Business Analysis for Engineers
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Lecture -22
What is Strategy?

Good afternoon. This class, will be the first session in which, we are going to spend some time, in understanding a very important concept, called strategy. And, we will be spending more time, in understanding what strategy is, the need for strategy. The various models, that different organisations adopt to strategize, and ensure that these organisations, are able to sustain in the business ecosystem. Now, before I get into the real technicalities, of this managerial concept of strategy, we must first understand that, the business ecosystem outside, is very vibrant and dynamic.

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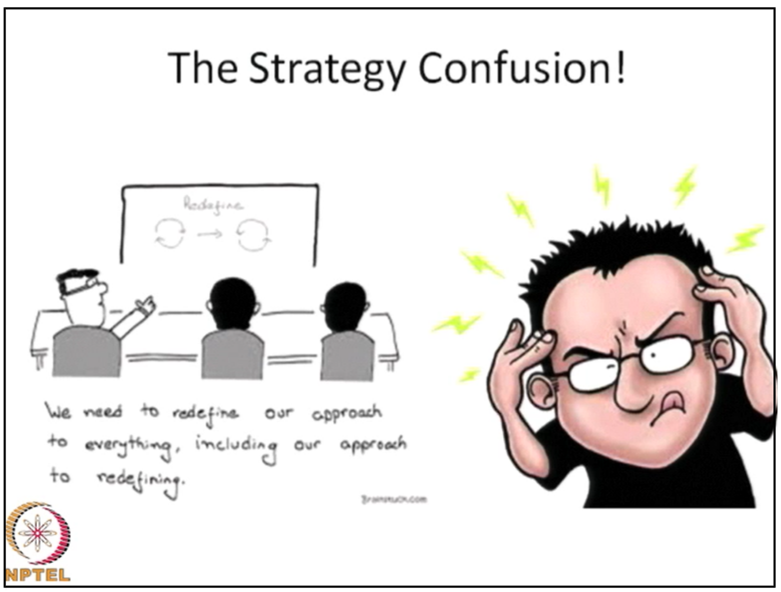

And, just as this slide shows you, that there is always a constant need, to redefine our approach to everything. Be it business. Be it our own personal life. Or, whatever be the context in which, we are situated, there is always a constant need to redefine. And, this also means that, there are occasions, where we should also include our approach, to redefining itself. As a result of which, we should realise that, the need to redefine our approach to everything includes, our approach to redefining itself. Now this, I thought will first become a good background, when I am going to introduce this concept of strategy.

The reason being, everybody knows, all managers know that, organisations need strategy. But then, there is no uniform understanding of, the concept of strategy. So, if you ask managers across different industries, across different countries, you should not be surprised, if you get different understandings, of the very word strategy. Which means, there is a need to redefine, and to see whether there is a common understanding of the concept of strategy, before we spend some time on developing strategic models. So, only when we have this basic understanding of this concept of strategy, we will we be able to move forward.

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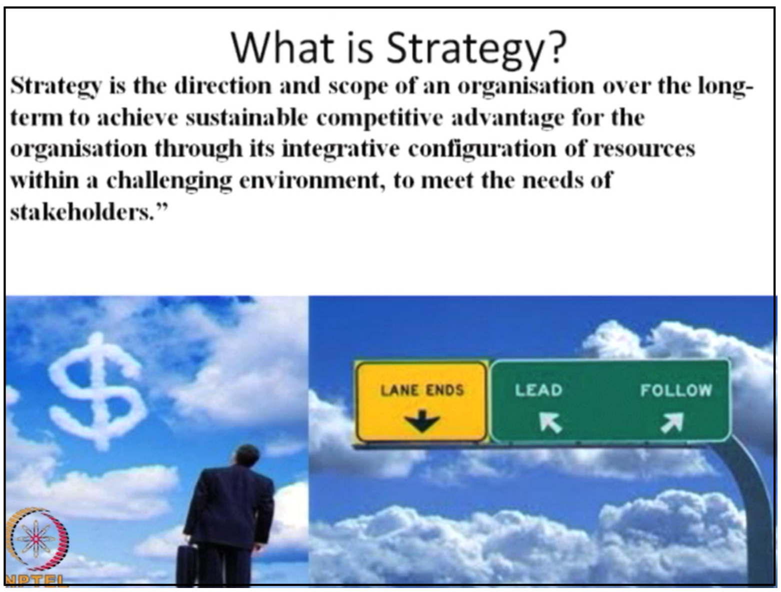

Now, let me just begin with, a textbook definition of, what strategy is. It is a concept, that sets the direction and scope of a business organisation, not just for a short-term purpose, but for a long-term purpose. Of course, there are short-term strategies. But, let us assume that, at a very broad level, we are talking about, a long-term purpose. And, in the process, we need to develop, something that gives the organisation, a sustainable competitive advantage.

And this, it should be able to do, by integrating all the activities and resources, that it has at its disposal. Within a business environment that is, as challenging as it is, it will be in the future. And, at the end of the day by doing all of this, it should meet the expectations of all the stakeholders. So, this is broadly, the textbook definition of strategy. You know, especially businesses that are engaging in fierce competition, by enlarge, excluding the businesses not for profit, they exist to add value to the shareholder.

And, this is a general management terminology, that you often would hear, that the purpose of business is to maximise shareholder value. It means that, there should be every effort to maximise profitability. So, the bottom line, is the return on investment. So, managers in the middle, the leadership, they always look at, how businesses can maximise profit. And, especially when the industry is very matured, growth is static, at times managers would feel that, at this business crossroad, we are just meeting the end of the road. There will be some industries, where there is a lot of potential to grow.

And, the best of those in the business, would have a lot of strategic value, that would make them leaders. And, there might be some industries, where it is best to be silent, and then to follow to create some value in the industry. So, whatever stage, and in whatever position, a business organisation is, looking at it from the business crossroads, to lead, to follow, to even exit out, because we have reached an end. For, all of these, we need to understand, what strategy is. And, to do all of this, we need to have a strategy in place.

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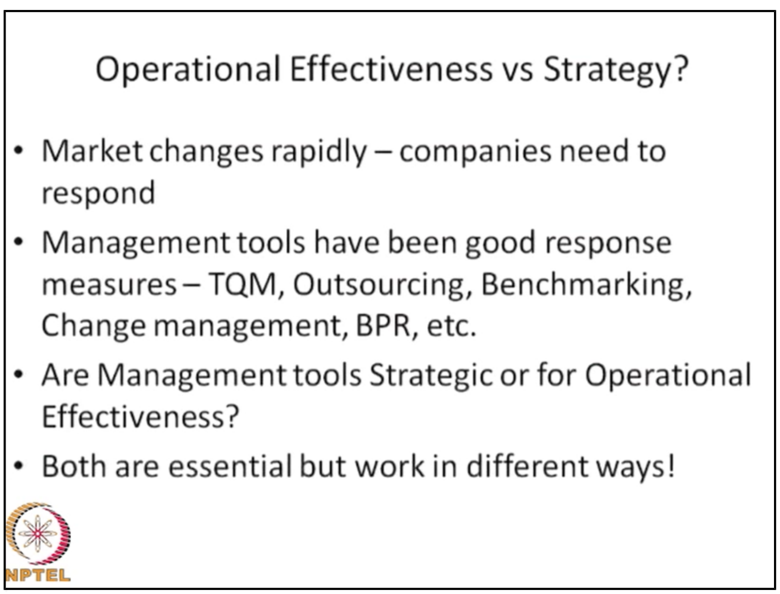

More often than not, there is a lot of confusion between, operational effectiveness and strategy. I began the class by saying that, there is change, that is happening in the business ecosystem. And, the market changes so rapidly, that to remain in the same place, we will have companies and businesses have to respond very quickly. So, there is a pressure on companies, to respond to such market changes. And, these responses have come in different forms. And, the ones, that are popular are these management tools, that have been good response mechanisms.

For example, you would have heard the terminology, Total Quality Management, or TQM, or Outsourcing, or Benchmarking, Business Process Re-engineering, BPR. So, all these management tools, are good response measures, to those changes that happen very dynamically in the industry. Now, it should not be mistaken, to be strategies. I will explain on this, a little later. But then, the very fundamental question, that we need to ask ourselves is, are these management tools, strategy, or, are these for operational effectiveness. My view, is according to Michael Porter is that, these management tools, are for operational effectiveness, and not strategic in nature.

But, at the same time, it is not that, operational effectiveness is not necessary. It is necessary. But, the argument is that, it is not correct to assume that, it is sufficient, and understood as, or rather misunderstood as, strategy. While, operational effectiveness is also necessary. We need to understand that; strategy is also equally important. So, both are essential, and both work in different ways. So, it is very important to understand that, strategy is different from operational effectiveness.

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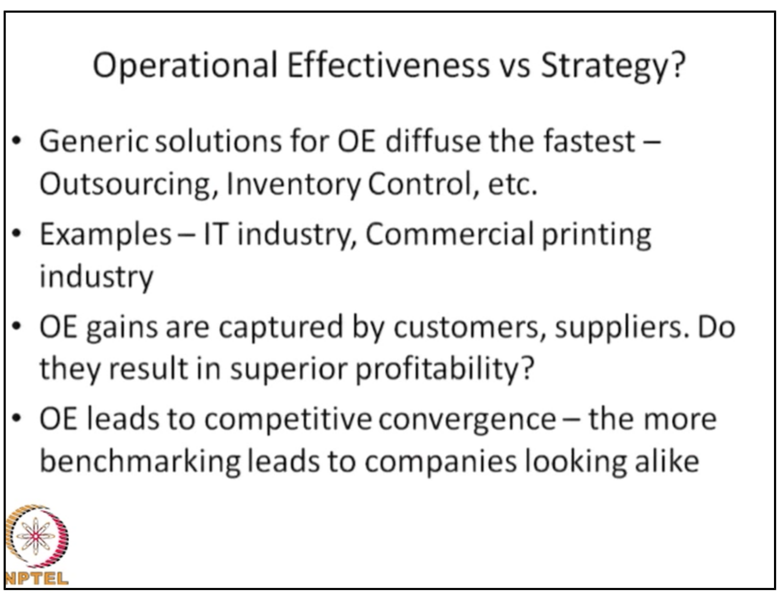

Now, expanding further on operational effectiveness. We have seen that operational effectiveness, is a result of some generic solutions, that emerge. Because, there is a great need, to provide such solutions, due to changes that happen in the business, in the markets themselves. For example, Outsourcing. The IT industry in India. One of the finest examples for, how successful IT services industry in the country was built.

Because of the concept of offshore, product development, software development, this concept of outsourcing emerged. And, few companies were able to leverage on this. And then, the rate at which, this was diffusing, we saw more and more companies entering into the IT services industry. As a result of which, more businesses, get into an industry, which at the very first place, let us assume that, was profitable. Because, the first movers, were able to sustain a profitability.

Because, they were able to put in place, certain management tools, that gave them operational effectiveness. But remember, this operational effectiveness, is not something unique to a particular business. And, this is something, that could be easily replicable. As a result of which, this just gets diffused fast. Now, when more and more businesses do this, will accompany in a particular industry be able to, sustain a unique value that it had, when the industry was at its nascent stages.

This is a very important question, for which we will be able to find answers as we move. Or, if the management tools, or the practices of the business. Let us for example, take the commercial printing industry. Because of the changing dynamics in the industry itself, if companies resort to cutting crew sizes, getting some of the best machinery, increasing the performance time. Now, these are all tools, that can be employed to increase the effectiveness. And, this is all pervasive. Now, when we do such things, the gains also, need not necessarily be captured only by the businesses themselves.

The gains could probably be, captured by the customers, could be by the suppliers. As a result of which, the inherent profitability of the industry, is not improved. And, a classic example is the commercial printing industry, where the net profit margin used to be 10%. And, more and more because of this operational effectiveness, where crew sizes were reduced, best of the machinery was imported for the printing industry, a lot of thing added value to the customer, or to the supplier. And, as a result of which, the profitability reduced to, around 3 to 4%, from 8%.

Now, does it mean that, operational effectiveness, necessarily means, superior profitability. No. An operational effectiveness, does it retain uniqueness to businesses. No. Because, it is easily replicable. As a result of which, there is competitive convergence. Because, the more and more, other businesses would like to replicate the same management tools, the more and more, companies would start looking alike, within the same industry. And, the problem is, when managers, misunderstand operational effectiveness, as strategy.

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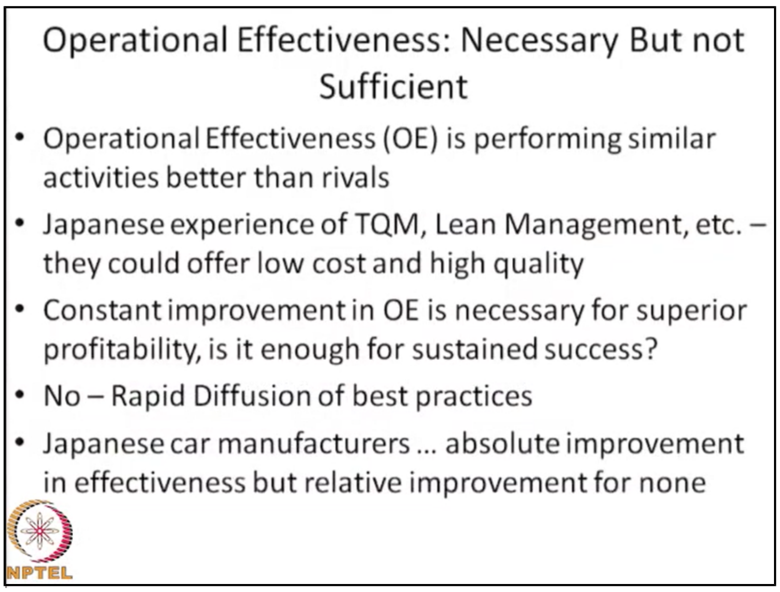

Now, there is a very distinct line, that distinguishes operational effectiveness with strategy. Now, operational effectiveness simply means that, you perform the same set of activities better than your rivals. Let us for example, take the Japanese auto mobile industry. They were the ones, who pioneered the inventory control, the TQM, the lean management. As a result of which, they were able to offer, low-cost and high-quality. Assume, Toyota started this. Quickly, Honda was able to do this.

The entire automobile industry was able to do this. As a result of which, there was a constant improvement amongst those businesses, within the same industry. As a result of which, there was continuous improvement, in the operational effectiveness of each of these businesses. But, was this enough, for sustained success. That is the key question. This is not enough, for sustained success because, such practices get rapidly diffused. And, the Japanese car manufacturing industry is a classic example.

Because, each of them were able to bring out absolute improvement, in their operational effectiveness. But then, the relative improvement for the industry, the relative improvement to each of them, was missing. There was absolute improvement in the effectiveness, but relative improvement for none. The understanding is that, such management tools that increases operational effectiveness, will only result in, one company being able to perform, similar activities better than rivals.

And, this could happen for a very brief period of time because, such activities are diffused in a faster rate. And, as a result of which, do not continue to become unique. And, as a result of which, the industry itself, will start to imitate such activities. And, all of them would be at par. Then, how do companies differentiate, and emerge from this crowd, so that they distinctly standout. Now, that is when, we will have to talk about strategy.

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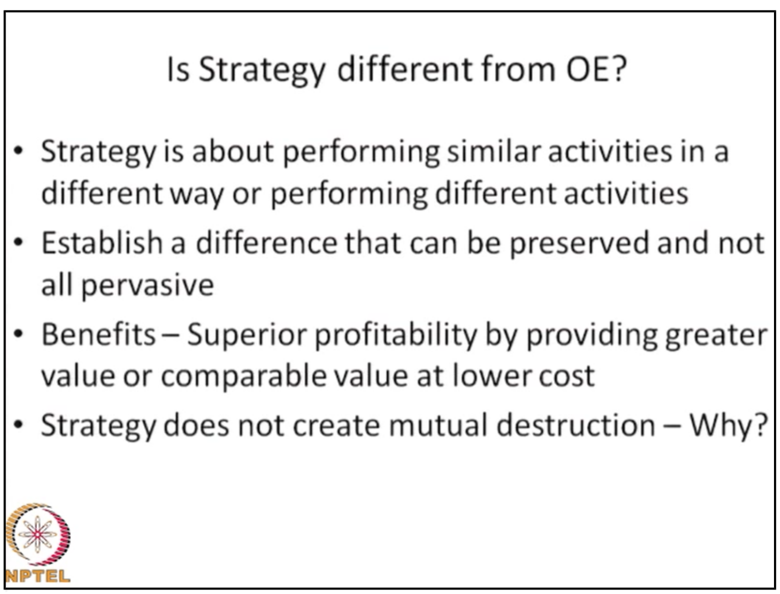

Now, that fine line of difference between strategy and OE is, while operational effectiveness is performing, the similar activities better than rivals, strategy is about performing similar activities in a different way altogether, or even performing different activities. Now, what is the benefit of doing this. The benefit of doing the same set of activities in a different way is that, when you do this, you can preserve the uniqueness with which you do these activities, if you think that, these are not easily replicable.

And, ensure that, it is not all pervasive. Now, what is the benefit of this. This would give you superior profitability, by either giving you great value. The business gives great value. Which means, there is a premium, that you can charge on the customer. Because, more value means, more price. Or, for comparable values, if we were able to deliver it at lower cost, and reduce the average unit price, then still there is superior profitability.

And, how do you do this? Not by doing the same activities, differently, better than the rivals. But then, you perform a different activity itself. Then, you are able to actually create some unique advantage. Now, this way, since it is not easily imitatable by competition, this does not create mutual destruction within the industry.

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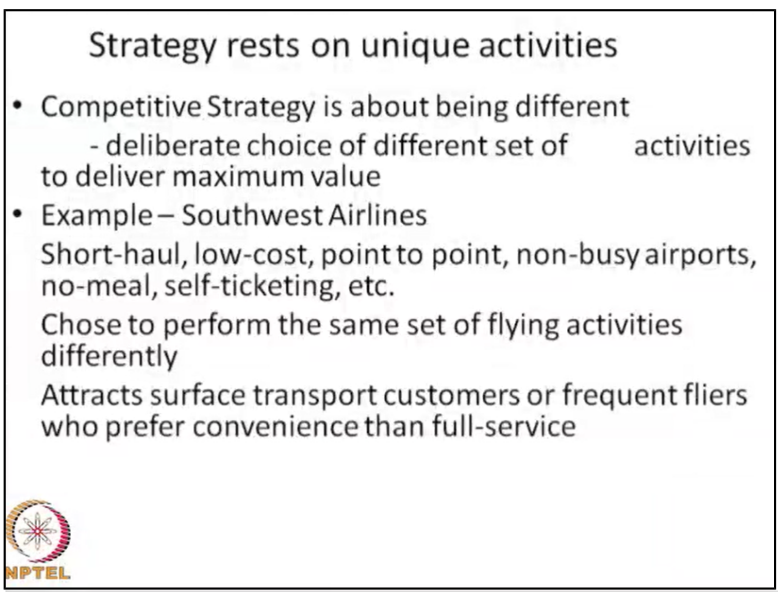

The reason is, competitive strategy is about creating, certain choice of different set of activities that businesses engage. And, these set of activities, deliberately chosen by the business, to ensure that maximum value is delivered. Or, the comparable value is delivered, at lower cost. Let us take the example of Southwest Airlines, to understand this better. Now, Southwest Airlines is known for its, low-cost, short-haul, point to point, non-busy airport, no-meal, self-ticketing. So, various experiences, characterises Southwest Airlines.

Now, what sets Southwest Airlines, apart from the others in the airline industry. Southwest Airlines chose to perform the same set of flying activities. But then, it chose to do it, a little differently. If you ask, who the customers for Southwest Airlines is, it is actually is attracting, the surface transport customers, who otherwise would have taken a car or a bus. Or, frequent flyers, who prefer convenience, then the full-service that, other airlines companies offer.

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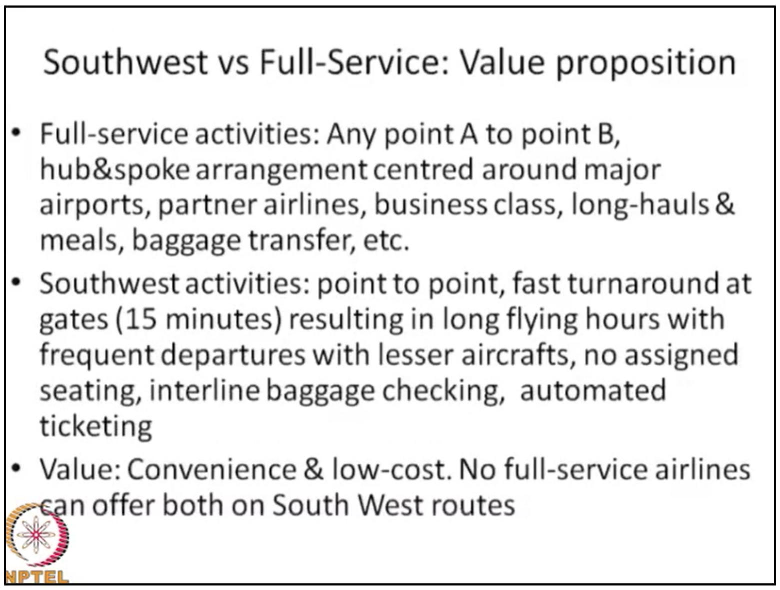

Now, let us understand this, better. Let us compare, Southwest Airlines with a full-service airline, and understand the value proposition, that Southwest Airlines gives. A full-service airline is, fly from any point A to any point B. And, this is possible, only if you have a hub and spoke arrangement with major airports. And then, you need to have partner airlines, taking you from point A to C, then to reach B. Provide business class services, and long-haul flights. Which means, meals, baggage transfer. But, this is also an airline business. And, this is also a set of activities.

And, Southwest Airlines is also in the airlines business. But then, decided to do this business by, engaging in a different set of activities. Where it said that, it is just going to be point-to-point. No hub and spoke. And, it ensures that its, the turnaround time of the aircraft at its gates were very fast, not more than 15 minutes. As a result of which, it was able to clock, long flying hours, with lesser aircrafts. No assigned seating. And, since it is point-to-point, no interline baggage checking. It removed, travel agents automated ticketing.

So, what is the value proposition, that Southwest Airlines was delivering. It was delivering convenience. And, it was also able to do it, at low cost. Because, it removed, a lot of other activities, that consumed cost. Now, a full-service airline cannot offer, the value proposition of Southwest, and continue to be a full-service airline. It is not possible. A full-service airline cannot have this value proposition on Southwest routes. As a result of which, it became very successful, in whichever point-to-point route, that Southwest Airlines started to provide services.

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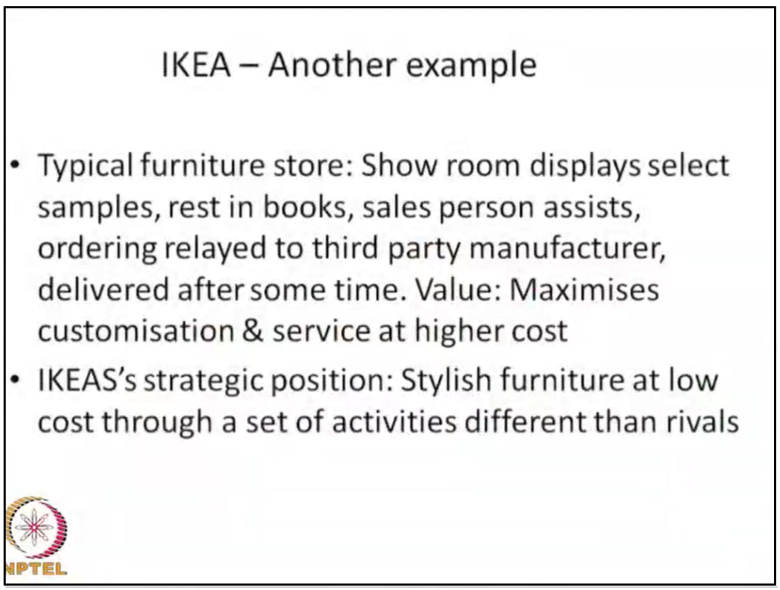

Another example is the IKEA, which is another big Swedish furniture giant. Let us compare, contrast this with the typical furniture store. You enter into a furniture store. It is a showroom, where you have some select samples for display. And, those that are not available for display, are available in some product brochure, in some designer books. And, you have some sales person assisting you. You will be taken through all those samples. And, after discussions, your order gets relate to a third-party manufacturer. And then, after the manufacturing is over, it gets delivered, after some time.

And, of course, there is value in this. The value is, there is maximum customisation. Because, you get furniture design, the way in which you want. And also, service through, all this customer sales force personnel, inside the showroom. Then, delivery happening at your doorstep. But, all of this at a higher cost. Now, IKEA's strategic position, is a little different. It delivers stylish furniture at low cost, through a set of activities, that it performs. Remember, both of them are in the furniture business. But, the IKEA set of activities, it is a little different from, what its competitors do.

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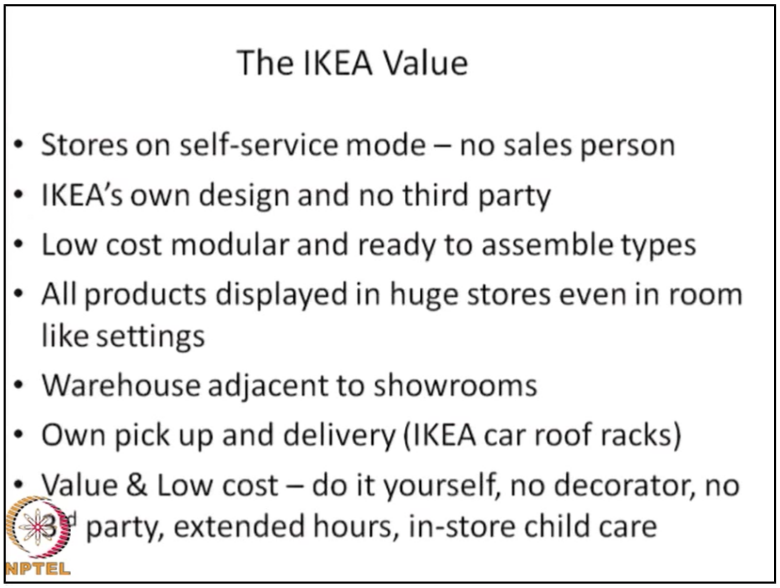

The IKEA stores is more on a self-service mode. So, there is no sales person. It will be IKEA's own design. So, no third party engaged in manufacturing. So, I get into an IKEA store. All of the IKEA designed products are available. And, these are designed in low-cost modular type. And, very easy to assemble, by the customer himself, by me. If I get into an IKEA store. I want to buy, let us say, a cupboard. I know, what design I want. Then, I know that, these are the different modular pieces.

And, these could be assembled by myself. And then, a cupboard is ready. And, since all the products are displayed in the huge stores, and even some in room like settings. So, that also dismisses the need for a designer to come and suggest, how this would look in a room. So, in such a room like settings, you have all the products displayed. And, they also have warehouses adjacent to showrooms. So, once you know that, this is the product that you want, you just pick it up and deliver.

And, the delivery is done by ourselves. So, we just take it in our own cars. And, even IKEA provides some car roof racks, which you can return, when you come to the store next time. Now, what is the value proposition here. The value proposition is that; I do all this myself. There is no need for a decorator. No third party engaged in manufacturing. And, most of the IKEA stores, work extended hours. Basically, this is actually targeted towards the, young urban professionals.

So, when they come after work, they come late. Some of the IKEA stores, in fact most of the IKEA stores have in-store childcare, so that they leave the children to play around, while the young urban professionals do the shopping. Now, there is also value in the way in which, IKEA does business in the furniture industry. And, this is also able to reduce, a lot of cost.

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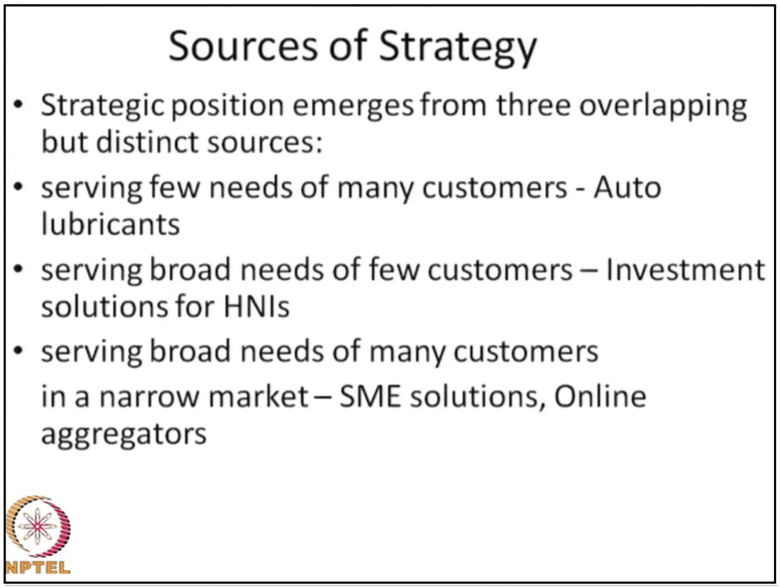

Now, if you look at the examples of Southwest, or IKEA, and many other examples that are readily available, we should understand that, every business needs to create a strategic position for itself, which emerges from three overlapping, but distinct sources. Some businesses can decide to serve, few needs of many customers. Right. Let us say, the auto lubricant providers. They do not provide, the automobile repair or maintenance service. They just provide lubricants.

Or, some businesses provide, broad needs of few customers. Example is, investment solutions for high net worth individuals, where the entire suite of financial products and services are available for such customers. Or, some businesses serve, broad needs of many customers in a narrow market. SME solutions, or the online aggregators like Amazon, or eBay. They provide a host of services for again, a wider base of customers.

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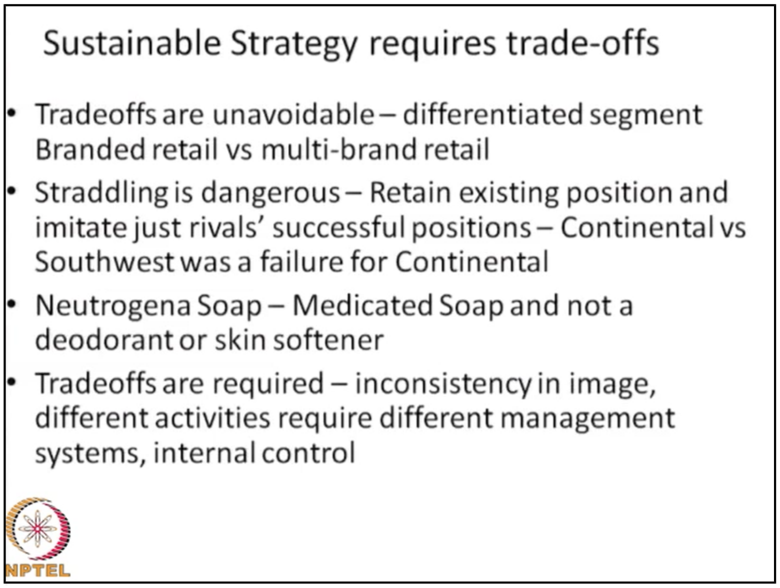

Now, we must understand that, when we decide to do certain set of activities, different from the rivals, or different activities itself, then definitely we need to make some trade-offs. Because, trade-offs are unavoidable. Because, we are trying to create a differentiated segment in which, we want to operate. So, you do not find, a branded retail shop, also trying to, also position itself as a multi-brand retail shop. Because, at the strategic level it decided that, it is going to be just a branded retail outfit.

It is very dangerous to straddle. Meaning, you try to retain your existing position, and also try to imitate your rival successful position. Especially, when the rival successful position is something, very unique and different. And, this Continental Airline tried to do, when it is actually trying to imitate, the low-cost point-to-point model of Southwest Airlines. And, also at the same time, trying to retain its original positioning of being, a full-service airline. That is why, Continental Light was a failure.

Another example of how, Neutrogena made a trade-off. Neutrogena soap, it positioned itself more as a medicated soap, not as a deodorant, or a skin softener. And, that is why, you find Neutrogena more in drugstores, than in the regular stores, where other soaps are available. So, when you are trying to do something unique, when you are trying to do activities which are different from your rivals, or doing different set of activities themselves, you are bound to make certain trade-offs.

Otherwise, it would create an inconsistency in the image, that you are trying to build. Because, you cannot have a dual identity to the business, that you are doing. Some images already formed if, you are trying to do a particular set of activities this way, as a result of which, you cannot try to do, a different set of activities. So, it might result in your image, not being properly communicated.

And, if you are not making this trade-off, it will be the same personnel, it will be the same equipment, it will be the same systems in place, but trying to do the activities differently, which will result in losing certain uniqueness, that the business has. Because, the way in which different activities are done, require different management systems, different types of people, different attitude, difference skills, different machineries.

As a result of which, you need to just make a trade-off and say, I am just going to do only this set of activities, in this particular way. And, from the internal control point of view, if the leadership is very clear, that it is going to make this trade off, and it is going to do only these set of activities, then that is easily percolated right up to the last employee. Now, that is why, sustainable strategy requires, trade-offs.

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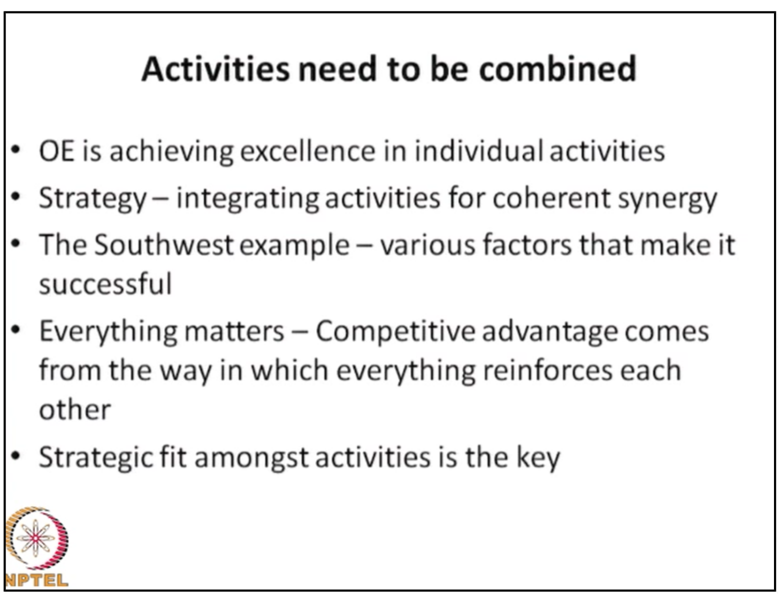

Another way to distinguish between operational effectiveness, and strategies to understand, the benefit of coherent synergy. Now, operational effectiveness is achieving excellence in individual activities. While, strategy is trying to see how, we can integrate the activities, to form coherent synergy. Again, you take the Southwest example. The various factors have made Southwest, a successful low-cost airline. Now, the question is, what is the key success factor. Then, the answer is very simple. You know, everything really matters for Southwest.

The reason is the competitive advantage, that Southwest Airlines get, comes from the very fact that, it is able to reinforce each of these activities, and each of these activities are intertwined. Which means, there is a strategic fit amongst these activities. And, that fit is the key for the success of Southwest. So, we need to understand, when businesses have a lot of activities, there should be an integration of these activities, so that, there is some coherent synergy, that emerges out of this. And, this is what, we call as strategic fit. Now, in a business is, a chain of such activities. And, each of them, may or may not be a source of value.

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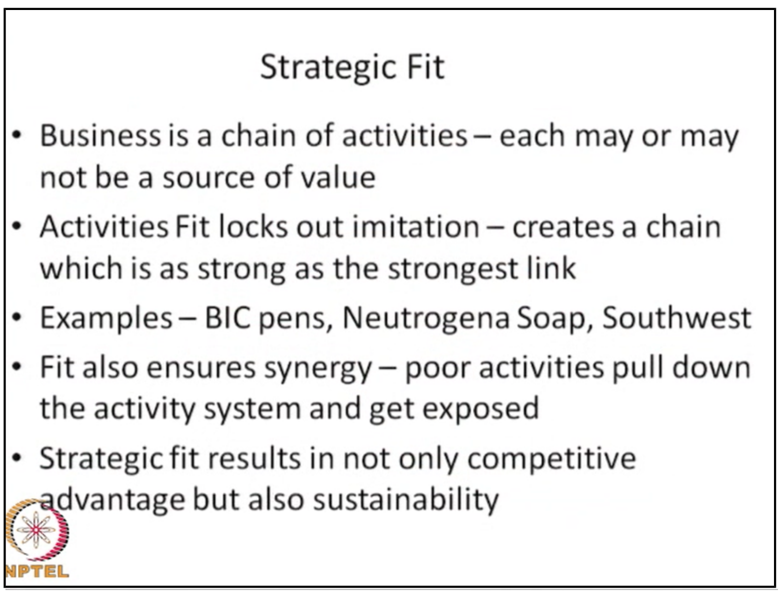

But, the benefit of having an activity fit is that, it clearly locks out imitation. The reason because, it creates a chain in which, the chain is as strong, as the strongest link. It is very difficult to duplicate, a Southwest model, or a Neutrogena soap model, by competition. Because, this strategic fit, ensures a lot of synergy, which is very difficult to duplicate. And also, when there is a strong fit amongst all activities, if one activity performs very poorly, it clearly gets exposed.

As a result of which, there is betterment, the way in which, these activities are linked. The reason that we need to have a strategic fit, is not only because, it gives a competitive advantage. Now, why does it give a competitive advantage. Because, each of the activities, are able to reinforce, a different set of activities. Take the case of Southwest Airlines. Because, the ground crew is efficient.

They are able to make, the turnaround time fast. And, because of that, flying hours is more. And, because of that, the flying productivity is more. Because of that, your bottom line is improving. No seating arrangements. The cabin crew is so efficient. As a result of which again, the customer experience itself is unique. So, you have a host of such activities, which reinforce amongst themselves to provide, that competitive advantage.

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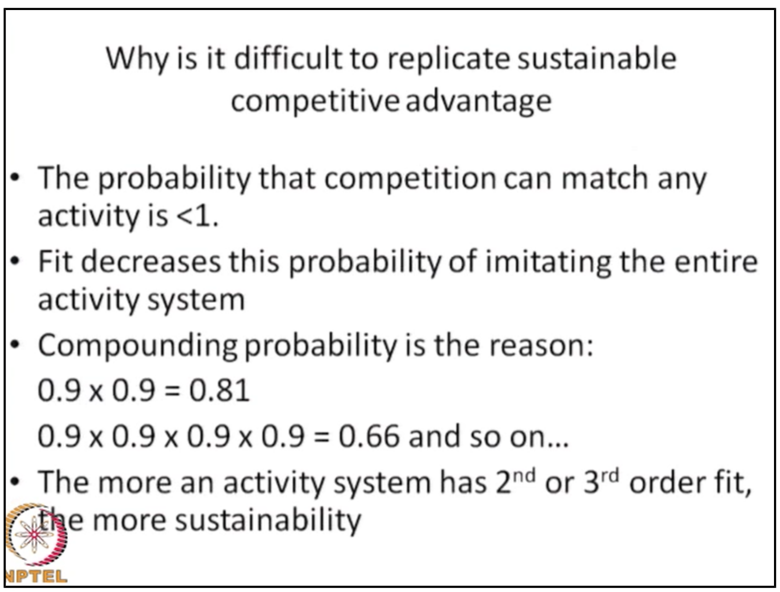

And, it is sustainable because, it is very difficult to imitate the activity of competition. Now, the probability that competition can match any activity is always less than one. If I am able to do a particular activity so well, the probability that somebody else will also do it so well, is less than one. Now, if there is a strategic fit amongst all these activities, then that ensures that, the probability of imitating the entire activity chain, is decreased.

The reason is, the probability gets compounded. The probability to imitate one activity is .9, to imitate two activities is .81, to imitate four is .66, and so on. So, you can understand, the more and more, the activity system has a third or a fifth order fit, the more and more is the competitive advantage sustainable. Because, it is very, very difficult to duplicate, an activity fit.

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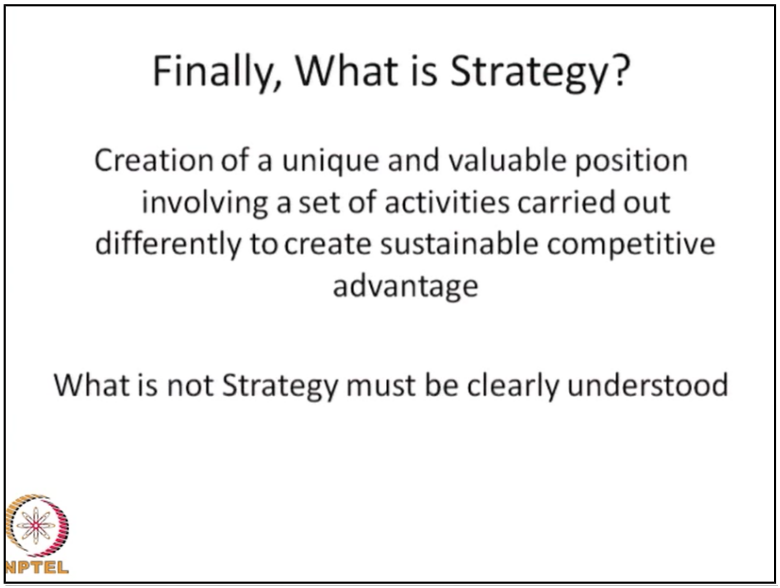

Now, we put all this together, and then ask this question, what is strategy? Then, the answer is very simple. Is that, it is a process that creates, a unique and valuable position, which involves a set of activities, that are carried out differently to create sustainable competitive advantage. Now, while we should understand, the strategy is different from operational effectiveness. It is very, very important for you to understand that. Because, today, aspirations are mistaken as strategies. Experiments are mistaken as strategies.

Mergers and acquisitions are mistaken as strategies. If I decide to put in place an ERP system, that is mistaken to be a strategy. Total Quality Management is mistaken to be a strategy. Well. These are all individual set of management tools, which improves the effectiveness of an organisation. These are not strategies at all. So, more than understanding, what strategy is. To me, strategy is just one piece. That is why, I do not believe in saying that, there is a marketing strategy, there is a HR strategy, there is an IT strategy.

There can never be different, different strategy, for a single organisation. There can be only one strategy. And, I have already told you that, I am a great fan of Michael Porter. And, before we even fully understand what strategy is, you should also understand, what is not strategy. That is also very, very important. Because, invariably managers have different understandings of, the very word strategy. And, many of these understandings are wrong.

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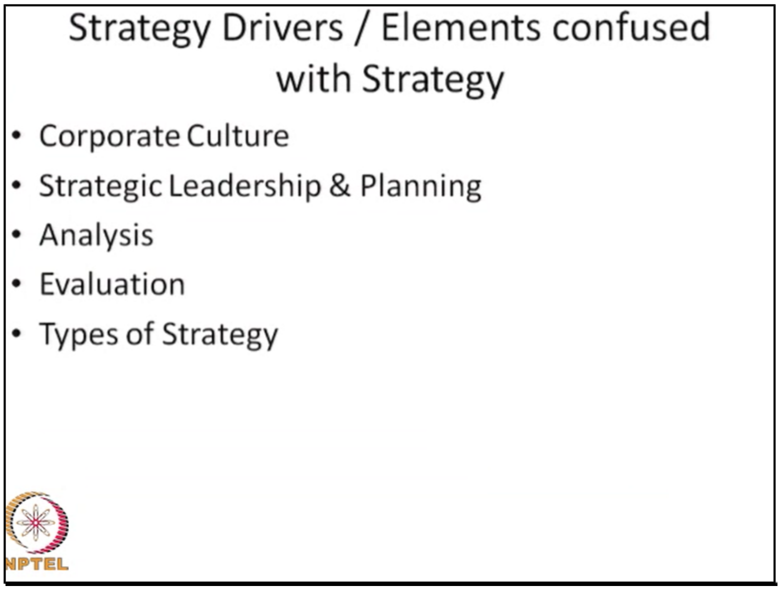

Because, most often, they confuse strategy drivers, and strategy elements, with strategy. Now, what are the strategy drivers. It could be the corporate culture of an organisation. It could be the leadership, and the strategic planning, that the organisation has. The way in which, the organisation analyses businesses, internal and external. The evaluation of a business. And, how a strategy is often mistaken, as strategy per say. Now, let us just understand, each of these strategy drivers.

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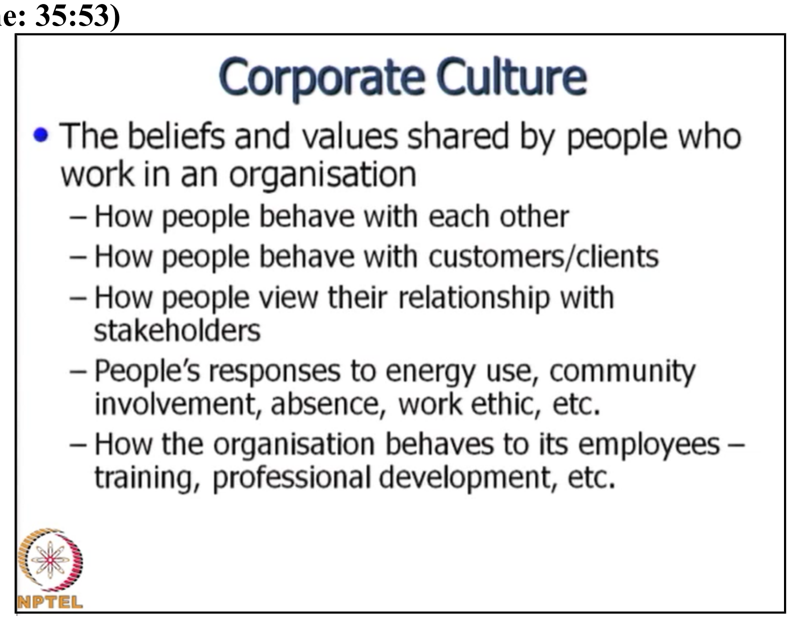

And then, I will also give you a short video on, so that you understand, what is not strategy. I have seen so many managers, misunderstanding corporate culture a strategy. Now, corporate culture is just a set of beliefs and values, that people within an organisation share. The way in which, they behave with each other. The way in which, they behave with their customer, clients, or any stakeholders.

That is corporate culture. And, if somebody asks, a strategy for a particular organisation. I have heard people saying that, the strategy of this organisation is to have, a corporate culture of this type, while it has got nothing to do with strategy per say.

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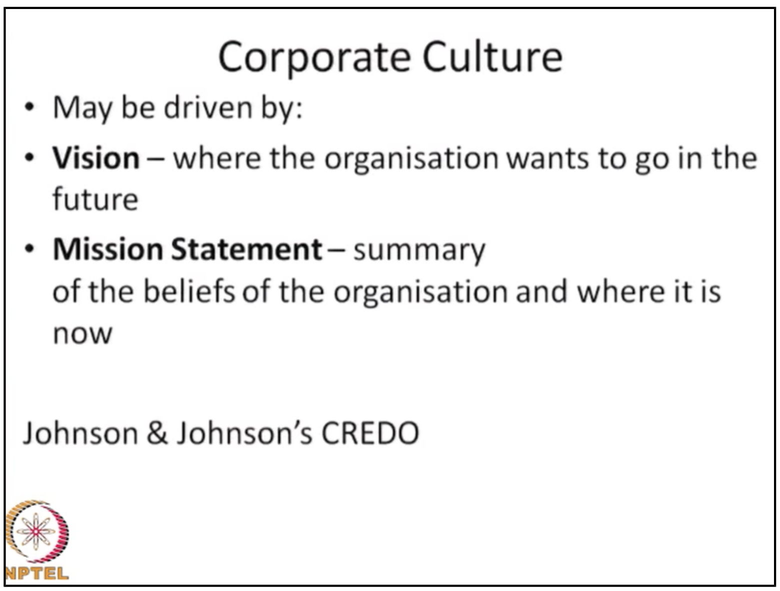

And, some even say, the vision statement, and mission statement, which is an integral part of the corporate culture, is strategy itself. For example, I have seen people saying, the CREDO of Johnson & Johnson as its strategy. While, it is actually not.

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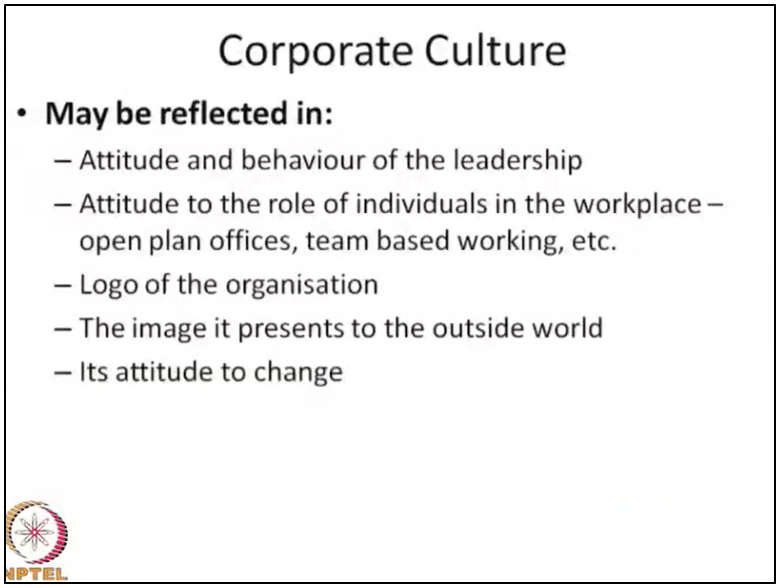

Corporate culture is just characteristics, that get reflected in the attitude and behaviour of the leadership, the employees in an organisation.

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At times, you find also the corporate culture reflected in the logos. And, at times, people also get mistaken. They even interpret corporate logos and say, from these corporate logos, I can make out, what the strategy of the firm is. I just leave these logos with you. So that, you ask this question yourself, what corporate culture do you think, the following businesses have managed to develop. And, is it right to just translate this corporate culture as, strategy per say.

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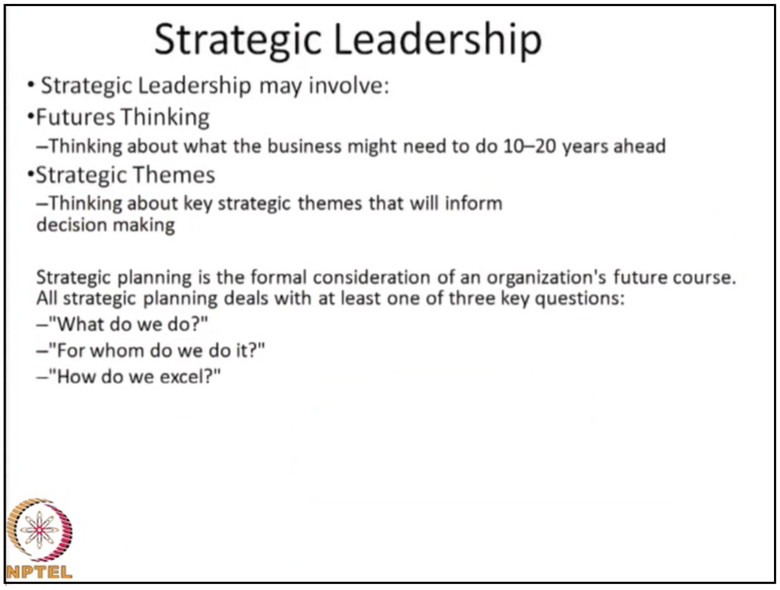

The second important strategy element, is the strategic leadership itself. Which involves, in setting the future agenda in place. Built around certain strategic themes, that answers three fundamental questions. What does the business do? For whom it does that business for? And, how the business is excelled? So, strategic leadership, followed by strategic planning, is also an integral strategic driver.

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Another important strategy element is, the analysis part. We need to analyse, things that are happening within the organisation, and things that are happening outside the organisation.

Growth of India and China, as manufacturing centres. This is an issue, that needs to be analysed. The changing demographic profile of the society. The age structure of the population. The political and regulatory climate, which affects businesses.

So, the effect of, let us say, technology in the business. So, lot of things happen, both inside and outside the organisation, which needs detailed analysis. For which, we need to know that, there are different models, available for such analysis.

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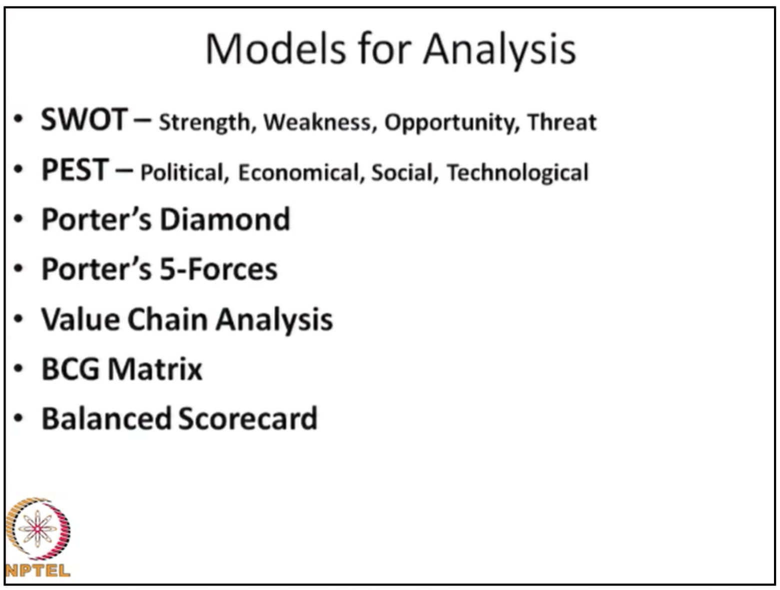

Internal being SWOT. Some of them internal. Some of them external. PEST external. Porter's Diamond, Porter's 5-Forces, external, internal. Then, you have a Value Chain Analysis, BCG Matrix, Balanced Scorecard. Now, these are all various tools, that we would be using for analysis.

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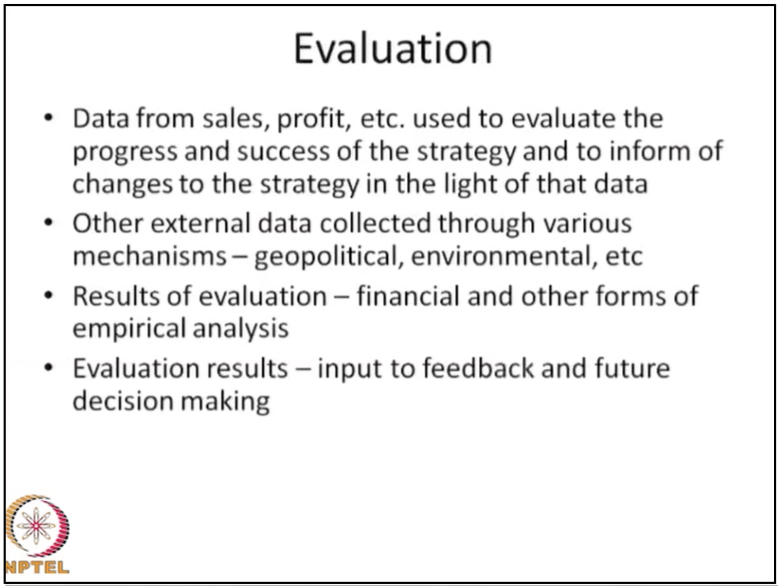

And, evaluation is also a key to build a strategy. We need to get some good, dashboard analytics that provides data, on sales, profitability, process efficiency. And, also other external data, that we collect to get information on the various, environmental and geopolitical parameters.

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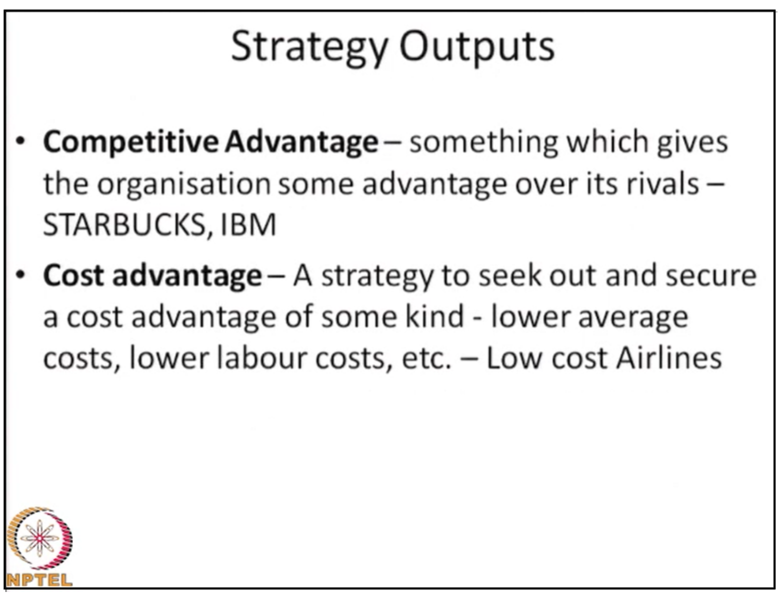

And, this evaluation is very necessary. I mean, we use all the strategic drivers and elements. All this is done to create, two main strategic outputs. And, this is the sum and substance, that defines strategy. By integrating all those activities, two things must clearly emerge. There must be a competitive advantage, which gives the organisation, some uniqueness, that is very difficult for competition to imitate. Or, comparable value can be delivered at lower cost.

So, unique value. Which means, there is room for charging more because, the value is unique, the value proposition is very unique. Or, comparable value, that can be delivered at low-cost. So, these two are the main strategy outputs, and if you are able to do, one of these or both. And, if the purpose of this business is to do, one of these or both, then that is the strategy of the business. And, both have to be, long-term sustainable.

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And, they can do it in different ways. See, the confusion happens is, the way in which we do this, is often misunderstood as strategy. That is why, you would see managers saying that, you know, Acquisitions, Mergers, and Takeovers, is going to be my strategy. But, that is not the strategy. It is how we do this, to achieve the unique value proposition, which is our strategy at the first place

So, I could do it, either by market dominance, which could be through an internal growth, or acquisitions. Or, through new product developments. Or, through expansions, or contractions, I mean, coming out of businesses.

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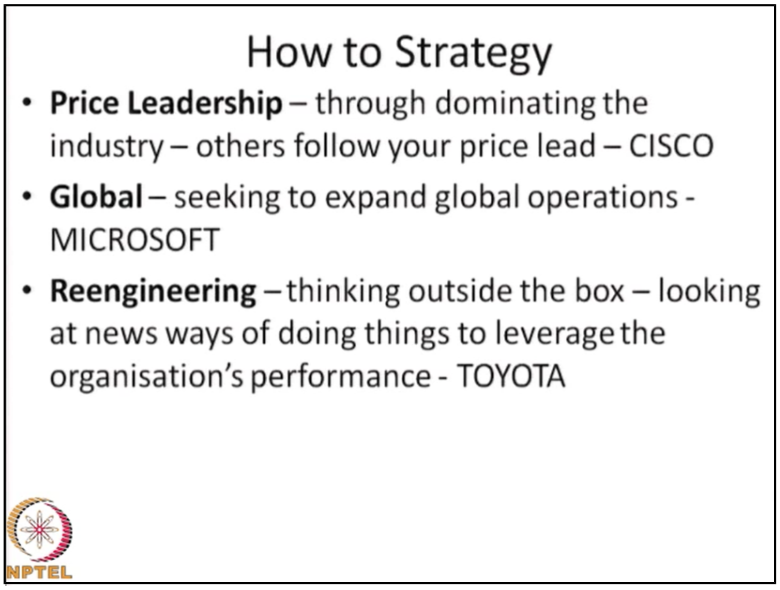

Or, become a price leader. Or, go global like Microsoft. Or, do some re-engineering, and just think out of the box and change the way in which, I could do the same set of activities differently, and leverage the organisation's performance, by doing that.

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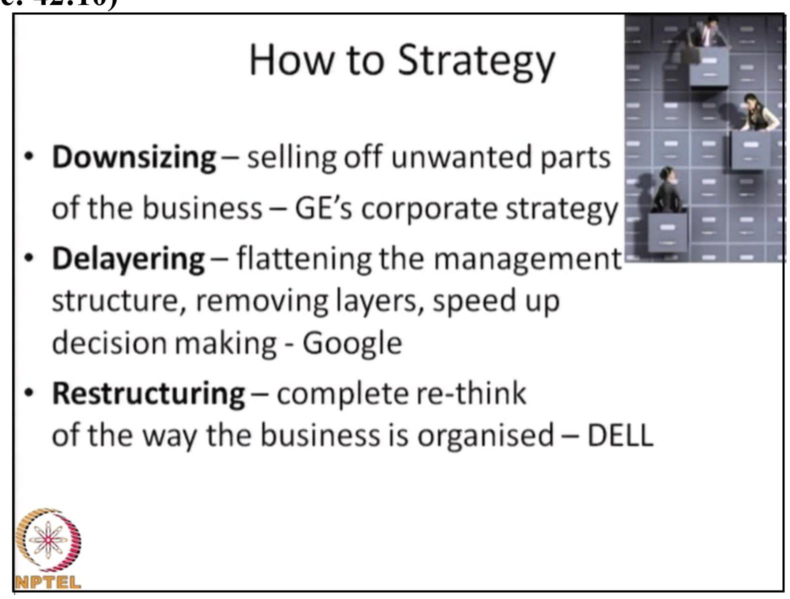

Or, the simple case of Downsizing, Delayering, Restructuring. Now, all these are the different ways in which, we try to implement the strategic objectives. Now, this should not be mistaken, as strategy per say. So, if somebody says, that the strategy of my firm is remaining flat. My organisation structure is flattened. And, that is the strategy of the firm. That is not strategy at all. There is more a decision-making process of a business, that provides some efficiency in the decision-making.

And, that cannot become strategy. Because, such processes are easily replicable by businesses, or competition outside. Then, what is strategy? I would like to just conclude with this definition. It is the way in which you create value, by integrating a set of activities and performing them in a different way, to gain a competitive advantage, that is sustainable over a long period of time. And, if you are able to do that, then you have a good strategy in place. So, I leave also some more reading material, so that you will understand, the concept of strategy better. Thank you.