The Economist

BUSINESS STRATEGY

A guide to effective decision-making

3rd edition

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1 What is business strategy?

BUSINESS STRATEGY is the plans, choices and decisions used to guide a company to greater profitability and success.

An inspired and clearly considered strategy provides the impetus for commercial success, whereas a weak or misunderstood strategy may lead to a company going out of business. Understanding what constitutes "strategy" is therefore crucial in developing a successful business, as is avoiding the tendency to label every plan and decision "strategic" when most are about implementing strategy rather than setting it. Equally important is for a strategy to be clear and effectively communicated to everyone with a role in implementing it, and to shareholders and other stakeholders.

A clear view

A focus on strategy will highlight where a unit or group of businesses can be more successful as well as those areas where it is weak, vulnerable or failing. It will show in detail where the business is making its money and why. This insight can be used to build profits, cash flow growth and shareholder value. Strategy indicates where resources (notably people, effort and finance) should be concentrated.

The process of developing and implementing strategy enables managers to understand their customers and competitors. Specifically, a sound strategy is grounded in an understanding of a business's customers. This understanding is dynamic – the company is able to develop its products and approach in line with its customers' changing preferences. Some of the strategies pursued by market-leading companies such as Microsoft and Apple involve anticipating what their existing and potential customers will like. Few purchasers of the Apple iPod were demanding a stylish new way to buy, download and play music before it was launched. Instead, Apple was able to combine developments in software, design, the internet and computer-chip miniaturisation with its understanding of what people would value to come up with a surprising product that caught the popular imagination.

Developing and implementing strategy strengthens a business in another important way. It makes sure that resources are devoted to the most important customers in order to retain their loyalty and get them to buy even more of the company's products or services.

Strategy helps to highlight how profits can be increased through the development of product extensions (new products based on existing offerings), changes to the product mix (the range of available products so that they complement each other), adjustments to prices or cuts in costs. The process of developing strategy also informs thinking about which products and markets to abandon.

Another benefit of strategy relates to developing and implementing a firm's internal organisation. A clear strategy shows managers where business skills need to be added or strengthened. It also highlights where productivity can be improved and why particular initiatives and activities have succeeded or failed. Above all, a clear strategy gives a company the impetus and focus needed to develop among its employees the culture, attitude and skills required to meet the needs of its customers profitably and in a rewarding way.

A business's strategy provides a guiding view of the future that influences employees' decisions, priorities and ways of working. People like to do work that is meaningful to them and that has a purpose. Strategy should provide that meaning and purpose. Those responsible for setting a business's strategy often lose sight of the intangible and valuable contribution it can make to employees' commitment, engagement, productivity and creativity. People work better and achieve more if they believe in what they are doing and have confidence in the direction they are going. Conversely, uncertainty or insecurity about the future breeds tension, lack of confidence and even cynicism, none of which are conducive to business success or personal achievement. A strategy that employees understand and believe in will help them develop their potential and attain new skills. In turn, this boosts self-confidence and increases self-awareness, both of which are qualities that intelligently managed companies need more of.

For owners or shareholders, strategy provides a way of measuring their business's progress. Events ranging from recessions to acts of God may obscure the reality of a firm's short-term performance, but what cannot be obscured is whether the right strategy and direction have been chosen, and the progress made in executing that strategy.

A strategy will not be successful if it does not provide benefits to customers. Indeed, they are more important than anyone. The crucial component of strategy is how it will result in greater appeal to customers. One business that has become adept in this area, growing steadily in a highly competitive and often turbulent market, is Cisco, which supplies networking equipment and network management for the internet. Its strategy is based on understanding what it can do to help its client achieve their goals, and then using this understanding to guide its decisions and focus its work. In short, customer success is the mantra behind client engagement.

Cisco and client engagement

At Cisco, people recognise that each client has different goals. Some are related to financial performance or market share targets; others are concerned with public-sector targets and governmental priorities.

Cisco places great emphasis on making sure that its approach focuses on helping customers to achieve their goals. Scott Brown, formerly vice-president, distribution for worldwide channels, says:

> *When we think about client engagement, the most important question we can ask is: What are we doing to deliver our clients' success and help them achieve their goals?*

The challenge is to make sure that the focus is consistent globally and from top to bottom within the company. Cisco's experience shows that several things are essential.

Understanding what constitutes customer success

This requires an understanding throughout the organisation of what constitutes success for each customer so that everyone shares the same goal and is clear about what it is. For instance, the Cisco badge that forms part of every employee's security pass highlights the most important elements of the company's culture such as open communication, inclusion, trust and teamwork, but it also makes clear that all those attributes serve a single goal: customer success.

Getting the measurements right

If you measure things that are important to the customer and the company, it helps to reinforce their importance among employees – so it matters that you get what you measure and the way you measure it right. The old adage "what gets measured gets managed" holds true, and to determine customer success Cisco uses a wide range of measurements including customer satisfaction, customer loyalty and the number of franchises within a business.

Getting the compensation structure right

The size and nature of their remuneration or compensation package matters greatly to most people. Getting the compensation structure right helps generate positive behaviour and gives people the incentive to do the things that need to be done. At Cisco, a substantial portion (approximately 20%) of executives' pay is linked to customer satisfaction.

Managing performance effectively

At Cisco people get feedback on the measurement of results and know that their compensation depends in part on how good those results are. This reinforces the focus on the customer and benefits everyone involved.

Collaborating and sharing expertise

If a new Cisco client has a specific need and the experience or expertise to address this resides somewhere else in the business, there is an expectation that help will be forthcoming. Collaboration is fostered and managers communicate the standards of professionalism and integrity they expect.

Using technology to communicate

Cisco's focus on customer success benefits from a network-based approach in which communication includes videos from sales leaders, regular information about client successes, examples of how customers use technology, and details of what has worked and what has not. For a company selling networking equipment none of this is surprising, but this kind of communicating is standard in many big companies.

Developing skills and insight

Once the principles of client engagement are understood, practical aspects that a manager can develop include the following:

- Dialogue. The ability to question, empathise and listen is crucial for establishing rapport with customers and ensuring their success.
- Coaching. Encouraging people who have attained leadership positions because of their results and technical expertise to share their skills and experience is essential.
- Knowledge. A sufficiently deep knowledge and understanding of a client's industry, market, customers (and what they want and value), competitors and overall market position is crucial to being able to make a difference.

What strategy is not

Although it is important to know what strategy is and why it is important, it is also useful to appreciate what strategy is not. There is much confusion about the nature of strategy. Strategy is not:

- A vision or mission statement such as "Our strategy is to be a leading-edge provider/employer". This explains neither where the firm is going nor how it will make progress. Consequently, it is not a strategy.
- A goal, budget or business plan. Strategy is not a goal such as "We aim to be the best or number one". This is, at best, an aspiration. Also, strategy is neither a budget nor a business plan, although elements of these may contribute to how a strategy is implemented.
- Data analysis. Too often, data analysis leads to strategy, when what should happen is that strategic choices are made first and then refined and explored further using data analysis.

The choice of strategy

The development of strategy involves making decisions about:

- Who to target as customers (and who to avoid targeting).
- What products or services to offer.
- How to undertake related activities efficiently.

In every industry there are several viable positions that a company can occupy. The essence of strategy therefore is to choose the one position that a company will claim as its own. An example of the difference clear strategic thinking and decision-making can make is Nestlé's turnaround of Nespresso.

Clear strategic thinking: Nespresso

Nespresso is an espresso coffee-making machine consisting of a coffee capsule and a machine. The coffee capsule is hermetically sealed in aluminium and contains 5 grams (about one teaspoon) of roasted, ground coffee. The coffee capsule is placed in the handle, which is then inserted into the machine. The act of inserting the handle pierces the coffee capsule at the top. At the press of a button, pressurised hot water is passed through the capsule. The result is a high-quality cup of espresso coffee.

TABLE 1.1 **Nestlé's winning decisions**

Who	Who should I target as customers?	Target individuals and households, not restaurants or offices
What	What products or services should I offer?	Sell coffee, not coffee machines
How	How can I best deliver the product to customers?	Subcontract the manufacture of the Nespresso machine to prestigious manufacturers Take control of coffee side and focus on the production of high-quality coffee capsules Sell the Nespresso machine through prestigious retailers Educate retailers so that they can teach the consumer how to use the machine Sell the coffee capsules direct through the Nespresso Club

Nespresso was introduced in 1986 as a joint venture between Nespresso and a Swiss-based distributor called Sobal. The new venture, Sobal-Nespresso, purchased the coffee-making machines from another Swiss company, Turmix, and the coffee capsules from Nestlé. Sobal-Nespresso then distributed and sold everything as a system: one product, one price. Offices and restaurants were targeted as customers and a separate unit called Nespresso was set up within Nestlé to support the joint venture's sales and marketing efforts, and to service and maintain the machines.

By 1988, the business had failed to take off and headquarters was considering freezing the operation. However, in 1988–89 Jean-Paul Gaillard, Nespresso's commercial director, changed the strategy and made the business profitable. Gaillard decided that the coffee side of the operation had to be separated from the machine side. Since Nestlé was not in the machine business, he felt he had to focus on the coffee.

Production of the Nespresso machine was assigned to several carefully selected manufacturers such as Krups, Turmix and Philips. The machines were then sold to prestigious retailers including Harrods, Galeries Lafayette and Bloomingdale's. It was the retailers' responsibility, under the guidance and control of Nespresso, to promote, demonstrate and sell the machines to consumers. It was the responsibility of the manufacturers to service and maintain the equipment.

On the coffee side, the Sobal partnership was ended and the operation placed under Nespresso (later Nestlé Coffee Specialties). The target customer was changed from offices to households and the distribution of coffee capsules was organised through a "club". Once customers bought a machine they became a member of the Nespresso Club. Orders for capsules were taken over the phone or by fax direct to the club and the capsules were shipped to the customer within 24 hours. The club covers around 60 countries and employs more than 9,500 people, compared with 331 in 2000. Furthermore, there is a strong brand loyalty, with over 3 million Facebook fans and 180,000 customers visiting Nespresso's online boutique every day.

Avoiding pitfalls

All businesses need a strategy of some kind, and they should reconsider it as the business environment changes. But many get into trouble through lack of understanding or clarity about their strategy.

The first principle, therefore, is that strategy needs to be as clear, simple and compelling as possible.

There are other principles that can help a strategy to be successful.

Create a unique strategic position for the business

Focus on who your customers are, the attractiveness of your offer to them (known as the value proposition), and how you can connect the two as efficiently as possible. The benefits of a unique strategic position are highlighted by the concept of value innovation, developed by W. Chan Kim and Renée Mauborgne in their book *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant.*[1] This is the concept of defying conventional logic to either redefine or create a market. For example, for many years US TV networks used the same format for news programmes. They were aired at the same time and they competed on the popularity and professionalism of their presenters and their ability to report and analyse events. This changed in 1980, when CNN launched real-time 24-hour news from around the world for only 20% of the cost of the networks. Viewers, with their increasingly busy lives, valued news and analysis at a time that suited them, rather than having to fit around a TV channel's schedule.

Consider the availability or potential availability of resources

Money and other resources are limited, even though the balance can be improved through alliances to bring in other kinds of resources such as knowledge and skills. Realistic decisions must be made about how to use them to the greatest benefit. For example, if a company wants to retain existing customers but expand the customer base, it must widen its product range and the range of value propositions. Toyota, one of the world's largest car companies, has products ranging from small, economical vehicles to luxurious marques such as Lexus. This is in contrast to the UK car industry during the 1970s and 1980s, when one nationalised company, British Leyland, produced many more models than its competitors but failed to distinguish between any of them. The company's resources were spread too thinly, with product development and marketing weakening rather than strengthening each other. In time, these issues combined with other problems, such as poor industrial relations and weak quality assurance, to create a tidal wave of other troubles that eventually submerged the firm.

Understand the importance of values and incentives

Strategy must be based on reality about both the external and internal environments. The external forces shaping business strategy include regulatory developments, demographics, economic growth and political stability (see Chapter 4). Internal factors include skills, people's attitudes to their work, their commitment or "engagement", the way they operate and the overall culture of the business. If specific aspects of employees' work in achieving a company's strategy are measured and incentives are given, they will respond accordingly and the strategy will progress. The converse is also true: if a company ignores the need to get people working in a way that is consistent with the strategy, progress will be haphazard at best.

Gain people's emotional commitment to the strategy

Any strategy, however brilliant, will fail unless people understand it and are emotionally committed to its success. Therefore it is crucial to explain why the strategy is important to the organisation and the individual.

Be open to strategic ideas wherever they originate

Although the top people must decide a company's strategy, there is a mistaken view that only they can develop strategic ideas. Ideas can come from anybody, anytime, anywhere.

Keep the strategy flexible

All ideas are good for a limited time, not forever. Continually question the answers to the "who, what, how" questions. Strategy should not be changed too often, but it will require adjusting to altered circumstances. Give employees the freedom to respond and to adjust without waiting for permission or instructions.

Most major businesses recognise the need to empower their