

# MODULE 1

Analyze your firm's internal fit

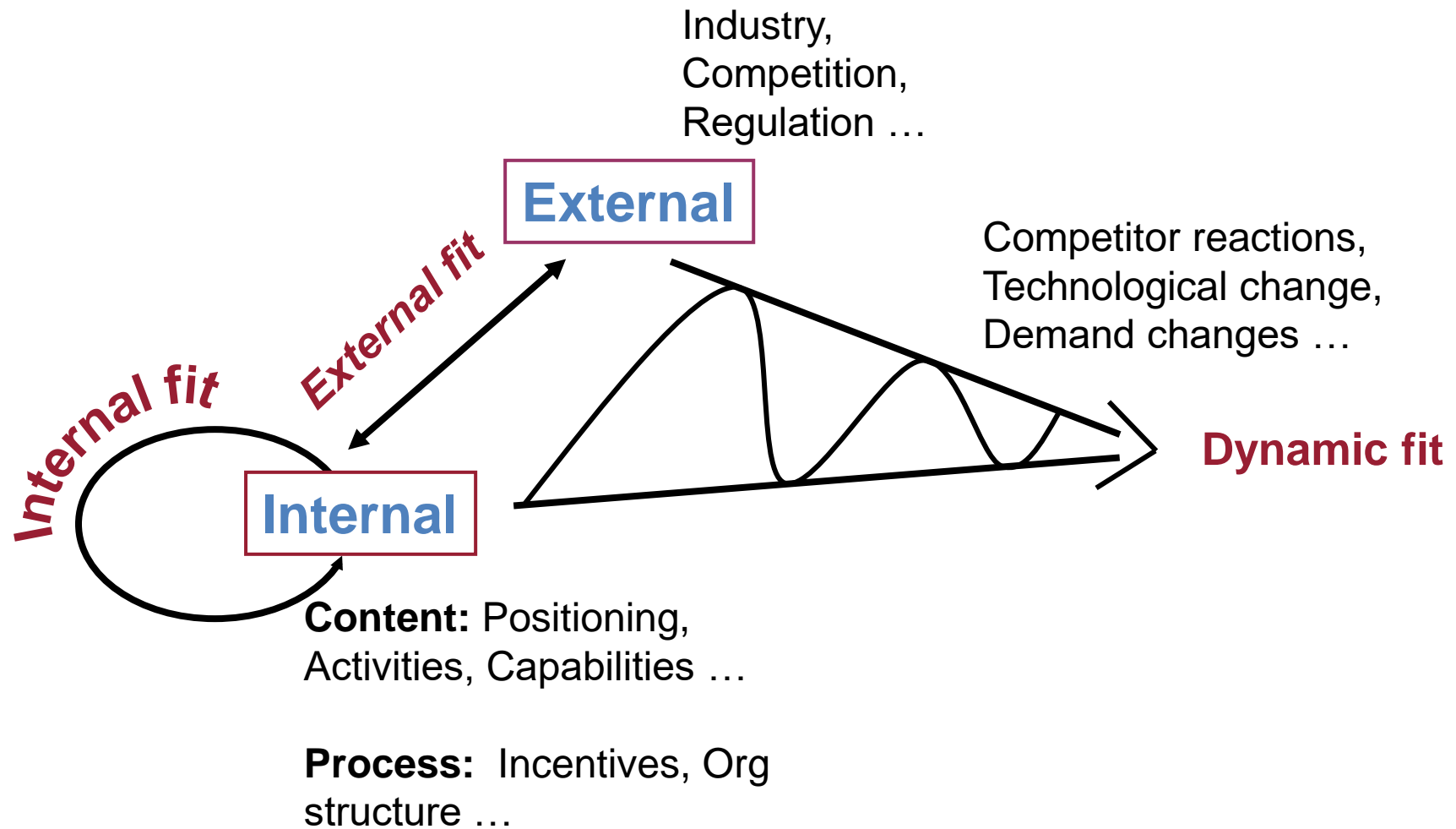


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ONLINE

# Defining Strategy and Introduction to Internal Fit

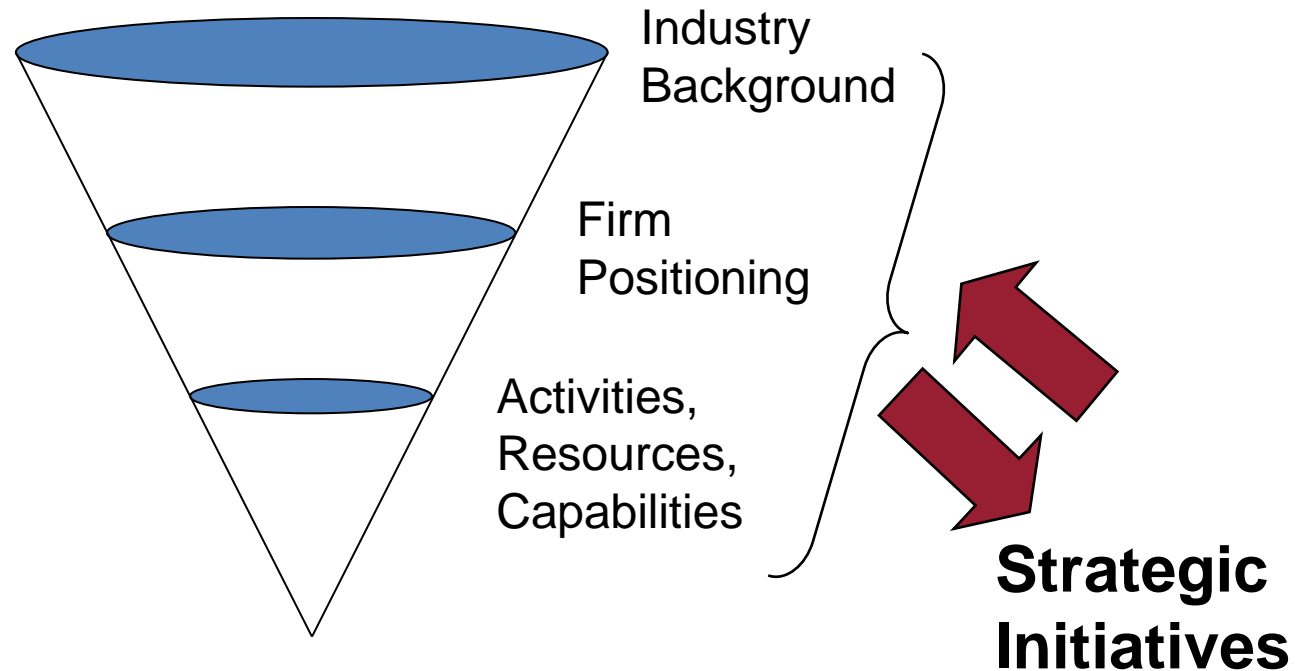
# Three types of fit to evaluate a strategy



# Strategy Audit

## Tools

- Industry Analysis
- Scenarios
- Drivers of Cost and WTP
- Strategic Positioning
- Value Chain
- Activity System

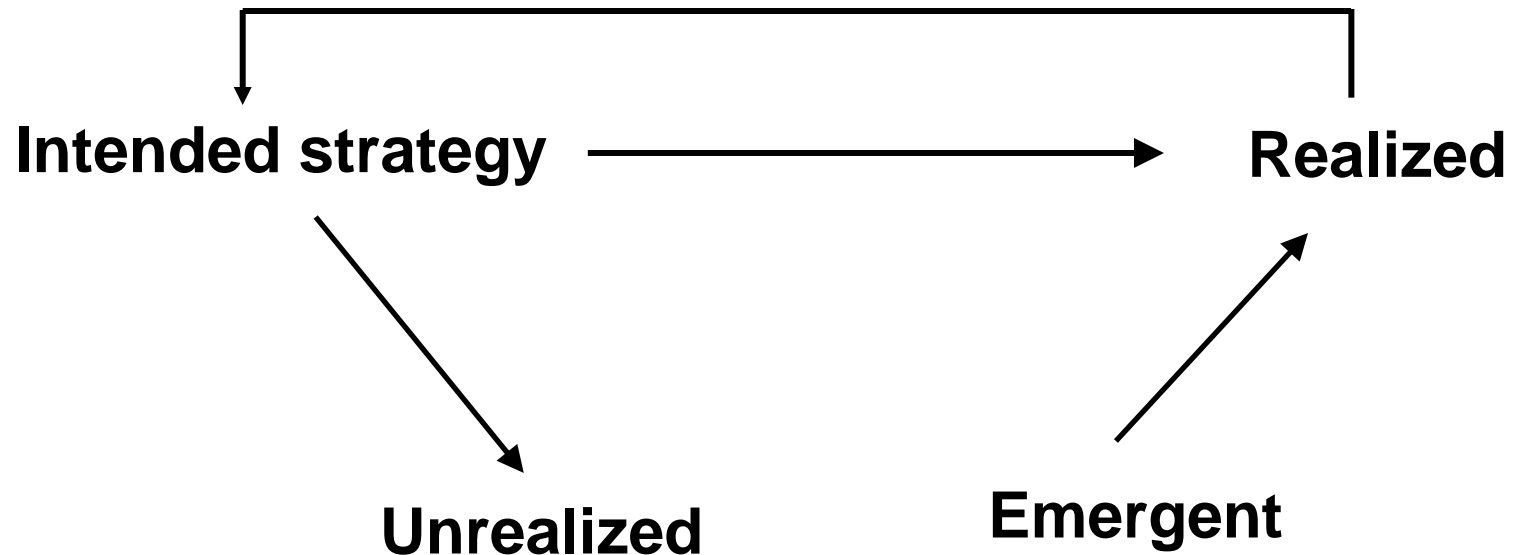


# The elements of a strategy

Strategy = Distinctive array of interdependent choices that address:

- A desired outcome
- Where to compete (market positioning)
  - Product
  - Customers
  - Geography
- Value proposition
- Source of CA (strategic positioning)
  - High-level (cost vs. differentiation)
  - Detailed level (activities, resources, capabilities)

# Strategy: Intended versus Emergent



“Let chaos reign, then rein in chaos-repeatedly.” (Andy Grove)

# Internal Fit

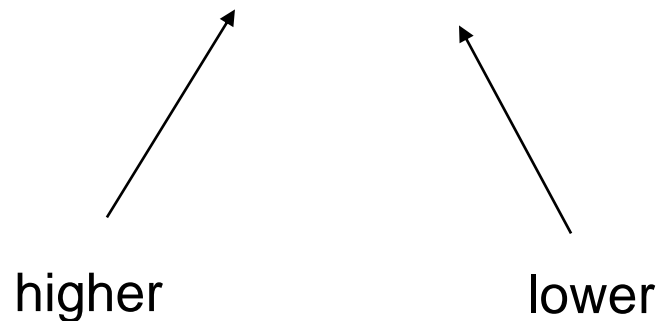
- Focus on one particular tool: mapping an activity system (system of interdependent choices)
- Two motivations
  - Creates clarity around the source and sustainability of competitive advantage
  - Helps with change initiatives

# Difference between OE and SP



# What does it mean to have a CA?

$$CA \propto (P - C)$$

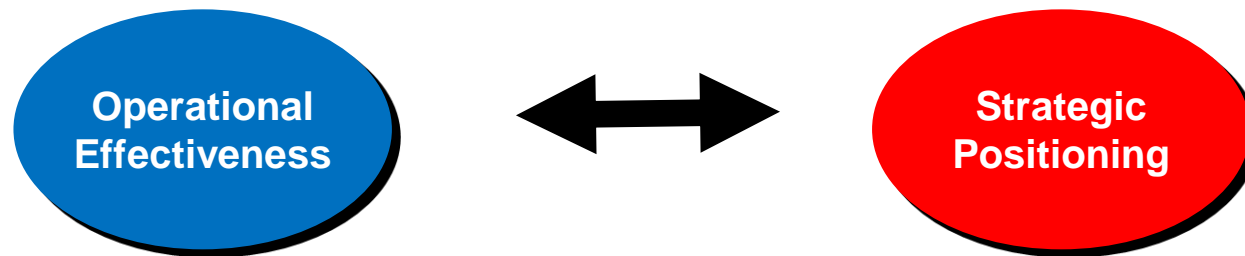


Can you achieve this by imitating what other firms do?

# No, but....

- What about
  - TQM
  - JIT
  - Six sigma
  - Benchmarking
  - Best practices ??????

# Operational Effectiveness $\neq$ Strategy



- Achieving and extending best practice

- Creating a **unique** and sustainable competitive position

Source: "What Is Strategy?" Porter, *Harvard Business Review*, 1996

# Determinants of company performance

Operational  
Effectiveness

- Improving operational effectiveness is necessary to achieving superior profitability, but it is **not sufficient**
  - Absolute but not relative improvement
  - Competitive convergence due to imitation

Source: “What Is Strategy?” Porter, *Harvard Business Review*, 1996

# Many things vs single advantage

# OK, we need to do something different...

- In order to make our competitive advantage sustainable, i.e., to make it more difficult for others to imitate us, should we do
  - one thing differently?
  - many things differently?

# “Many things” sounds intuitive, but....

What about

- Core competence
- Key success factors
- Critical resources ?????

# In general

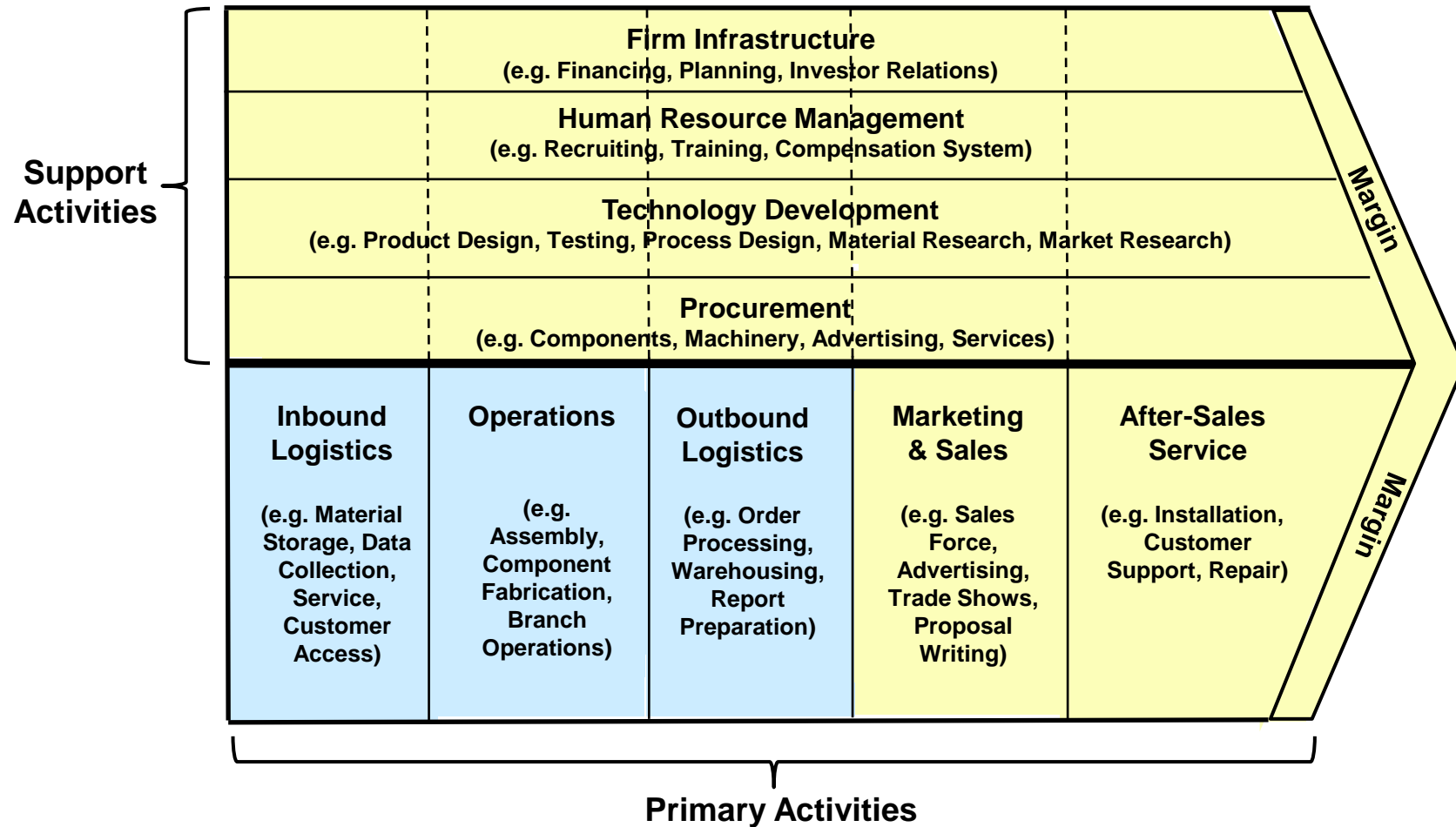
- “Silver bullet” strategies tend to be very fragile
  - Everyone knows your source of competitive advantage, thereby focusing imitation attempts
  - Environmental shifts may make your key success factor not as important anymore



# “One” might be enough if...

- Legally protected (patent)
- It has major beneficial (for you) impact on industry structure
  - Huge investment
  - Entry deterring
  - Commitment (specialized, durable, non-tradable)

# Competitive Advantage and Activities

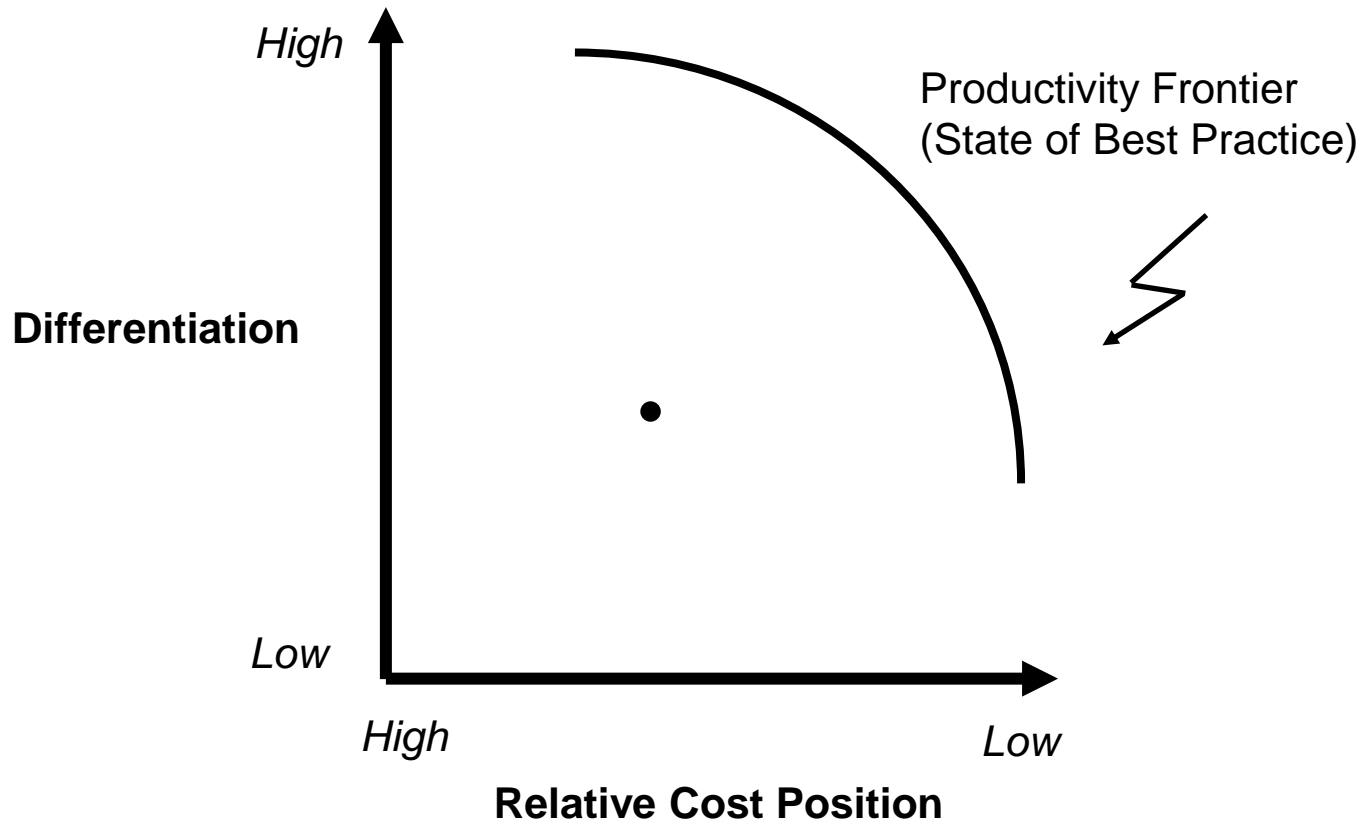


Companies are collections of discrete **activities**, in which **competitive advantage resides**

Source: Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, Collier Macmillan, 1985

# Production Possibilities Frontier

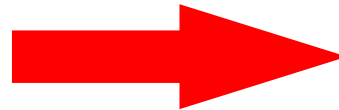
# Operational Effectiveness vs. Strategic Positioning



Source: "What Is Strategy?" Porter, *Harvard Business Review*, 1996

# What is Strategy?

Strategy is a race  
to one ideal  
position



Strategy is the  
creation of a **unique**  
and valuable  
position, involving a  
**different set of**  
**activities**

# Non-linearity and Example: Southwest Airlines

# Non-linearity

- If competitors copy 70% of your activities
  - and they get 70% of the benefits => bad news
  - and they get <70% of the benefits => better news
  - and they get -10% to 10% of the benefits => good news
- Interactions among activities create such non-linearities

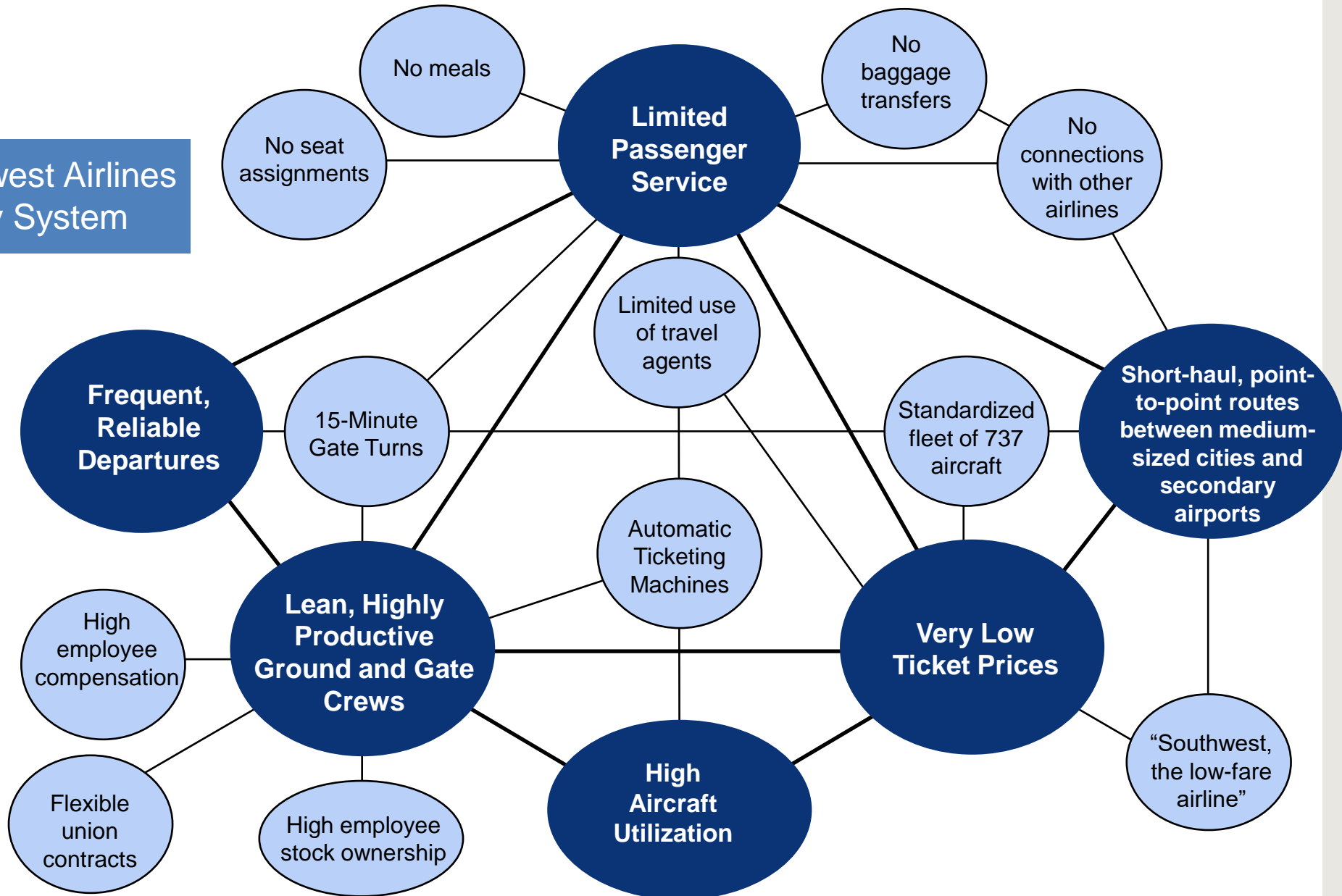
# What is the source of Southwest Airlines' Competitive Advantage?

## Core Competency Perspective

- Ability to turn planes around quickly
  - Incentive systems
  - Flexible union contracts



# Southwest Airlines Activity System



Source: "What Is Strategy?" Porter, *Harvard Business Review*, 1996

# Continental Airlines: “Continental Lite”

## Straddling

Activities Matching Southwest on a Subset of Routes	Activities Changed Across the Board	Activities Left Unchanged
<ul style="list-style-type: none"> <li>Point-to-point route network within Continental’s hub-and-spoke system</li> </ul>	<ul style="list-style-type: none"> <li>Reduced commissions to travel agents</li> </ul>	<ul style="list-style-type: none"> <li>Maintained position as full-service airline</li> </ul>
<ul style="list-style-type: none"> <li>First class service eliminated</li> </ul>	<ul style="list-style-type: none"> <li>Ended upgrades and promotions on frequent-flier program</li> </ul>	<ul style="list-style-type: none"> <li>Continued use of existing hub-and-spoke system</li> </ul>
<ul style="list-style-type: none"> <li>Meals on Lite flights eliminated</li> </ul>	<ul style="list-style-type: none"> <li>Overhaul of fare structure for short flights</li> </ul>	<ul style="list-style-type: none"> <li>Maintain fleet of several types of aircraft</li> </ul>
<ul style="list-style-type: none"> <li>Fares lowered</li> </ul>	<ul style="list-style-type: none"> <li>Focus 75% of advertising budget on Lite service</li> </ul>	<ul style="list-style-type: none"> <li>Interline baggage checking and seat assignments</li> </ul>
<ul style="list-style-type: none"> <li>Quickened turnaround time at gate</li> </ul>		

# Continental Lite: Outcome

- Severe operating problems including delays and cancellations
- Alienated passengers, frequent fliers, corporate clients and travel agents
  - 1,000 complaints a day, customer defections to other airlines
- Customer confusion about Continental service
- Overcapacity: mimicking Southwest led to frequent departures to cities that did not need the service



- Matched Southwest's prices without matching its low costs
- Lost hundreds of millions of dollars
- CEO was fired

# Tradeoffs and IKEA example

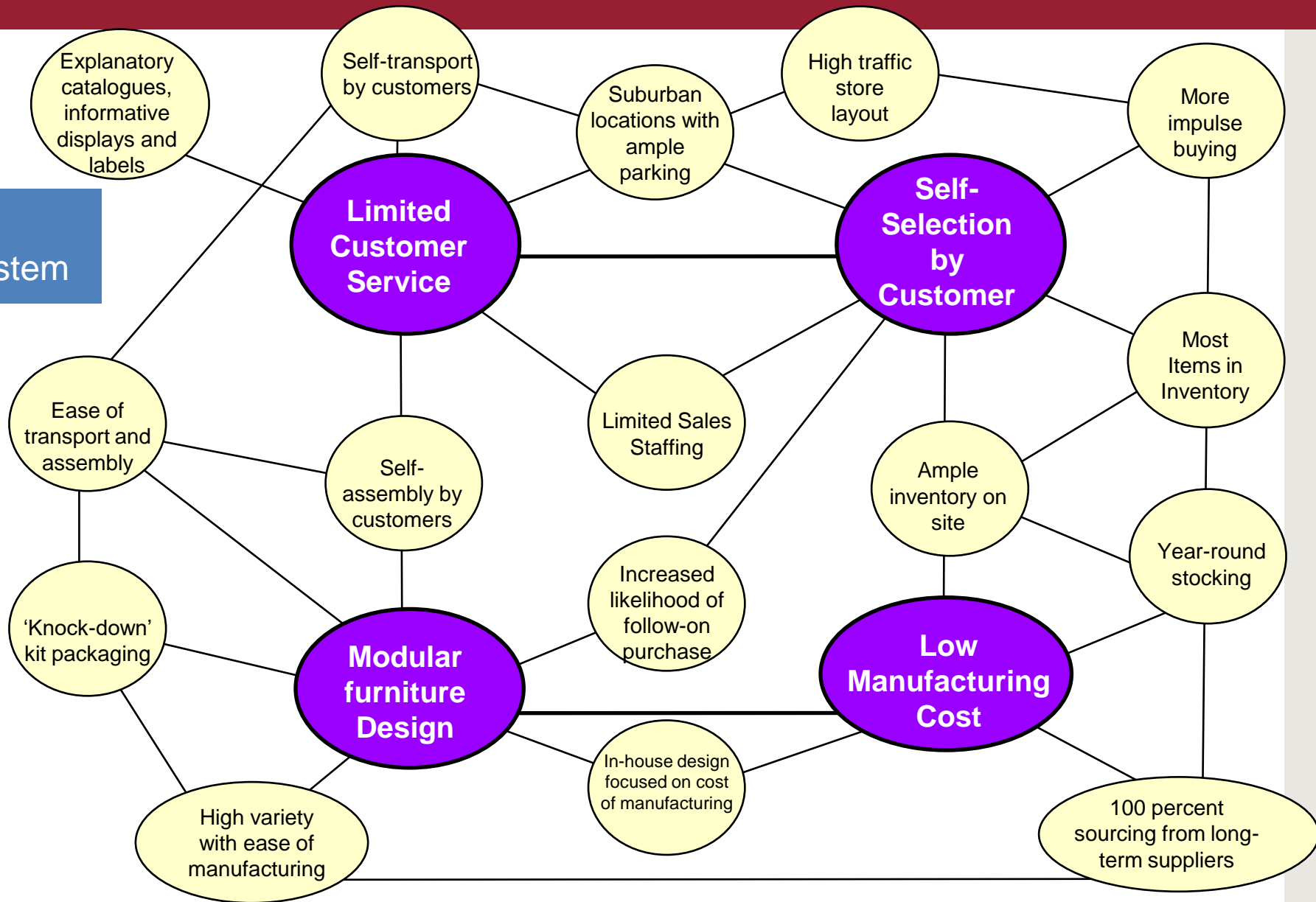
# Fighting imitation

- Interactions drive both complexity and tradeoffs
- The role of complexity
  - Increases the difficulty of wholesale imitation
  - Decreases the value of partial imitation
- The role of tradeoffs
  - Decreases the desirability of imitation
  - Deters straddling, because straddling is costly
    - Inconsistencies in reputation
    - Different set of optimal activities
    - Limits on internal coordination and control
- The choice of what **not** to do is a central part of strategy
  - This is not easy to do; “Failure to choose”
  - Most common problem: Growth trap

# Positioning Tradeoffs: IKEA

IKEA	Typical Furniture Retailer
Limited variety, no custom options	Extensive variety, customization of fabrics, colors, finishes
Centralized, in-house design of all products	Purchase from the lines of outside suppliers
Furniture design and manufacture heavily influenced by cost	Design and manufacturing heavily influenced by image /style/materials
Huge warehouse stores to display entire line	Stores display partial line
Self-selection. Information in the form of catalogs, do-it-yourself videos, explanatory ticketing	Extensive sales assistance
Large on-site inventories	Low inventories/order with lead time
Childcare provided in the store	No arrangements for children
Long hours of operation	Traditional retail hours
Suburban locations with large parking lots	Urban/suburban locations
Assembly by customers	Fully assembled furniture
Self delivery by customers	Provide delivery

# IKEA Activity System



Source: "What Is Strategy?" Porter, *Harvard Business Review*, 1996

# Summary: NUMMI Example and Intel's Copy Exactly Method



# Summary: NUMMI Example and Intel's Copy Exactly Method

NUMMI example

Intel copy exactly

# Strategic continuity

- **Strategic continuity** over sustained periods contributes strongly to sustainable competitive advantage
  - Reinforces identity with customers and channels
  - Builds truly unique capabilities and skills
  - Sharpens understanding of tradeoffs
  - Extends and strengthens the fit among activities
  - Saves costs and confusion associated with frequent shifts in positioning



- Strategic continuity must be combined with continuous improvement in operational effectiveness
- There is a tension between achieving sustainable advantage and maintaining the flexibility to respond to any conceivable environmental change

# In sum

- Positions built on activity systems are far more sustainable than those built on individual activities
  - Harder for a rival to match the whole system than to imitate one feature, product or service
  - Difficult to discern relevant parts from outside the company (but sometimes also within)



- Incompatible activity systems, because of tradeoffs, are what underlie the most viable strategic positions
- Interaction among activities is fundamental both to competitive advantage and sustainability

# Use of Activity Systems for Organizational Change

# Use of Activity Systems

- Consistency check of present implementation of positioning
- Uniqueness check (What are the roots of our competitive advantage?)

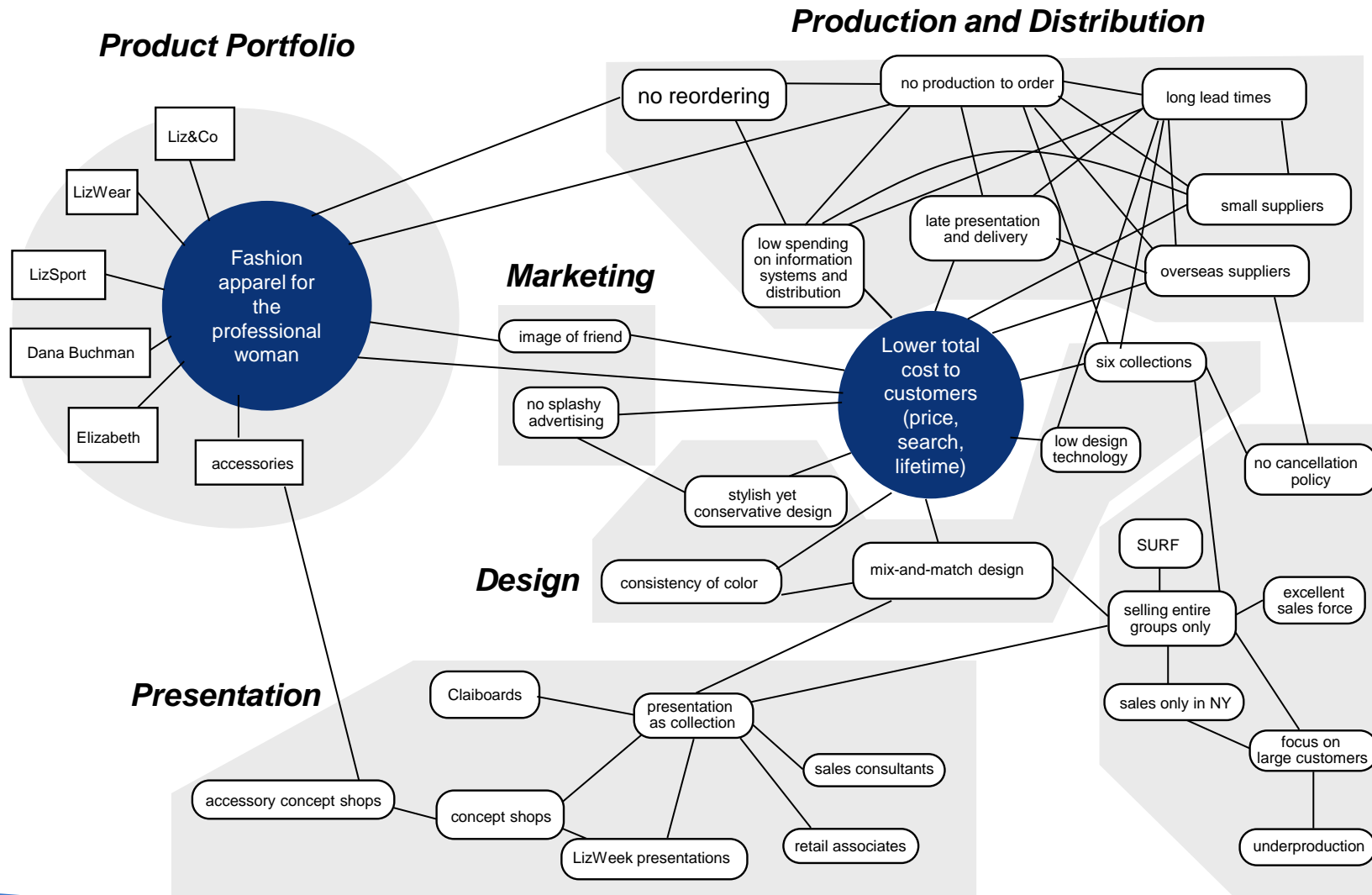
# Another example: Case facts

- Setting: U.S., early 1990s
  - Firm: very successful women's fashion apparel manufacturer
- 
- Low cost due to pioneering production in Far East
  - Many small suppliers; little technology (on both sides)
  - Mix-and-match design
  - Design and presentation of clothes as “collections”
  - Support/training for floor presentation
  - Long lead times between design and delivery
  - Late presentations
  - No-cancellation policy; no-reordering
  - Six design cycles (six seasons)
  - Focus on large department stores
  - No sales force; sell only in NY

# Need to adapt

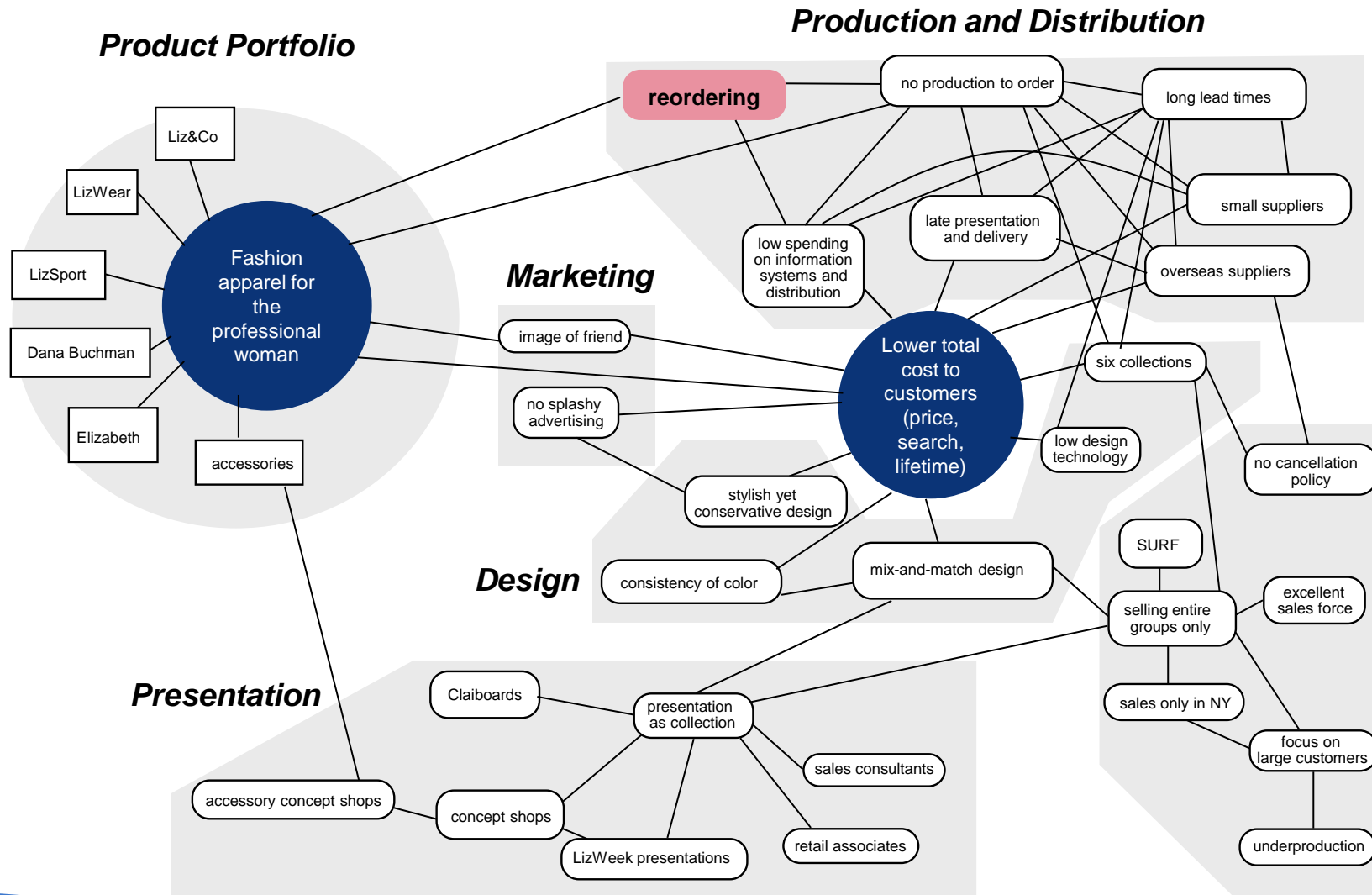
- Up to now, the firm was able to shift inventory onto customers
- Now, customers demand re-ordering
  - shift of product range
  - customer cash constraints
  - competitors
- What to do?

# Liz Claiborne's Activity System (1980s)

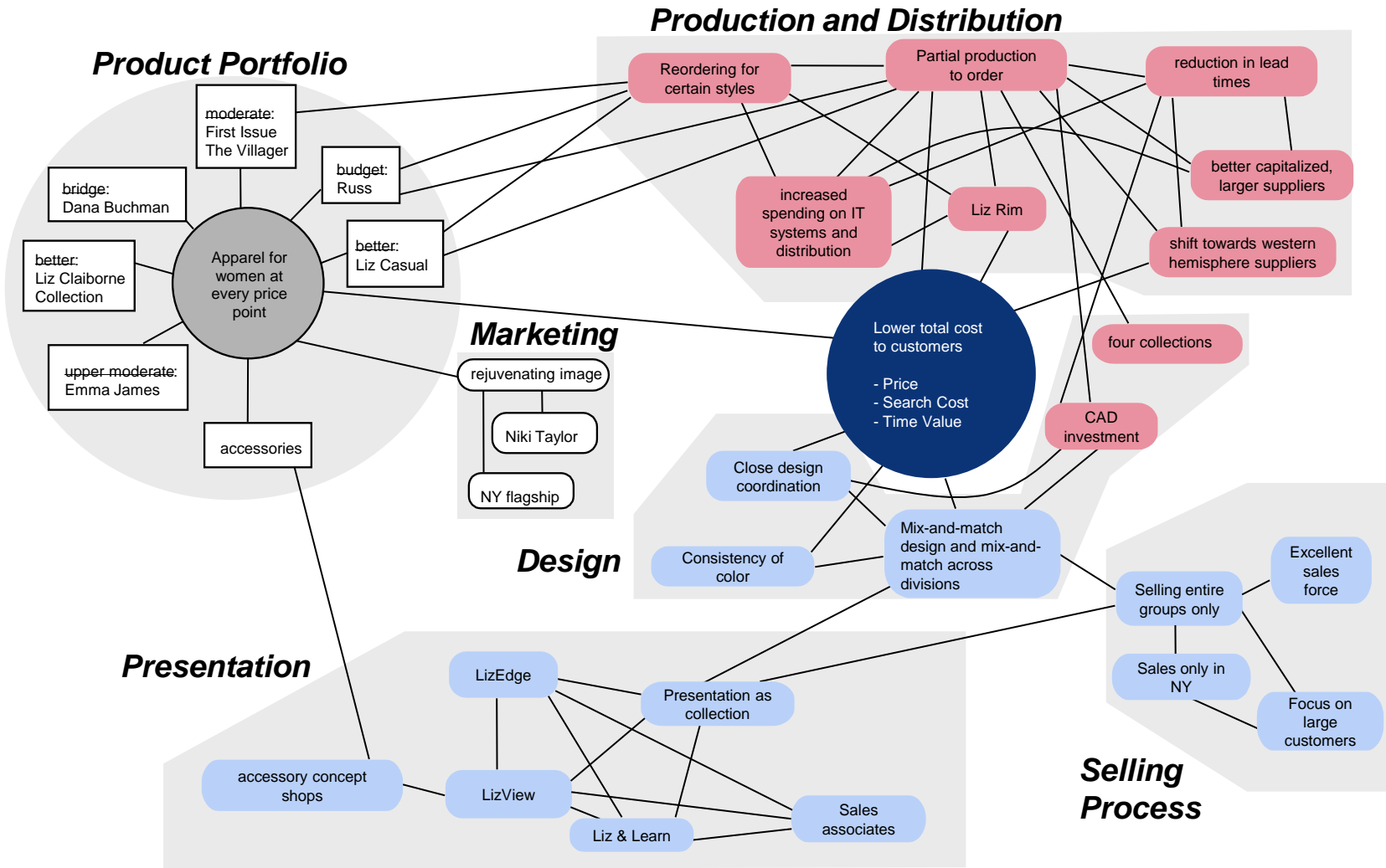




# Liz Claiborne's Activity System (1980s)



# Choices in 1997



# Use of Activity Systems

- Consistency check of present implementation of positioning
- 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?)

# Interactions

# Complementarities

Definition 1: Two choices/activities A and B are complementary if doing more of activity A increases the marginal benefit of B, and vice versa.

For the engineers watching: If  $\Pi(x_1, x_2, \dots)$  is our profit function, then the cross partial derivative  $\delta^2\Pi/\delta x_1\delta x_2$  is positive

For those of us who don't have an intuitive feeling for cross-partial derivatives, we need a different thought experiment...

# Test for complementarities

Pick one variable set it at a low value, ask what is the marginal benefit of increasing the other variable...

Example: product variety and flexibility of machinery

Example: product variety and investment in inventory management system

# Summary: Central Questions of Strategy

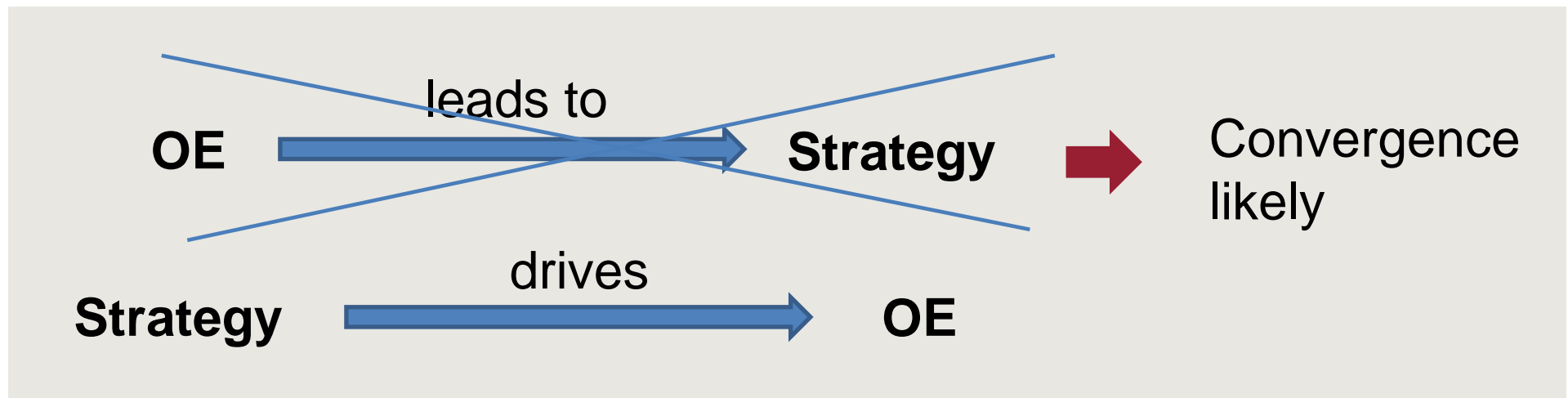
# Central Questions

- What are the explicit tradeoffs underlying our strategy?
- Which of our activities are best practices (operational effectiveness); which of our activities strengthen our strategic positioning? => Where is the source of our sustainable CA?



# Strategy, Operational Effectiveness, Best Practices

- Thought Experiment: If my competitor were to imitate activity/choice A would they get the same benefit from it as I do?
  - Yes = industry best practice => probably not a source for sustainable CA
  - No, I get more benefit from it because the way it is embedded in my system of choices = firm/strategy-specific (good/best) practice
- Each strategic positioning has its own set of activities that yield maximal operational effectiveness, so strategy and OE go hand in hand, but...



- How do we strengthen, protect, extend these activities?
- What are the implications for our existing AS when we add new activities (when we expand)?

# Value Chain Assignment

**Describe the value chain of your organization.**

- 1. Change the labels on the various activity “buckets” if necessary.**
- 2. For each stage of the value chain, list the key activities that your firm is engaged in.**
- 3. Ask yourself which activities are particularly distinct, i.e., different from those of your competitors.**

# Mapping your Company's Activity System Assignment

Please draw your firm's System of Interdependent Choices (refer back to the value chain that you have drawn in Assignment 1)

Identify which choices are best practices, vs which choices are truly enhancing your distinctiveness. (Fill out the following worksheet)

# Mapping Activity Systems

- Identify overarching positioning choices
- Identify activities/choices (value chain analysis)
- Relate activities to positioning
- Examine pairwise reinforcement
- Look for choices that have many interconnections
  - other core choices than those already identified?
- Sketch an activity map

# Example: Vanguard

- First stab at overarching positioning choices:
  - Focus on low cost
  - Focus on conservatively managed funds
  - Focus on long-term performance
  - Mutual structure

# Example: Vanguard

## Value Chain of Typical Mutual Fund Provider

### Organizational Structure

Human Resource Practices

Asset  
Management

Account  
Management

Selling &  
Marketing

Information  
& Customer  
Service

### Product Portfolio

# Vanguard's Selling and Marketing Choices

## What they do/What they don't do

- Direct distribution, 1-800 (toll-free) number; internet
- No-load
- No retail branches
- Little advertising
- Decline assets if considered “hot” money



# Operational Effectiveness vs. Strategic Positioning

Assume our competitor were to duplicate our activity/choice A. Would they get the same benefit from it as we do (= OE)? Would we get a higher benefit from it, given the way A is embedded in our activity system (= SP)?

Activity/Choice	OE or SP	Why?
Most refined pricing system	SP	Higher benefit due to more heterogeneous customers

# Choices and Tradeoffs Assignment

**What do we NOT do?**

**What do we do differently?**

**What are the tradeoffs arising from our choices?**

**How do we communicate these tradeoffs, these choices within our firm? How do we make sure people know what NOT to do?**