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STRATEGY

HOW TO CREATE, PURSUE AND
DELIVER A WINNING STRATEGY

FOURTH EDITION

RICHARD KOCH

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Ashridge Strategic Management Centre Director

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deliver a winning strategy

Fourth edition

Richard Koch

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Richard Koch is the author or co-author of 20 books, including the bestselling 80/20 trilogy – *The 80/20 Principle*, *The 80/20 Individual* and, most recently, *Living the 80/20 Way*.

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Other books authored or co-authored by Richard Koch

Superconnect

The Star Principle

Simply Strategy

Suicide of the West

The Breakthrough Principle of 16×

Living the 80/20 Way

Smart Things to Know About Leadership

The 80/20 Individual

The Power Laws of Business

Smart Things to Know About Strategy

Moses on Leadership

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Managing Without Management

The A–Z of Management and Finance

The Financial Times Guide to Management and Finance

The Financial Times Guide to Selecting Shares that Perform

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Foreword

This is a good time to be a strategist. We have seen the disasters that can result from following the herd or from letting profit alone lead managers forward. Both approaches contributed to the bankruptcy of many companies and the near destruction of our financial system.

One solution is more controls: tighten the guidelines so that even the blind cannot stray off the path. This is what the financial regulators are trying to do. We know from history that this approach cannot work. The only other solution is better quality strategic thinking. Strategists must start to stand up and be counted: to shout 'bullshit' when strategically weak proposals are made, to have the courage to challenge poor logic even in the face of good profits and to demand clear strategic reasons for major business investments.

About fifteen years ago, I wrote an article titled 'Boo if you hear someone propose balance'. At the time, 'balance' thinking was undermining success. Leaders were trying to balance their portfolios in terms of cash generating and cash consuming businesses. They were trying to balance geographically across Europe, Asia and the Americas. They were trying to avoid having all their eggs in one basket, with such intellectually demanding strategies as the third leg of the stool or the fourth leg of the chair. I even recall Shell having a 'sixth leg' strategy at one point. These seemingly sensible ideas still get traction today and still crowd out quality thinking.

So, what is quality strategic thinking? Happily, Richard Koch lays it out for you, and not in a dry plodding way, but in an exciting, even breathless, way. He points out that business is a war of strategies, where the few good strategies win and laggards fall by the wayside. Strategy is the friend of the customer, the manager and the shareholder. In fact, strategy is the friend of economic growth. For those trying to win customers and earn high margins, strategy exposes a two-edged sword, wonderful if you are on the right side of it, lethal if not.

As Richard Koch shows, strategic ideas and the practice of strategy are alive and strong. The foundations have been well laid. Resource-based theory,

the dominant tautology, provides firm ground on which to build: you will not be successful unless you have some skills or assets that are superior to those of competitors. Better to build your strategies around the resources you have than around the glittering opportunities that you see or around ideas like balance.

These strong foundations have spawned vibrant and varied thinking about strategy in universities, research centres, business schools and consulting firms. Koch guides you through the profusion. Whether it is micro-economics, the boundaries of markets, the dynamics of competition or new ideas from biology, mathematics, sociology, psychology, and the science of networks, this book opens the door. Some of the new ideas are well tested and grounded. Other ideas are fertile yet unproven, and others again are frankly snake-oil, complex rearrangements of half-truths to create a fresh but fallacious matrix or methodology that panders to bosses' biases. Some new approaches are highly practical and can be used by any manager; most are not.

Koch also understands that we are all human. Our brains are not computers. While we can be intuitively brilliant, our thinking is also often distorted by our subconscious. Hence we need powerful ways of checking and challenging the urges and ideas that emerge from our intuitive processes. Unless we educate our neo-frontal cortex with the right frameworks and rationales, we are little more than skilled cavemen reacting to events as they unfold.

Koch's flair and willingness to talk straight show how exhilarating it can be to craft a strategy or to transform – with trial and error, with sensitivity to customers and other stakeholders, and with a degree of luck and humility – the shape and performance of a business. What readers get is strategy stripped of its jargon and baggage, and explained in a simple and appealing way.

May this book educate and enthuse you. But never forget that there are no simple ways of developing a good strategy. If there were, all businesses could succeed. Strategy work is creative. Some will find a winning path. Others will not. Happy strategising!

*Professor Andrew Campbell
Director, Ashridge Strategic Management Centre
London, April 2011*

Preface to the fourth edition

I'm delighted that this very simple guide to one of the most important forces in the universe – the strategy of *individual* businesses, the creation of new wealth from raw materials that nobody else thought to use that way before – has made it to a fourth edition. And I'm even more pleased that the strategy area is alive and well, with more exciting new thinking in the past five or ten years than in the previous twenty – far more than I ever expected, with no signs of drying up.

What is different?

There's been a large amount of new material on strategy published since the last edition, and I have assiduously trawled it all, sorting the insight from the snake-oil. This has led to telling revisions throughout – about a third of the book has been changed. To get a snapshot of the changes and what doesn't need to be changed, you might want to start by reading Chapter 4 of the Introduction – What's New and Useful in Strategy?

At the same time as new approaches and ideas have added a great deal of depth and range to strategy, I have become more and more convinced, along with some of the best strategists in the world, that the primitive approaches based around understanding where and why a firm makes very high returns in certain products and serving certain customers hold the key to strategy. So as well as bringing you a synthesis of all the best new work – especially from outside disciplines such as psychology, sociology and network science – I keep returning throughout the book to the old verities, and to a deeper and deeper understanding of them. As reflected in Chapter 5 of the Introduction – Towards a Synthesis – one of the great and most rewarding challenges is to understand your core customers, and what they like about your products and the firm, more with each passing day. But who are your core customers? You may be surprised when you find out – and you will certainly be in a hugely better position to take the business forward.

Apart from updating the text throughout, I have completely reworked Part 3, Strategic Thinkers, and Part 4, Strategic Ideas – Concepts, Tools and Techniques. One hundred and fourteen of these essays are different – 34 are substantially revised, and 80 are completely new. The entries are organised alphabetically so you can get the gist of any strategic subject quickly and conveniently. I also recommend trawling at random through Part 3 and Part 4 when you have a spare moment – and wise strategists, in contrast to most of their colleagues, always ensure they have time to think. I've tried to include everything that is valuable regarding strategy, including salient tactical issues such as marketing, and vital but rather miscellaneous issues such as what is ambiguously called 'globalisation', or the role of board members and the importance of strategy in their work. I've also aimed to inject into these essays everything that any eminent and distinctive strategist has highlighted, and everything I know that is useful and insightful about strategy, based on the experience of (the good Lord help me) four decades as a manager, strategist, entrepreneur and investor, and the passion that all good strategists bring to their work. Please do browse through the essays in short but frequent sessions. I dare to say that you will find inspiration there for all the strategic challenges you face, and every opportunity you are presented with – provided you notice when it crosses your path. I hope you will return again and again to these sections when you have a little time – just ten minutes reading an entry or two can refresh your day enormously, and may even provide the answer to the problem with which you are grappling.

How can you best use this book?

The short Introduction sets the scene – why strategy is valuable, how it's developed over time, what's new in the past few years and what's of enduring importance.

Part 1 describes strategy for an individual business – in the jargon, Business Unit Strategy. Through using a story – a real-life example, slightly disguised to protect the guilty – it gently explains all you need to know about how to develop a great strategy for a single business.

Part 2 deals with Corporate Strategy – what happens at the level of a *whole firm* that comprises more than one individual business unit. A large corporation may have dozens or even hundreds of business units. The question becomes, what does the Centre of the company add or subtract? Would it be better if some of the businesses were owned by another firm? What skills and assets does the firm have that are rare and better, in certain

markets, than those of any rival firm? What is the real core of the company – its core customers, products, markets, heritage, strategically valuable resources – its heart and soul? This, I suggest, is an *ecological* question involving both the ‘inside’ and the ‘outside’ of a firm. Any company is ideally suited to certain terrain, certain customers, certain products and technologies, and a certain unique way of doing business where the ‘inside’ and ‘outside’ resonate in exciting ways. Finding the true core of a firm is a voyage of discovery that never ends – the firm can always find better terrain and serve customers and collaborators, as well as employees and owners, in a way that constantly gets better and better and that no other firm can do as well. Firms thrive because they are *different* from other firms and make a unique contribution to the world. Conversely, they do not thrive if they aren’t really different and don’t add unique value.

Part 1 is best read when you are trying to devise or revise strategy for a single business, and Part 2 when you are doing the same for the total firm. Parts 3 and 4 are different. They are a series of essays, organised alphabetically, and, in contrast to Parts 1 and 2, are not meant to be read straight through. *Part 3* deals with the most intriguing strategic thinkers, the people, dead or alive, who have made the greatest contribution to the science and practice of strategy. *Part 4* deals with strategic ideas – concepts, tools and techniques. Parts 3 and 4 can be used for reference purposes, when you want to know more about a particular person or topic, but I also suggest that you dip into these sections at random whenever you have a few minutes to delve into them and indulge in a spot of strategic daydreaming. You should derive benefit of some kind from a few minutes’ reflection – please surprise yourself and see how surfing these pages can often unlock a puzzle that you are grappling with in your daily work. Cross-referencing to names and terms discussed in Parts 3 and 4 is indicated throughout the book by the use of SMALL CAPITALS.

If you are new to this book, I’d even suggest *starting* by flicking through Parts 3 and 4 to whet your appetite for the rest of the book. Just let your eyes pick up topics that you find interesting. Or you could start by reading the following entries as another introduction to strategy:

- In Part 3, the essays on Andrew Campbell, David Collis, Cynthia Montgomery, Philip Rosenzweig and Chris Zook
- In Part 4, the entries on Coherence, Competing on Resources, Core, Core Customers, Free Customers, Globalisation, Innovator’s Dilemma, Loyalty, Net Promoter Score, Network Effect, Network Star and Three Ways to Compete.

I promise scanning those articles will get your creative juices flowing!

That's enough throat-clearing from me. I've really enjoyed making the extensive revisions to this book and hope that both new and old readers will come to share my enthusiasm for and pleasure in the strategic feast that follows, and that it will inspire you to create a better world.

Richard Koch, 2011

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Thanks to everyone named in the earlier three editions for your help – you know who you are and I'm as grateful now as ever.

I'm greatly in debt to Andrew Campbell – possibly the best strategist in the world – for providing such a perky Foreword, and all the other assistance and hints in making my extensive revisions to this book.

In case readers are a little weary of Andrew and I saying what a good chap the other one is, let me also highlight the advice and insights generously provided directly to me by Marcus Alexander, David Collis, Michael Goold, Peter Johnson, Greg Lockwood, Simon Newman, Chris Outram, Jamie Reeve, Fred Reichheld, David Sadtler and Chris Zook, as well as by three other strategy experts who wish to remain anonymous but provided great help. These are all eminent and busy professors or professionals in great demand and I am humbled that they thought it worthwhile spending time to make this a much better book than it would otherwise have been. Of course, none of them would endorse everything I say here, and any eccentricities of judgement and errors that have slipped through the net are entirely mine.

I'm also lucky to have such an excellent editor as Dr Liz Gooster at Pearson who has again masterminded the publishing process and made it so simple for me. Deep personal thanks are also due to Matthew Grimsdale and Francisco Martins for encouragement and practical support throughout.

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Swings in strategic thinking: seven phases

The *first* focus, at the end of the 1950s and in the 1960s, was on the best way to plan the development of large, multi-product firms. This was the province of *classic strategic planning* at the Centre, although the dominant prescription was to decentralise into largely autonomous divisions, and to diversify by making acquisitions in attractive but often unrelated businesses.

The *second* and most fruitful period, roughly from 1965 to 1975, was that dominated by BCG and its concept of *portfolio management*. BCG's micro-economic approach was highly prescriptive, telling firms to:

- focus on business positions where the firm had, or could realistically obtain, market leadership
- divest other businesses
- focus on cash rather than profit
- aim for cost advantage over competitors (i.e. have lower costs than them)
- manage competitors so they would withdraw from the firm's key profit segments
- use debt aggressively to finance growth, reinforce market leadership and raise returns for shareholders
- avoid overextending the product line or building in too much complexity or overhead
- use excess cash flow to diversify and apply the precepts of portfolio management to a new set of businesses.

BCG's ideas encouraged two already established and related trends: towards building up large central planning departments in conglomerates and towards further diversification. Neither of these was central to BCG's view of the world, yet both came back to haunt strategists later.

The *third* phase, the mid to late 1970s, was one of intellectual exhaustion, corporate disillusion, and a retreat into pragmatism on the part of the strategists. By now it was clear that the micro-economic techniques for analysing competitive advantage were very powerful. They were increasingly used, however, not at the level of central Corporate Strategy, but for developing *Business Unit Strategy*. This was partly because the earlier promise of central portfolio management became increasingly discredited. After the oil price shock of 1973 and the stock market crash of 1974, which hit go-go conglomerates particularly hard, the virtues of both central planning and conglomerate diversification became seriously tarnished. Furthermore, firms like GE and Siemens that had established huge central strategic planning departments soon found the results from these bureaucratic behemoths profoundly disappointing. Intellectually, the GROWTH/SHARE MATRIX, the icon of portfolio management, came under sustained attack. The assault was largely misconceived, but BCG chose discretion rather than valour. The BCG MATRIX went largely undefended and became unfairly neglected.

The *fourth* strand in strategic thinking, stretching from 1973 to the present, was a mild dose of heresy, a wave of reaction to the excessively analytical orientation of the Boston school. It involved a realisation that firms generally did not derive their strategies scientifically and rigorously, and a celebration of the intuitive, adaptive and creative aspects of strategy.

In 1973, Henry MINTZBERG challenged accepted thinking about *The Nature of Managerial Work*, pointing out that successful chief executives were intuitive action men, not reflective planners, that they cherished soft information and anecdotes rather than hard facts and figures, and that they read and wrote little, preferring face-to-face communication and decision-making. Mintzberg has since developed the idea of 'crafting strategy' using the creative, right-hand side of the brain, rather than the logical left side.

The 1980s also brought to prominence Kenichi OHMAE'S celebration of successful Japanese strategists: intuitive, creative leaders of Honda, Toyota, Matsushita and other firms, who were totally obsessed with establishing market leadership, beating competitors, and satisfying customers. The period from 1980 to 1994 has further consolidated the ranks of the *soft*

strategists, influential writers like Charles HANDY, Rosabeth Moss KANTER, Tom PETERS, Richard SCHONBERGER and Robert WATERMAN.

The 1980s also saw the *fifth* development: the strengthening of the rigorous micro-economics school of strategy, with the emergence of the Michael PORTER phenomenon. Porter extended the BCG framework of competitive advantage to include structural industry factors like the threat from new entrants, the bargaining power of customers and suppliers, and the threat from substitutes. His message, though based on additional data and analyses, was similar to that of BCG from the start: the firm should try to find markets and niches where it could dominate and erect barriers against competition, either by low cost or by product/service differentiation. Porter also built on early work by economists and strategy consultants and developed a theory of national competitive advantage to overlay or underpin the micro-economic analysis of individual firms' competitive advantage.

The *sixth* trend, from 1990, which I call the RESOURCES school, has been a new focus on a firm's skills and capabilities (generally called its 'CORE COMPETENCIES'), its ambitions and commitment ('STRATEGIC INTENT'), its ability to learn, its sense of mission or vision, and on the role of the Centre as the 'PARENT' of its operating businesses. Corporate Strategy is therefore seen less as overseeing the allocation of resources, and more as the definition, creation, stimulation and reinforcement of ambitious skills and capabilities that can then be applied across several market segments. The most important writers here include Gary HAMEL and C.K. PRAHALAD, John KAY, and the Ashridge trio Marcus ALEXANDER, Andrew CAMPBELL and Michael GOOLD, all of whom are profiled in Part 3.

The sixth phase reached its logical destination with a landmark article, 'Competing on Resources', by David COLLIS and Cynthia MONTGOMERY.¹ Although purporting to provide a new approach to strategy by combining the internally focus resource-based with the external market framework of Michael PORTER, this excellent article is best viewed as the culmination of the Resources phase and its coming to terms with external reality. Collis and Montgomery asked, 'What gives your company a competitive edge?' Their answer was 'your *strategically valuable resources*'. The resources could be physical assets, such as freehold stores when competitors mostly have to pay rent, or a great brand, such as Gerber in baby food, or capabilities, such as Southwest Airlines' 'culture of fun, family, frugality, and focus'. So far this was pretty much in line with what other resource-based writers had said. The breakthrough Collis and Montgomery made, however, was in going on to define strategically valuable resources as being those

which are better than those of any competitor or effectively unique, thus sneaking in the whole BCG/PORTER framework by the back door. Continental or United Airways, for example, might try to copy Southwest Airlines' routes, fast gate turnarounds, and low prices, but what they couldn't do was replicate Southwest's culture and its appeal to customers, because nobody could work out how the culture arose in the first place. Although they didn't call it an ECOLOGICAL THEORY, their article supplied the first base for the ideas on ecology that I have developed in Part 2.

From 1995 to 2011 we have reached a *seventh* phase, characterised by a wonderful welter of eclectic new ideas, the proliferation of strategy and its extensive use by front-line managers, and the importation of insights from other disciplines, including psychology, sociology, game theory, and biology. Strategy also grew up. The best strategists belatedly realised that strategy can never be absolutely definitive or certain, that there is always an element of groping in the dark, and that there is always serious risk involved in any seriously radical strategy. It's been said that history is always written by the victors, giving an unjustified sense that what happened had to happen. The same can be said of any celebrated strategy – the hindsight illusion is always present. Yet an appreciation of the uncertainty of strategy in no way diminishes its value or its fun. It just makes strategy a daily preoccupation of anyone in business. Each day we can learn something new, elaborating or slightly revising our business's strategy, while holding firm and deepening its source of competitive advantage and the skills and culture that appeal to its customers.

The seventh phase of strategy is so varied and interesting that I have devoted the next chapter to exploring it.

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