fight the seven signs of aging’ promise. P&G can get strong and cooperative partnerships with the mass retailers. P&G can create the holistic purchase and usage experience that will earn close-to-prestige channel pricing.

**Competitor Prediction:** Prestige brand competitors will not attempt to follow Olay into the ‘masstige’ positioning because of channel conflict. Mass competitors, such as Dove, will be slow to follow because it will be difficult for them to achieve Olay’s price point and thereby support the required cost structure.
Process for Setting the Burden of Proof
Process for setting the burden of proof

– The whole group is involved, not just the originator of idea
– At the first stage, be inclusive with conditions; ask only the underlying rationale for a condition; then put it on the list.
– At the end of this stage ask: If all of these conditions were in fact true, would you advocate for and support this choice?
  • If all agree proceed; if not, ask those who don’t advocate it what is missing
– This process uncovers the underlying logic for and against this idea
Process for setting the burden of proof

• Perform a premortem (Gary Klein)
• What did go wrong?
• Generate plausible reasons for the failure of the strategy
• “prospective hindsight”
  – Important: At this stage there is a strict prohibition against declaring whether any condition is actually true or not
  
=> Creating a well-specified hypothesis that can be tested.
Process (continued)

– Cull conditions: In the next step, try to cull “nice-to-have’s” and be left with “must-have’s”

| Condition 1 | Condition 2 | Condition 3 | Condition 4 | Condition 5 |

– For each condition ask: “If every other condition was demonstrated to hold but this one didn’t, would you eliminate the possibility or still view it as viable?”
– At the end of this, we still need to have full agreement on “if all of these conditions held true, would you advocate for and support this possibility?”
Process (continued)

– Next, socialize the reverse-engineered possibility: repeat the process with whoever needs to eventually approve the possibility. Better to find out objections now, not later.
– Ask: “If it turns out that these conditions can be shown to hold true, would you be confident of choosing this possibility as well? If not, what additional conditions would you want to include in the reverse-engineered position?”

– The status-quo should be included. This can be quite insightful. The status-quo is rarely riskless.
Process (continued)

Important shift in mindset:

“What do I believe?” → “What would I have to believe?”
Burden of proof for the status-quo: External conditions

For our current strategy to work, what do we have to believe?

– Customers
  • What do our customers want?
  • What are they willing to pay for?
  • How do they buy? What channels do they use?
  • How many buyers are there?
  • What segments exist?

– Competitors
  • Capabilities of competitors?

– Suppliers?
– Distributors/Channels?
– Regulators?
– Complementors?
Burden of proof for the status-quo: Internal conditions

For our current strategy to work, what do we have to believe?

– Our company
  • What is our cost position relative to our competitors?
  • What capabilities/resources do we need in the areas of...
    – R&D
    – Operations
    – Sales and Distribution
    – Marketing
    – After-sale service
    – Procurement
    – Human Resource Management
    – Regulatory/Policy/Stakeholder management
    – Etc.
Burden of proof for the status-quo: Dynamic conditions

For our current strategy to work in the future, what do we have to believe?

– Competitors
  • How will our competitors react?
  • What new competitors might (not) enter?

– Technologies
  • What new technologies will be developed/not developed?
  • What substitutes might be developed?

– Customers
  • Will customer tastes change?
  • Will segment sizes change?

– Macro-economic conditions
  • How will the overall economy behave?
  • How will regulation evolve?
Other Conditions and Design Tests - Olay Example
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Order conditions and design tests

- Order conditions: at the top of the list is the condition that the group thinks is least likely to be true

  | Condition 3 (least likely to hold) |
  | Condition 1 |
  | Condition 5 |

- Skeptical group members must be encouraged to raise, not suppress, concerns
  - Let the most skeptical person design the test
  - If possible, make the most skeptical person for a condition also the one to conduct/lead the analysis

- Sometimes more than one test is needed to convince everyone about a particular condition
Conduct required analyses

- Sequence the analyses by starting with the one that the group feel is least likely to hold; if it doesn’t no further analysis is needed
- This is a key difference to many consulting projects that analyze everything (whether relevant or not) and often sacrifice depth for breadth
- Tests will not eliminate all uncertainty. That is why it is important to create testable conditions for the status quo: The team then clearly sees that the status quo is not free of risk either.
Olay team’s ordering of barriers to choice

1. **Consumer Value:** Consumers will value the benefits enough to pay a premium (with opening prices of $25 to $50+)

2. **Channel Value:** The mass channel will partner with us to create a ‘masstige’ experience because we can give them sales growth and a product win-win.
   - Consumers will switch from department and specialty stores to buy skincare in the mass channel.

3. **P&G Capabilities:** We can create a prestige-like brand positioning, product packaging, and in-store promotion elements in the mass-retail channel
Olay team’s tests

1. They designed in-market tests with important retail partners.

2. They designed concept, advertising and simulated purchase tests with consumers.

3. They created simulations to ‘war game’ the likely behavior of the key competitors, especially from the lower end of the prestige brand competitors.
Olay team’s test results

- The most challenging test with the most surprising results was with respect to price points

- They tested the product at $12.99, $15.99, and $18.99
Olay team’s test results

• Positive response at $12.99, but most were mass shoppers; very few department-store shoppers were interested at that price point.

• At $15.99, purchase intent dropped dramatically.

• At $18.99 intent went way up. At that price point, shoppers who shop in both channels became interested. It was just below Clinique and considerably below Estée Lauder.

• For the prestige shopper, it was great value, but not too cheap to be credible.

• For the mass shopper, it signified that the product must be considerably better than anything else on the shelf.
Shifts in Mindset
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Olay team’s recommendation

- The Olay team recommended to launch the first new line Olay Total Effects at $18.99
- Retail partners loved it and saw new shoppers buying a new price points
- Over time, added a new lines, at higher price points.
- Olay grew at 15% compound from the re-launch in 2000 and became a $2.5 billion brand.
A possibilities-based approach to making strategic choices: Shifts in mindset

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“What should we do?” ⇒ “What might we do?”

“What do I believe?” ⇒ “What would I have to believe?”

“What is the right answer?” ⇒ “What are the right questions?”
A possibilities-based approach to making strategic choices

1) Formulate multiple integrated alternatives

2) Set burden of proof

3) Conduct implied analyses

4) Choose among alternatives

What would have to be true about the world, for the alternative to be a good solution?

Which alternative fits best with how the world actually looks?
Analyze your Current Strategy Assignment

- Describe your current strategy (or a strategic initiative):
Summary
Three types of fit to evaluate a strategy

**Content:** Positioning, Activities, Capabilities ...

**Process:** Incentives, Org structure ...

**External**

Industry, Competition, Regulation ...

Competitor reactions, Technological change, Demand changes ...

**Dynamic fit**

**Internal fit**
The Value Chain

**Primary Activities**

- Inbound Logistics (e.g. Material Storage, Data Collection, Service, Customer Access)
- Operations (e.g. Assembly, Component Fabrication, Branch Operations)
- Outbound Logistics (e.g. Order Processing, Warehousing, Report Preparation)
- Marketing & Sales (e.g. Sales Force, Advertising, Trade Shows, Proposal Writing)
- After-Sales Service (e.g. Installation, Customer Support, Repair)

**Support Activities**

- Firm Infrastructure (e.g. Financing, Planning, Investor Relations)
- Human Resource Management (e.g. Recruiting, Training, Compensation System)
- Technology Development (e.g. Product Design, Testing, Process Design, Material Research, Market Research)
- Procurement (e.g. Components, Machinery, Advertising, Services)
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Choices in 1997

**Product Portfolio**
- Apparel for women at every price point
  - Upper moderate: Emma James
  - Budget: Russ
  - Better: Liz Casual
  - Bridge: Dana Buchman
- Accessories

**Production and Distribution**
- Lower total cost to customers
  - Price
  - Search cost
  - Time value
- Partial production to order
- Reordering for certain styles
- Increased spending on IT systems and distribution
- Liz Rim
- CAD investment
- Shift towards Western Hemisphere suppliers
- Reduction in lead times
- Better capitalized, larger suppliers
- Four collections

**Marketing**
- Rejuvenating image
- Consistency of color
- Close design coordination
- Mix-and-match design and mix-and-match across divisions
- Niki Taylor
- NY flagship

**Design**
- Consistency of color
- Mix-and-match design and mix-and-match across divisions

**Presentation**
- LizEdge
- Presentation as collection
- LizView
- Liz & Learn
- Sales associates
- Accessory concept shops

**Selling Process**
- Selling entire groups only
- Focus on large customers
- Sales only in NY
- Excellent sales force
Complementarities

Two elements A and B are complementary if doing more of A increases the value of doing more of B.

misalignments are costly

coordination becomes important

Complementarities (or interactions in general) create a very rugged landscape.

you can get stuck on a local (low) peak

the height of peaks can change

you may have to traverse a “valley of death” to get to the next peak
Use of Systems of Interconnected Choices Maps

Consistency check of present implementation of positioning (fit vs. misfit)

Uniqueness check (What are the roots of our added value?)

Consistency check for future expansions

Guide for changes to system (What can stay constant? What has to change?)
<table>
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<th>Value Created</th>
<th>Willingness to pay [Utility in money]</th>
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<tbody>
<tr>
<td></td>
<td>Price</td>
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<tr>
<td></td>
<td>Cost</td>
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<tr>
<td></td>
<td>Supplier’s cost</td>
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<tr>
<td>Consumer’s share</td>
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<td>Firm’s share</td>
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<tr>
<td>Supplier’s share</td>
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Value Appropriation - Industry Analysis: 5 Forces

• **Who wants to appropriate value?**
  - Buyers → Lower Price
  - Suppliers → Increase Price  } Supply Chain

• **Who else limits the amount you can appropriate?**
  - Current Competitors → Lower Price
  - New Competitors → Lower price
  - Substitutes → Lower price

• **What other factors determine profitability in your industry?**
  - Regulation?
Complementors

A player is your complementor if customers value your product *more* when they have the other player’s product than when they have your product alone.

A player is your complementor if it is *more* attractive for a supplier to provide resources to you when they also supply the other player than when they supply you alone.

Added Value and Value Appropriation

Transaction-level CA \approx

(WTP - Cost)_\text{you} - (WTP - Cost)_\text{others}

Thus, you need to create asymmetries.

Strategic Positioning

Strategic Positioning = Performing different activities

Implications

At the frontier there are tradeoffs!

Moreover, sustainable positions require trade-offs:

makes imitation through straddling more difficult
inconsistencies in reputation
different set of optimal activities
limits on internal coordination and control

The essence of strategy is choosing what not to do.

When and how do established companies (fail to) innovate?

1. Perception problem: We don’t know we’re behind
   - Measures, delays
   - Cognitive frames
   - Lack of vertical information flow

2. Knowledge problem: We know we’re behind, but we don’t know what to do about it
   - Don’t understand the full system, interdependencies

3. Motivation problem: We may know what to do, but we won’t do it
   - Don’t have time to do it (overload; fire-fighting)
   - Don’t have money/resources to do it
   - Asymmetric payoffs (risks higher than rewards)
   - What good is saving money if that just cuts my budget?
   - Rich and happy or resignation

4. Implementation problem: We know what to do and we want to do, but we can’t get it done
   - Coordination problems (across divisions)
   - Sequencing problems => losing motivation if performance dips
   - Non-imitable/difficult-to-imitate resource or capability
   - Politics
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