1

PERSISTENT WINNING AND LOSING

Many companies perform better than their competitors for short periods of time, but few are able to sustain competitive advantage over a long period.[1] *Saks, for instance, provided investors with a return of 28 percent in 2003, but its average annual return over 1993 to 2003 was just 3 percent. Similarly, Supervalu's stock rocketed up 78 percent in 2003, but over 1993 to 2003, it earned just 8 percent per year.*

Natural parity is the condition that prevails in most industries. Dow Chemical, Du Pont, and Rohm & Haas, for example, delivered virtually the same average annual return to investors—between 10 and 12 percent—from 1993 to 2003. Kroger's 14 percent average annual return to investors from 1993 to 2003 was little different from Safeway's 15 percent.

Dominant winners and losers are rare. Companies that consistently achieve sustained competitive advantage and disadvantage are outliers. Any firm can have a few good years, but for it to continue in its winning ways is difficult.

Hitting the mark means being a dynasty, not just having a few good years. Sustained competitive advantage (SCA) is "long-term profitability" or "above average performance in the long run."[2] *It is long-term return on invested capital better than your competitors. In contrast, sustained competitive disadvantage (SCD) is long-term return on invested capital that is poorer than your competitors.*

01_marcus.qrk 8/23/05 8:53 AM Page 4

From 1992 to 2002, only about 3 percent of the 1,000 largest U.S. corporations consistently and significantly outperformed their industry's average stock market performance, and about 6 percent did the opposite. Table 1.1 lists companies that meet these criteria. Figure 1.1 shows how an investor would have fared had the investor put money into firms that hit the mark as opposed to those that missed it. (Chapter 2, "Companies That Hit and Missed the Mark," explains in more detail how these companies were chosen.) Surprisingly, the high performers were not regularly cited in popular business books or the media as exemplars. They often operated under the radar, and their stories have not been told until now.

In this book, I take a close look at these companies. I examine what they did to be big winners and losers. I compare the big winners and big losers and uncover the traits that led to their success and failure.

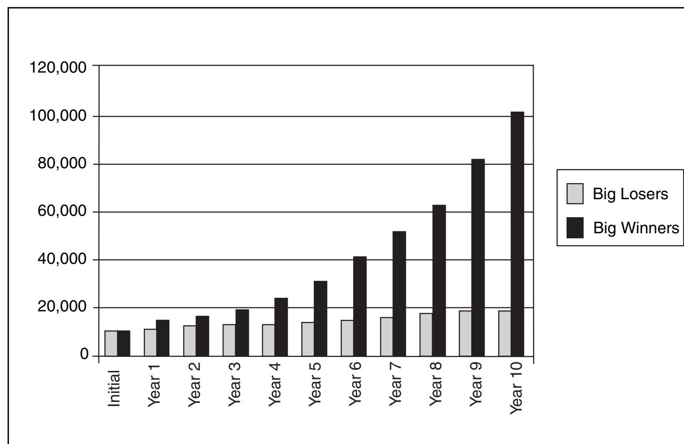


Figure 1.1 1992 to 2002 average earnings from investing in big winners as opposed to investing in big losers, assuming an initial investment of $10,000.

Table 1.1 Sustained Competitive Advantage and Disadvantage, 1992 to 20026*

9 Comparisons	18 Companies	5-Year Average Annual Market Return (%)	Sectors
Advantage	Amphenol	34.0	Technology
Disadvantage	LSI Logic	3.4	
Advantage	SPX	28.8	Manufacturing/appliance
Disadvantage	Snap-On	1.7	
Advantage	FiServ	31.2	Software
Disadvantage	Parametric	–21.2	
Advantage	Dreyers	22.4	Food
Disadvantage	Campbell Soup	–2.8	
Advantage	Forest Labs	58.5	Drugs/chemicals
Disadvantage	IMC Global	–18.7	
Advantage	Ball	23.9	Manufacturing/industrial
Disadvantage	Goodyear	–11.5	
Advantage	Brown & Brown	48.7	Financial
Disadvantage	Safeco	–1.0	
Advantage	Family Dollar	36.1	Retail
Disadvantage	Gap	9.8	
Advantage	Activision	24.1	Entertainment/toys
Disadvantage	Hasbro	–0.1	

A Sweet Spot

Winners had four qualities that led to their success. First, they were in a "sweet spot." This is a position that is so unique that they had virtually no competition.[3] Winners occupied a space that few other firms occupy. If you are in this position, you are better able to control the classic five industry forces—suppliers, competitors, customers, new entrants, and substitutes—that impact the success of your business.[4] If your company is in such a position, it is essentially a category of one, or nearly so. If your company remains as such for a considerable period, it is better able to achieve sustained competitive advantage. It offers customers something rare, hard to imitate, valuable, and nonsubstitutable.[5] It gives them something of great value that few other firms provide.

01_marcus.qrk 8/23/05 8:53 AM Page 6

The claim that is sometimes made is that just four good spots are worth occupying. (See Figure 1.2.) A company can be a (i) narrow or (ii) broad cost leader or a (iii) narrow or (iv) broad differentiator. The conventional wisdom has been to occupy one of these four positions and avoid the middle. The middle is supposed to be a compromised position, where a firm's products or services are in no way distinct.

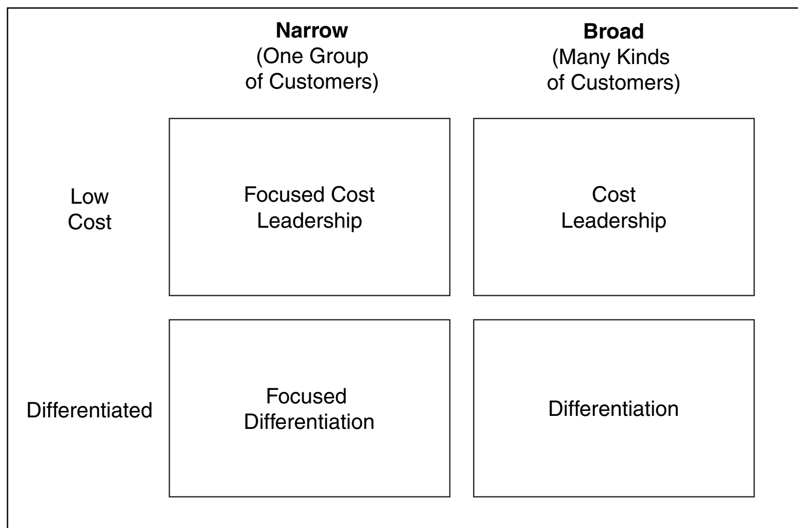


Figure 1.2 Four generic strategies.

But many companies today have moved to the middle. The position they occupy is one of best value. They combine low cost and differentiation in attractive, value-for-the-money packages. Among the examples of firms that have moved in this direction, Toyota is still one of the best. It sells inexpensive cars like the Corolla that don't have the maintenance and safety problems of earlier U.S. counterparts, such as the Corvair and Pinto. Along with other Japanese manufacturers, Toyota has demonstrated that inexpensive cars can be built well, be safe to drive, and last for years. Similarly IKEA, the Swedish retailer, has a business model based on the concept of "democratic design"—furniture that is not only inexpensive but also attractive, high quality, and extremely functional.

Agile, Disciplined, and Focused

Finding and exploiting a sweet spot means combining low cost and differentiation in striking packages that bring together exceptional value. But companies that achieve sustained competitive advantage do not just occupy sweet spots. Three other attributes are necessary for companies to be long-term winners. They must be agile, disciplined, and focused. They combine position, movement, hard-to-imitate capabilities, and concentration in hard-to-imitate packages. Agility brings these companies to sweet spots, discipline allows them to protect and defend these spots, and focus enables them to exploit the spots.

The companies that miss the mark, in contrast, migrate to or are stuck in contested or sour spots. These companies are rigid about not abandoning these spots, inept in defending and protecting them, and too diffuse to fully exploit them (see Table 1.2).

Table 1.2 The Four Secrets of Long-Term Business Success and Failure

Attribute	Advantage	Disadvantage
1. Position	Sweet spot—Being in an uncontested space	Sour spot—Being in a contested space
2. Movement	Agility—Getting to an uncontested space	Rigidity—Not getting to an uncontested space
3. Hard-to-imitate capabilities	Discipline—Protecting an uncontested space	Ineptness—Inability to protect an uncontested space
4. Concentration	Focus—Exploiting an uncontested space	Diffuseness—Inability to exploit an uncontested space

Sweet spots attract swarms of competitors. Other firms quickly move in and try to occupy the same ground. If you are in such a position, you have to have the discipline to protect it.

You must be agile to compete, but agility by itself is not enough. You must be in a position you can defend. Andy Grove recommends that companies must be "agile giants."[7] They have to have the agility to move quickly to new competitive ground, but once they occupy that ground, they must be giants who are capable of defending it. They must be able to take on all comers. A classic example of a firm unable to protect the position it occupied was Netscape.[8] In 1997, at the height of the browser wars, this company had close to 90 percent of the market. One year

later, its market share was down to less than 50 percent. At first, Microsoft more or less ignored Netscape. But in December 1995, Bill Gates proclaimed that Microsoft was going to be "hard core" about the Internet. Gates was determined to break Netscape. Netscape's executives taunted Microsoft and were not prepared for Microsoft's resolve. They moved into a sweet spot but could not defend it.

Successful firms not only have an uncanny ability to move into attractive spaces, but also the discipline to protect these spots. As Porter has written, "The corporate strategist's goal is to find a position in the industry where his or her company can best defend itself."[9] Without an adequate defense, occupying a position does you little good. Movement for movement's sake gets you anywhere. You have to move to a spot you can defend.

Winning is not about achieving one-time gains. It is too demanding and difficult for this. It also does not involve digging in and defending a position against all odds. A stagnant and defensive stance where your sole aim is to protect the spot you occupy also has its limits. After you have identified, occupied, and fortified a position, you must take full advantage of it. You have to really focus on it. Of course, that takes discipline, but it is about more than discipline. You have to reap all the benefits that the spot you occupy has to offer. Focus is the ability to extend the scope and breadth of a sweet spot and reap all the benefits it has to offer. Winning companies are uniquely focused in comparison to losers. Losers never seem to find something upon which to center their attention.

This book shows you that the way to be a big winner is to identify a sweet spot with value to customers that no one else exactly provides, to move into it (be agile), to protect it (be disciplined), and to extend it (be focused).

A firm must possess all these qualities. (See Figure 1.3.) It must be *agile*—not entirely bound by the past, but free to reinvent itself for an uncertain future by moving into new territory. It must have the *discipline* to cultivate the strengths and competencies it needs to protect the space it occupies. Also, it must have the *focus* to define and expand that space. To achieve sustained competitive advantage, you must be more

01_marcus.qrk 8/23/05 8:53 AM Page 9

than agile. You have to have momentum to keep moving, and you must defend where you are at. You also must be expansive and be able to deepen and expand the space you inhabit.

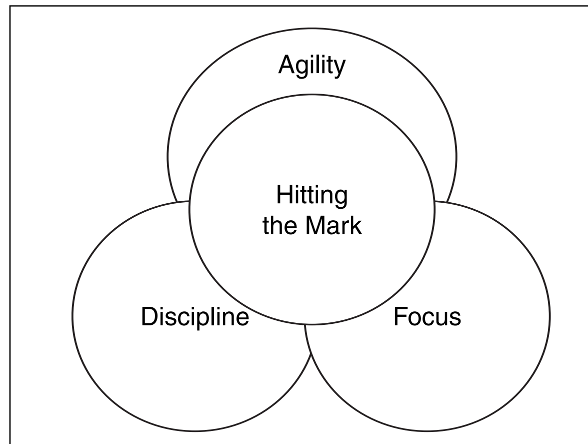


Figure 1.3 Big winners hit the mark.

To be a big winner, you must understand what you stand for; otherwise, you'll fall for everything. Say yes to some possibilities and no to others. Winning firms do not deviate from what they do best. They choose an area where they have comparative advantage and stick to it. They take full advantage of it. They have the agility to find a sweet spot, the discipline to protect it, and the focus to exploit it. Losing firms have the opposite characteristics—rigidity that leaves them in a contested or "sour spot," ineptness, and diffuseness.

These traits are complicated to develop in a single company. They contradict one another. They must be woven into patterns that are hard to copy and especially valuable because they are complex and distinctive. The characteristic patterns of the winners and losers are explored in subsequent chapters. Appendix D, "Patterns of Winning and Losing Companies," is a summary of these distinctive patterns. This book will help you understand how your company measures up. What are its strengths and weaknesses? Is it in a sweet spot? Does it have agility, discipline, and focus? If it is in a sour spot and is rigid, inept, or diffuse, what can it do to improve?

Managing the Tension

There is built-in tension to hitting the mark. **Agility** means maintaining the flexibility to change direction quickly, whereas **discipline** and **focus** imply the opposite—digging in, reinforcing, and securing a space, and refusing to budge or give it up until all the benefits have been reaped. The tension between agility on the one hand and discipline and focus on the other has to be managed creatively.[10] If managed well, you have realized one of the rarest, most valuable, and hardest-to-reproduce capabilities that your firm can possess. (See Table 1.3.)[11]

If the tension among agility, discipline, and focus is not managed well, you might have a disaster on your hands. An example of a company that did not manage this tension well was Xerox. The personal computer (PC) revolution came about because of innovations made in the 1980s at Xerox's Menlo Park research division.[12] Prior to the 1980s, its research division pioneered in almost all the building blocks that went into the PC, from the mouse to the printer. Years after Xerox played a substantial role in inventing these devices, it still was in the copying business. It saw no profits from these efforts. It did not have the agility to move to a new position.

When you find a sweet spot, you cannot let internal politics keep you from taking advantage of it. You must move into the space and occupy it. If you know about a sweet spot and do nothing, what good have you done?

Managing the tension among agility, focus, and discipline is paradoxical. To be successful, you have to explore for new territory, but you also have to exploit the ground you currently hold.[13] You have to prospect for new businesses while defending the positions you presently occupy.[14] You have to be a constant analyzer on the lookout for new ground to occupy, while protecting the spaces you currently hold. Doing all of this well and at the same time is a formidable undertaking that strains even the best management teams.

It is rare for a company to be able to do all of this simultaneously. Thus, it is rare for companies to persist in their winning ways for long.

Keep in mind that your firm is always operating in a state of tension between what it is now and what it is trying to become. Thus, you must

have a mission that expresses pride in what your firm has been good at in the past and a vision that serves as a roadmap for where you would like to go in the future. You are constantly tugged and pulled apart by the poles of what you have been, what you are good at and what got you to where you are today, and what you would like to be.

Future conditions are unclear, and you need to have options for whatever contingency arises. If you want to achieve sustained competitive advantage, you must keep at least three horizons in the forefront simultaneously. You have to defend your core business, build emerging businesses, and create real options for future growth. [15]

Table 1.3 Big Winners Manage the Tension Among Agility, Discipline, and Focus

A Sweet Spot	**Agility (Move)**	**Discipline (Protect)**	**Focus (Extend)**
Goal	Achieve growth	Enhance profits	Realize profits and grow
	Innovation	Efficiency	Reform and refinement
	Reinvention	Operational excellence	Fine-tuning
Actions	Explore	Exploit	Explore and exploit
	Prospect	Defend	Analyze
Strategies	Vision	Mission	Mission-vision
Conditions	Disequilibrium	Equilibrium	Equilibrium-disequilibrium
Technologies	Disruptive	Sustaining	Sustaining-disruptive
Industries	Dynamic	Static	Dynamic-static
Image of the Future	Unpredictable	Like today	Gradually evolving
People	Revolutionaries *Break rules*	Controllers *Enforce rules*	Improvers *Fix rules*

Creating future options is where agility plays its primary role. It means building emerging businesses. Discipline means sharpening what you currently do best, while focus means reaping the full benefits of the activities in which you are currently involved. An example comes from the automotive industry. A company today must concentrate on the internal combustion engine and its associated technologies to meet current profitability goals. It has to have the discipline to do so efficiently and effectively. The competition in today's markets is brutal. But an

01_marcus.qrk 8/23/05 8:53 AM Page 12

automotive company must go beyond today's technologies and start to market hybrids that combine current technology with lighter and more aerodynamic materials, electric engines, and regenerative braking. And even this is not enough. A company must look further into the future and be open to a different tomorrow by undertaking research and development on hydrogen-based fuel and fuel cell technologies. An automotive company must consider these three horizons simultaneously and manage them concurrently, but concurrent management is not easy.

Concurrent management is a juggling act of immense proportions that helps to explain why being a big winner is so hard. You want to thrive today and plan for tomorrow and for the day after.

Winning companies put together the attributes of agility, discipline, and focus into larger wholes that allow them to function well today and to plan for tomorrow and the day after. Losing companies combine rigidity, ineptness, and diffuseness, which make it impossible for them to do well today, tomorrow, or the next day.

Real Trade-Offs

Winning firms face real trade-offs. For example, if a firm is agile, it must be constantly ready to move. It has to be able and willing to abandon the space it currently inhabits for something better. If it is disciplined, on the other hand, it foregoes the capacity to rapidly morph into something else. If it is focused, it deepens its commitment to the space it currently occupies.

Of the 1,000 largest U.S. firms from 1992 to 2002 (see Chapter 2), only about 3 percent were big winners. Another 6 percent did the exact opposite—they endured the pain of regularly losing. The ability to manage the tension of moving, protecting, and extending a sweet spot is hard. If it were easy, everyone would do it, and it would be of little value. The fact that it is so hard to do is the best indication of the contribution it makes to the creation of enduring advantage. Because enduring advantage is so uncommon, it is very difficult to do.

The problem has been that until now, gurus of one sort or another have put too much emphasis on just some of these qualities—either agility or discipline and focus. (See Appendix A, "Best Sellers Compared.") Yet the truth of the matter is that you must do it all. Excessive movement and excessive staying put are not the way to stand out. Too much agility would be just as problematic as too much discipline and focus. Distinction comes from achieving the right balance. It derives from properly managing this tension.

Winners achieve sustained competitive advantage a step at a time by cultivating qualities that capture aspects of agility, discipline, and focus. They fashion unique patterns of these attributes. Losers, on the other hand, engage in the opposite process. One by one, they accumulate the negative qualities that lead to their demise.

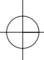
In Summary

Achieving sustained competitive advantage is not easy. You cannot dismiss any element. A sweet spot, agility, discipline, and focus are essential. Although managers might be able to identify future opportunities, few have the agility to move into them, the discipline to protect them, and the focus to take full advantage of them.

The firms that hit the mark showed an uncanny ability to do all this. One by one, they built an ensemble of positive traits. When the traits came together, they had a powerful force. Similarly, the losing firms took individual steps that fused together patterns of rigidity, ineptness, and diffuseness that were a deadly combination.

The next chapter describes how the big winners and losers that were analyzed were selected. The four factors that led to their success are discussed in Chapters 3 through 7. Then I turn my attention to the losers. The traits that led to their undoing are described in Chapters 8 through 12. The conclusions in Chapter 13 are based on a comparison of the successful and unsuccessful firms. This chapter is a coda of best practices for hitting the mark. You can use it to assess your own firm (or perhaps use it to choose a portfolio of firms in which you want to invest). The final chapter touches on turnarounds—sweet and sour

01_marcus.qrk 8/23/05 8:53 AM Page 14



companies that changed course. It explains what you have to do to start a take-off and avoid a nosedive.