Contents

The External Environment

Outside In Approach To Strategy

"Strategy requires making explicit choices – to do some things and not others – and building a business around those choices. Strategy is *choice*"
(Lafley and Martin 2003)

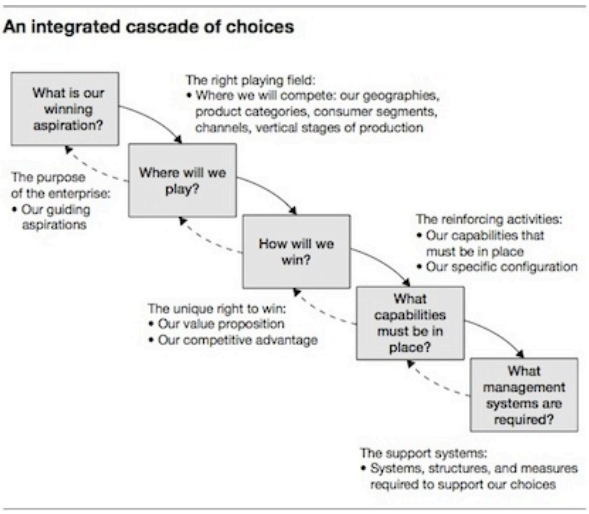
Playing To Win Strategic Framework

What is it?
The Playing to Win Framework was formulated by a former CEO of P&G and a business school dean of the Rotman School of Management. It outlines the approach to strategy taken by P&G b/w 2000-2009.
5 key questions form the basis of this framework:

- What is our winning aspiration?
- Where will we play?
- How will we win?
- What capabilities should be in place?
- What management systems are required?

Strengths
- Provides a long term focus for strategic decisions
- Flexible in that questions can be revisited and the business strategy repositioned
- User friendly/not worded academically
- Alignment tool (each level of management can set the boundaries – decision rights – of each lower level ensuring aligned thinking and decision making)

Limitations
The framework is broad and should be used in conjunction with other more specific goal setting tools (e.g. S.M.A.R.T.)
Does not contain a review metric
Is long term in focus
Requires frequent re-evaluation and revision
Because it is so fluid, it can be difficult to compare shifting strategy to actual outcomes and determine whether decisions were effective
Does not take into account how investing in top line capabilities can compromise bottom line results



"When a strategy succeeds it seems a little like magic"

Execution without the direction of strategy is all over the place. You might win occasionally, but you're probably not going to win consistently, reliably or sustainably
- A.G. Lafley

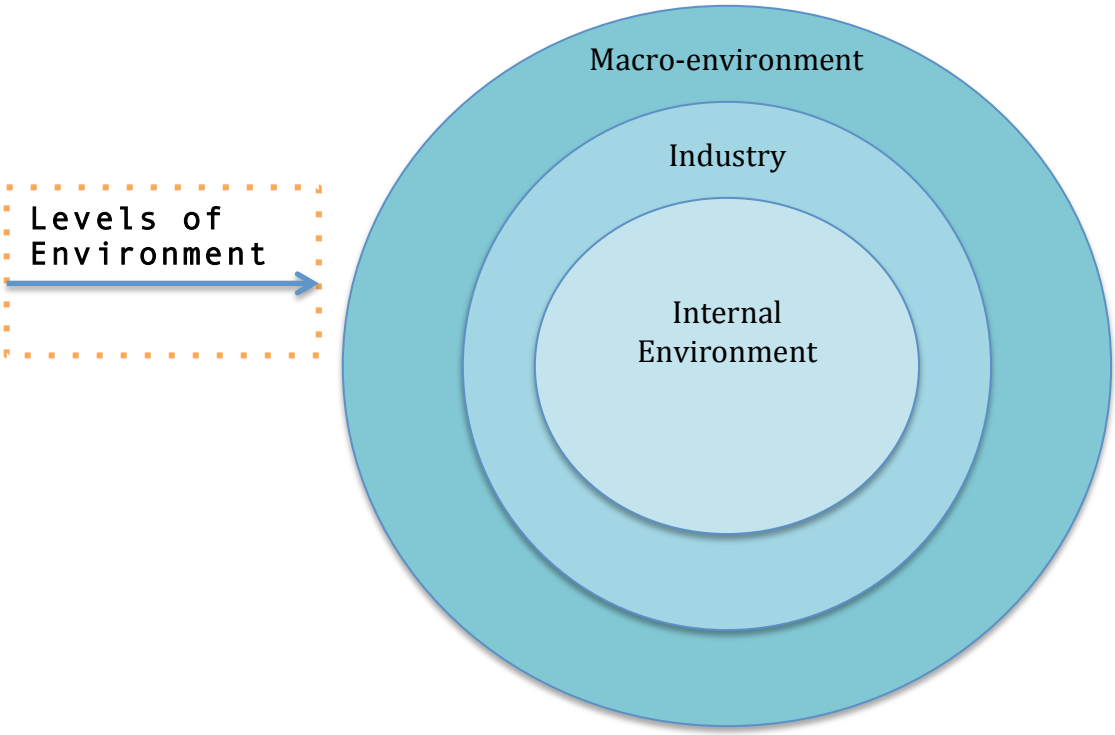
Strategy is a messy social, iterative process. (3 steps forward one step back)

Setting a Winning Aspiration

NOTES:

- Clear and strong purpose exists in organisations such as emergency response or healthcare
- Values are historical
- Vision can be sort, medium, long term. Actual long-term vision is the longest time horizon that you are actually putting dollars against.
- SMART goals – specific, measurable, aligned (but not too attainable), realistic (relevant), timeframe.
- Highest level of an organisation will typically have between 4-6 high level goals – Financial Performance, Growth (competitive performance), Customers (net promoter score), People & Culture (employer of choice), Innovation (% of sales from new products and services), Corporate Social Responsibility
- Financial performance is not an input goal, but an output of other strategies.
- Strategies needed to achieve these aforementioned goals

Strategy processes like a river. A river has a current and takes you in a particular direction. But within the current there will be little eddies and swirls going in opposite directions.



PEST Framework

Political Competition Laws, ACL, OH&S, Employment laws, environmental regulation, lock-out laws, smoking laws, RSA, government stability, bribery and corruption, taxation laws, geopolitical instability, wars, etc.	**Economic** Economic cycle, GDP, interest rates, cash rate, inflation, unemployment, disposable income, energy costs, emerging markets, etc.
Socio-cultural Population demographics, ageing population, income distribution, inequality, labour force mobility, lifestyle changes, consumer preferences, consumerism, education levels, religion, gentrification, urbanization, etc.	**Technological** The internet, social media, hacking, government spending on research new discoveries, innovation and development, speed of technology transfer, NBN (fibre optic cabling), high frequency trades, etc.

Notes:

- Improve your noise/signal ratio – amount of information available can be overwhelming for businesses. Need to be able to filter out what is useful and relevant to your business, and what is not.
- Know what factors will drive change in your industry
- What scenarios can be envisaged for the future?
- Framework can be enhanced to include environmental factors (PESTE)
- Got to anchor your data analysis to an industry or to an organisation (in order to draw conclusions) e.g. rising Australia dollar (anchor to industry i.e. bad for tourism industry as makes Australia less attractive destination.)
- Large organisation use formally – e.g. shell use external analysis to formulate possible scenarios 10 years into the future. (Scenario planning).
- Smaller organisations – use more informally, perhaps involve consultants.
- Rank possible impact 1-10 (probability: high or low. Positive or negative. Etc)
- Agility – having a superior environmental understanding (to seize an opportunity or act to insulate your business from external threats)
- Business Agility – superior environmental scanning capability
- Example of an outside in approach to strategy

Factor	Current Issues	Trends	Disruptions	How might this affect my business?
Political				
Economic				
Socio-cultural				
Technological				

Limitations

- Have to anchor in an industry or to an organisation in order to make sense of 'signals'
- Snapshot view of external forces
- In order to be useable, limits have to be specified (i.e. what changes are occurring and how will they affect a specific industry, or a specific organisation, etc.)
- Doesn't take into account actions of competitors.

*** 2 Ways To View Strategy ***

Outside In Approach To Strategy

Resource Based View

<u>Industry Analysis</u>

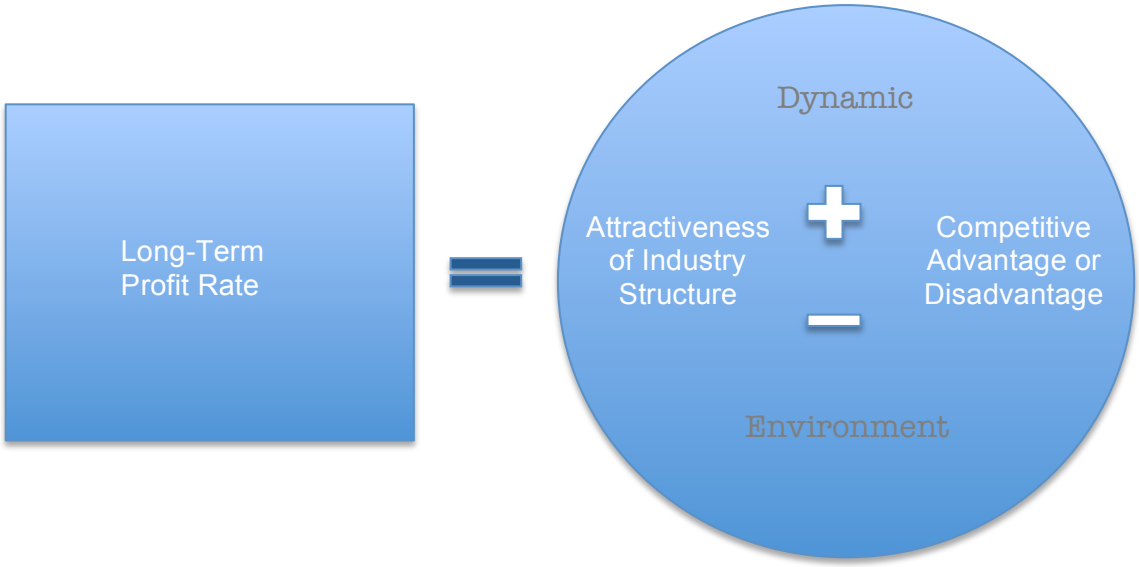
Instrumental to making

'where to play?' decisions ...

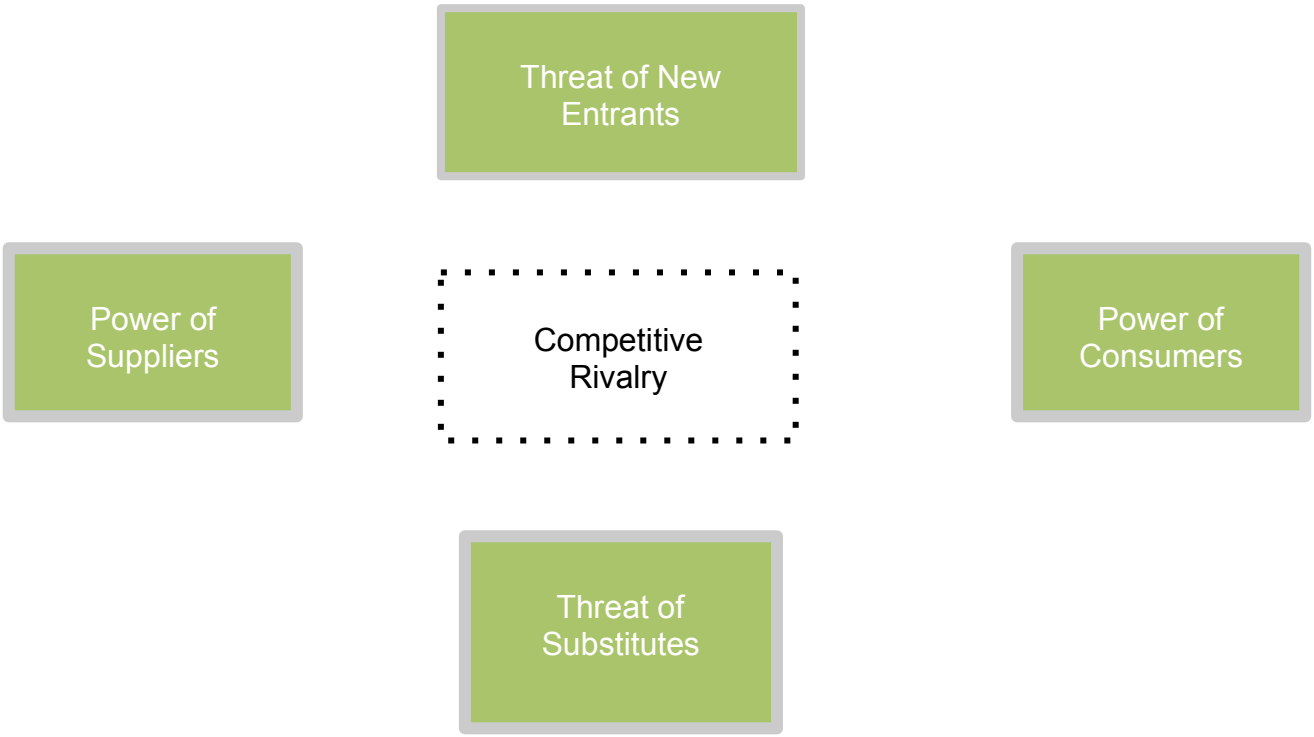
The Winning Formula

Where are we going to play?

How are we going to win?



Five Forces Industry Analysis Model (Porter 1979)



Core Assumptions

1. Every industry is unique and the structure of an industry will change over time
   E.g. Australian education industry (what are the key determinants of what it looks like today and what are some trends going forward)
   Use it as a strategy-planning tool (are we expecting the structure of an industry to evolve in a way that will make it a better or worse place to play?)
2. Competition is a bad thing (from the perspective of an individual business in a market)
3. Competition is everywhere (Porter broadened our view of competition)

Limitations

- Snapshot view of industry at a particular point in time
- Everyone is in competition -> businesses need to identify relevant signals ignore 'noise'
- Lot of data needs to be sourced for this analysis
- Elaborate analysis

Note:
Not only useful for existing businesses but for investors contemplating entering an industry as well.

QUICK & DIRTY VERSION
- Size of market (revenue)
- Market growth rate
- Competitive Intensity

Table 1: Market Attractiveness

FACTOR	LOW	MED	HIGH	Key Issues/Trends/Strategic Options
Threat of new entrants				
Threat of substitutes				
Bargaining power of suppliers				

Strategic Options

New Entrants

- Build entry barriers
- Watch out for mavericks!

Powerful Suppliers

- Diversify supply base
- Reduce supplier costs
- Standardise requirements
- Integrate backwards

Internal Rivalry

- Strengthen competitive advantage
- Re-segment
- Outsource to reduce fixed costs
- Acquire competitors with care

Powerful Buyers

- Select customers
- Build customer switching costs
  - Specifications
  - Relationships
  - Service
- Integrate forward

Substitutes

Understand customer preferences before reacting

- Critically examine indirect substitutes
- Consider diversification

More intense the competition = less attractive the market

Key questions:

- ✓ How can I reduce buyer power?
- ✓ How can I create pull through?
- ✓ How can I gain competitive advantage?
- ✓ How can I raise barriers to entry/substitution?
- ✓ How can I make the industry more attractive/make our position within the industry more attractive?

Need to understand what life-cycle stage your industry or competitor is in because competitive conditions will ***change***

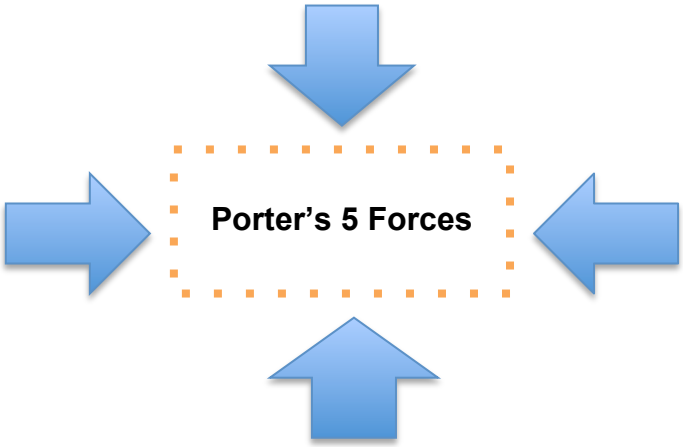
The Life Cycle Concept

Development	Growth	Shakeout	Maturity	Decline
- Early adopters - Few competitors	- Entry of competitors - Fight for share Undifferentiated products	- Selective purchase - Strong competition - Price cutting for volume	- Saturation - Fight to maintain share - Efficiency, low cost	- Drop-off in usage - Exit of some competitors

Going further than Porter…

The New Strategic Game

OLD GAME



New types of cooperation and competition: more than an arms length competition

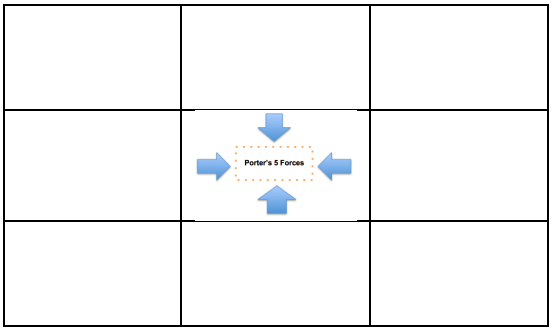
New sources of value: competitive advantages no longer based only on structural advantages

Increasing uncertainty: today's industry structure is probably not a good indicator of the future

NEW GAME

Industry structure/conduct

- Codependent systems
- Privileged relationships
- Traditional arm's length



Basis of Competition

- Structural advantage
- Frontline execution
- Insight/foresight

Structural Advantage
Traditional microeconomic assumption that creating value is only possible by exploiting structural advantages over competitors and potential industry entrants due to scale, now how, technology, patents, market access, etc.

Frontline Execution
Creating value by consistently outperforming competitors in the execution of day-to-day activities via cost, quality, and time. (Core competencies)

Insight/Foresight
Creating value by exploiting superior knowledge or insight due to scientific or technical expertise, pattern recognition, or sheer creativity. (Special privilege knowledge that you act on – you know something that your competitors don't!)

Codependent Systems
Cross industry structures such as:
- Networks
- Economic webs: Sets of companies that use a common architecture to deliver independent elements of an overall value proposition that grows stronger as more companies join the web (e.g. Samsung and Apple in fierce competition, but Samsung supplies to Apple)

Privileged Relationships
Companies single out other companies (often in the same market) for a special price or treatment because of financial interest, friendship, trust, or ethnic loyalty

Traditional Arm's Length
Microeconomic model based on "rational" industry structure with competition for control of economic surplus, not only with competitors but also with suppliers and customers

Porter's 5 Forces –> companies are independent entities in competition with each other

NOW –> companies can function in networks and be co-dependent as well as in competition.

<u>Key Success Factors</u>
- Major factors that determine competitive success in a particular industry
- KSF can be a skill or a competitive capability that the company must achieve (technology, manufacturing, distribution, marketing, or organizational resources)
- KSF vary from industry to industry and change over time
- Can be traced back to individual customer segments
- KSFs are driven by what the customer wants
- Understanding what is driving customer preferences is essential
- Can only have a few KSF
- KSF evolve over time as the business environment changes

Basis of Competition	Possible KSF
▪ Competitive price →	▪ Efficient raw material sourcing ▪ Productive plant ▪ Low overheads
▪ Good product quality →	▪ Production design skills ▪ Quality control procedures ▪ Understanding what customer wants
▪ Service →	▪ Reliable delivery system ▪ Flexible logistics operation ▪ Good sales and marketing team ▪ Ability to offer technical support
▪ Reassurance →	▪ Company reputation or image

E.g. Baxter Pharma – free disposal of medical waste –> customer comes to expect this service -> forces competitors to match. This becomes a KSF of theirs, driven by servicing the needs of consumers, and in turn attributing them a competitive advantage. (However these costs need to be internalized -> scale is necessary to absorb these self-imposed costs). Baxter have the only manufacturing extensive footprint in Australia – by building this service into customer expectations, whilst simultaneously forcing competitors cost structure up, they brand themselves as being responsible towards their impact on the environment.

Porter's 4 Corners Analysis

Drivers (Motivation)

Financial goals
Corporate culture
Organisational structure
Leadership team background
External constraints
Business Philosophy

Current Strategy (Actions)

How the business creates value
Where the business is choosing to invest
Relationships & networks the business has developed

Competitors Future Strategy

Management Assumptions (Motivation)

Company's perception of its strengths & weaknesses
Cultural traits
Organisational value
Perceived industry forces
Belief about competitor's goals

Capabilities (Actions)

Marketing skills
Ability to service channels
Skills and training to workforce
Patents and copyrights
Financial strength
Leadership qualities of CEO

Motivation

Drivers

(What is it that *drives* the competitor?)

– What is our winning aspiration?

Understand a competitor's actions by attempting to understand their strategic goals as well as their current position. If the gap between the two is significant -> the competitor is likely o react to an external threat. If the gap is small they may employ a more defensive strategy.

Management Assumptions

(What are the competitors' assumptions about the industry and it's own capabilities?)

– What management systems are required?

The perceptions and assumptions the competitor has about itself and about the industry in which it operates play a part in the formation of their strategy. What would the competitor consider its strengths & weaknesses? What is their corporate culture like and how do they perceive it to be?

Actions

Strategy

(What is the competitor actually doing & how successful are they in implementing strategy?)

- How will we win?

Competitor's strategy determines *how* they will compete in the market. However discrepancy can exist between intended strategy and actual execution.

Capabilities

(What are the strengths & weaknesses of the competitor?)

- What capabilities must be in place?

The competitor's core competencies may determine their inherent ability to initiate or respond to external forces. Though a competitor may have the motivation to initiate a strategic change, the effectiveness of this strategy will be entirely dependent on its key success factors and core capabilities. Its strengths will determine how likely they will be to respond to an external threat. E.g. a competitor with strong financial performance in one segment may initiate a price drop in another to capture market share (milk wars).

Limitations

- Predictive in nature
- Can never fully know the motivations behind a competitor's actions, or if they are meeting their own strategic goals
- Snapshot of a competitor at a single point in time

The Internal Environment

Resource Based View To Strategy
(Inside Out Approach)

OVERVIEW

Competitive Advantage

The SWOT Framework

Competitive Positioning

1. *Competitive Advantage*

The basis for competitive advantage exists when *a firm's core competencies are aligned with industry key success factors (KSF).* The broader and deeper this alignment = the greater the competitive advantage. KSF exist in the external environment. Competitive advantage is a bridging concept between the external and internal environment.

Competitive advantage exists when a company has:
- Highest margins in their peer group
- The ability to consistently win battles to acquire and retain key customers
- Is the player that the 'smart money' bets are on …

Outcome oriented aspect to the concept (even if you can't articulate *why* you are winning, if you are winning, you must have competitive advantage. However, paradoxically, you can have an advantage and still not win.

*** Mirror Concept = Competitive Disadvantage***

Competitive Advantage (Core competency that enables you to win)	Competitive Disadvantage (Prevents your ability to win)

Eliminating competitive disadvantages can be a solution to the paradox of having advantage but not always winning.

Resources & Capabilities

Resources are things you have that are:

- *Valuable*
- *Rare*
- Non-substitutable
- Non-imitable

In practice the first two actually tend to cover the second two
All resources meet these three criteria (all resources can be isolated, valued, be bought and sold i.e. they are fungible assets)

- Generic
- Measurable
- Tradable

Capabilities

- Organizationally specific
- Complex
- Fragile
- Incorporate an 'X' factor

Resources can move across organisational boundaries (can be traded) but capabilities are organisationally specific.

Resources have value potential but have to be integrated or embedded in a capability system in order to unlock or unleash this value. (They have to be 'put in motion').

They are complex. Because they are complex they are fragile and incorporate a magical 'x 'factor that can't be completely understood.

'X' factor can be good in that it cannot be contributes to a barrier to imitation. If you can't understand it then your competitors can't understand it. However 'X' factor makes a capability fragile, in that any changes you make to the organisation (however small) may have unintended and unforeseeable negative impacts.

E.g. **pharmaceutical company acquired smaller laboratory in the UK and made some small changes to make the acquisition more like the parent company**:

- Changed dress code to semi-formal/casual (from very informal)
- Created hierarchy in the organisation by:

- Creating separate dining room for executives
- Car park switched from first come first served to car parks set aside by rank.

So pissed off employees and technicians that half the staff left within the year.

E.g. Lionel Messi

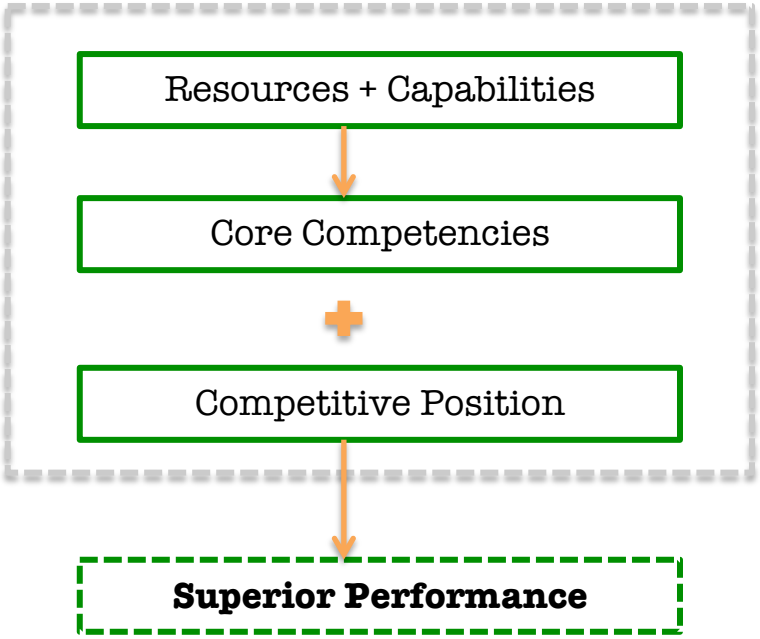
Player for FC Barcelona + Argentine National Team

Not as successful in creating value for his country than his team FC Barcelona – a phenomenon which can be explained by considering organisational capabilities. Argentine National Team and FC Barcelona do not have similar resource bases, training systems, medical recovery regimes, dietary regimes, strategies and tactics, training facility qualities, etc. The result is that Messi creates more value for FC Barcelona than for the National Team.

E.g. **superstar CEO poached by another company –> might not be as successful in a new environment.**

Part of performance in previous organisation that made the superstar a superstar was not attributable to them as an individual but to the organisation, most likely embedded in the team that directly reported to them. CEO's that are poached often recognize this and take their trusted lieutenants with them.

Example: Ryan Air's Competitive Advantage:



Notes:

- Ryan Air customer surveys consistently reveal that their customers hate them
- Their success can be linked to their in depth pursuit of operational excellence value discipline (at the cost or total disregard to customer intimacy)
- Number one in creating shareholder value in what is a crappy industry to compete in.
- Low cost airports, brand = great value, web booking, all combine to create the lowest cost operator
- Ryan Air win customers based on lowest price for short haul routes
- Their success is not any one thing, it's a complex system a combination of resources such as: modern aircraft that are fuel efficient and require less intensive maintenance, labour flexibility non union environment, share market options for employees, flying secondary airports where landing rights are cheaper and there is less traffic so you are more consistently on time, common aircraft (staff don't have to train to operate different aircraft)

THE RESOURCE BASED VIEW (Summary)

- Know your strengths – if you aren't sure, ask your key customers!
- Compete based on your strengths (The theory dictates that businesses should not worry so much about their weaknesses – in practice the notion of net competitive advantage, suggests that sometimes you need to park your strengths and attack your weaknesses in order to succeed)
- Create new strengths from existing strengths
- Develop dynamic capabilities (internally and externally oriented) to maintain fit with environment (term is not used so much in the real world, instead terms like business 'agility' a concept which is made of 3 key concepts –
  1. Superior ability in environmental scanning
  2. Leadership team which is both perspective diverse and aligned
  3. Resource fluidity/mobility (internal flexibility so that if the environment changes suddenly you can respond)

Assessing Resources & Capabilities (Firm level Value Chain Analysis)

Support Activities and Costs

<table>
<tr><td colspan="5">General Management</td></tr>
<tr><td colspan="5">HR Management</td></tr>
<tr><td colspan="5">Product R&D, Technology, Systems Development</td></tr>
<tr><td>Supplies and Inbound Logistics</td><td>Operations</td><td>Distribution and Outbound Logistics</td><td>Sales and Marketing</td><td>Service</td></tr>
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Primary Activities and Costs

There is no economic theory about the firm. Economists treat the firm as a black box
This tool opens up the black box -> helping us better understand the firm…

<u>Strengths/Limitations</u>

Snapshot of value chain at a particular point of time

Shows us specific strategic decisions that were made at a particular point in time and allows us to compare these to actual market based results.