THE LIFE-STORY OF STRATEGY : Kim Warren

DRAFT Nov08

This document is a draft section for chapter 1 of the second edition of Strategic Management Dynamics [Wiley, 2008, 1st edn at www.wiley.com/go/smd]. Note this is aimed at new-comers to the subject of strategy, so works up from first principles.

Please respond to my blog post 'What is Strategy?' 20 Nov '08 at www.kimwarren.com.

More on strategy dynamics at www.strategydynamics.com.

Before trying to develop tools and frameworks for understanding and improving organizations' strategy and performance it will be useful to appreciate the wider perspective – what exactly *is* "strategy" and what is "strategic management"?

Although we can get very detailed and sophisticated about defining the term, it is sufficient for now to use a rather simple definition:

An organization's 'strategy' is how it tries to reach its objectives.

This seemingly simple definition is made up of some elements that have important implications for understanding what strategic management is all about. First, it requires that some 'objectives' exist and that people know what they are. Then, the question of 'how' those objectives are pursued splits into two parts – the position that the organization adopts relative to other organizations, and the various initiatives, policies and decisions it adopts as it moves forward through time.

'Strategic management', then, consists of three related activities:

1 *Choosing objectives for the organization*. Objectives may be financial, e.g. growth in cash-flow, or non-financial, such as a target number of customers. Unless an organization is in such difficulties that it seeks merely to survive, several aims can be pursued in parallel, e.g. growth in market share *and* profits. And some objectives may be constraints on others, such as increasing profits whilst not harming service quality. Non-financial aims are common in public service and voluntary cases, such as cutting rates of crime or reducing levels of hardship, but also arise in business cases. Airlines, for example, commonly have targets for passenger volumes, and telecoms firms have aims for numbers of subscribers. However, such aims are often linked strongly to revenue or profit goals. Objectives also evolve as we make progress towards them.

2 *Positioning the organization relative to others in its market or environment*. In business cases, this involves deciding which customers to serve, what products and services to provide, and how this will be done[i]. It is rarely best to try serving all possible customers in a market, so the strategic positioning involves targeting particular groups and their needs. Choice of what to offer is not limited to the list of products and services, but includes their characteristics – quality and performance, for example. The question of *how* this will all be done covers a variety of issues, for example the hoped-for price level relative to competitors, marketing messages intended to differentiate products from

alternatives, and what market channels to use – through stores or distributors, or direct to the final customer. Non-business organizations also make positioning choices. A charitable organization, for example, may decide to serve some groups of potential beneficiaries and not others, focus on providing a particular set of services, and do so by employing its own staff or by funding others to undertake the work.

3 *Steering the organization over time through the policies and decisions that affect its performance*. Having decided on a position where the organization might be successful in pursuing its objectives, management then has the *on-going* challenge of developing effective policies and making good decisions to steer its strategy and performance. Those decisions may be both large and infrequent, for example trying to enter a new market, or continuous and apparently small, such as what rate to hire people. However these apparently small decisions can have substantial implications for performance outcomes long into the future. Choices and decisions may be well-organized into a deliberate strategy, or may evolve as the organization reacts to events.

There will be much more to say about objectives, positioning and how strategy is steered through time, but only after we have described how these three elements operate together.

Although people at all levels and in all parts of an organization may have some influence on its strategy, it is easiest first to think in terms of a top-level individual or management team who develop and steer its strategy and try to ensure this leads to strong performance. Not every organization is explicit or deliberate about their strategy, but we will make a strong case that working out what might be best to do will more likely bring success than making things up as you go along. We will therefore lay out how strategy *should best* be done – taking what is known as a 'normative' stance – rather than devoting much attention to how strategy often *is* done – referred to as a 'positive' approach.

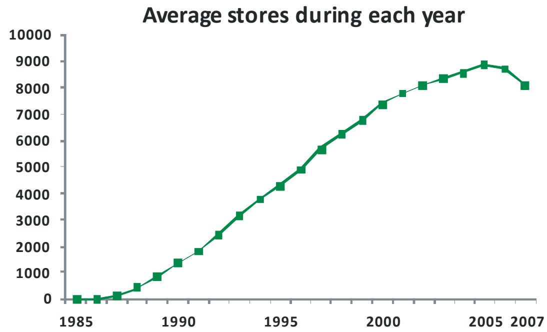
The three elements of strategic management listed above are most easily understood in the context of a commercial firm seeking to make profits for its investors. The study of how profit-oriented businesses perform in competitive markets has dominated research into strategic management for over half a century, and led to most of the tools and methods used by professionals in the field. However, other kinds of organization – public services, voluntary and other non-governmental entities, security forces, even criminal groups – have strategies too, the management of which also encompasses the three components above.

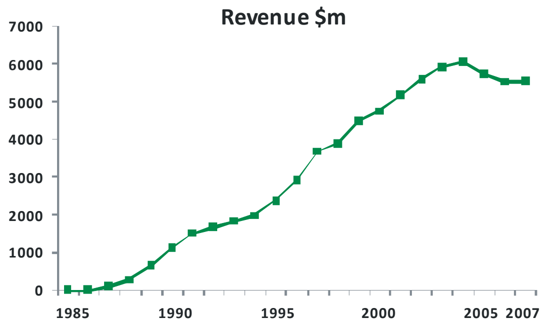
A life-cycle example: Blockbuster video rental

It will help clarify the contribution and relationship between the aspects of strategic management if we follow the story of an organization that could have lived right through its whole life, from start-up to closure. A suitable example for this purpose is the well-known video-rental business Blockbuster Inc[ii]. This company still survived by 2008, although had it acted differently in the past, this might not have been the case.

Video-cassette recorders [VCRs] became popular back in the 1980s and were the first devices allowing consumers to both time-shift live TV and buy or rent movies to view at home. This was before DVDs, before the rental market for computer games, before the internet made it easy to rent movies from home, and long before down-loading videos was any more than a distant dream.

Figure 1.1 shows the entire history of the company's store numbers, revenues and operating profits, from its start in 1985 to 2007. Let's look at how the three elements of strategic management above developed during the main phases of the company's life.





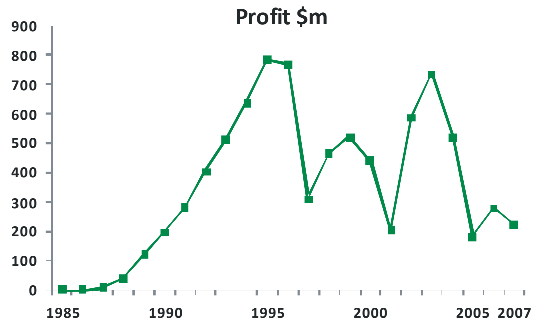


Figure 1.1: Blockbuster Inc performance history.

Start-up. Although the business adapted and extended what it does over the years, back in 1985, the founder David Cook identified an opportunity to offer consumers with VCRs the facility to rent movies for an evening or two, from stores located near residential neighborhoods. At the time, 30% of US households had VCRs, a fraction that was growing fast.

- David's *objectives* during that first year or two might have been to open, say, 20 stores each year, grow revenues to perhaps $50 million after 3 years and generate $10 million in profits.
- The *positioning* was to offer larger neighborhood stores with a wider range of family oriented movies than the many smaller mom-and-pop stores in the market. The business used smart IT systems based on a customer membership card for control and to ensure popular movies were available and so capture consumers and their rental spending.
- *Steering* the strategy required continuous decisions on the range of movies to offer, price levels, staff hiring and training, marketing spend and message and – critically, as for any retailer – the rate, location, size and design of new store openings. The business's rapid growth gave it strong buying power with the movie distributors, and hence low costs and early access to new titles.

If the business continued under David Cook's ownership and *nothing* changed about its strategy, it could well have delivered growth in stores, revenues and profits in line with the objectives above, and continued in that direction for many years. Even by the late 1990s, when DVDs were replacing video-cassettes as the preferred movie medium, the same basic positioning could still have worked. Even adding to the product range games titles for Nintendo, Playstation and other consoles made no significant difference to the basic value proposition offered to consumers.

We can therefore imagine a realistic alternative history in which the business could have continued right up to today with *no change* to its strategic positioning, and much slower growth, to a smaller scale, than in Figure 1.1. It would likely not have survived independently, however, since most small to mid-sized rental store chains were absorbed by larger businesses in the intervening years.

Growth. Blockbuster itself *was* acquired, but not merely to be absorbed into a larger group. Within just 2 years of its start, the business's potential led to its being bought for $18 million by Wayne Huizenga, an already successful entrepreneur. He saw the opportunity to expand strongly within the fragmented video-rental industry, and set about dominating major markets fast, by growing store numbers quickly over the next 8 years.

- The business *objectives* changed to reflect the new ambition. Growth targets increased to hundreds of stores per year, aiming for revenue of over $1 billion, and for operating profits of hundreds of millions of dollars.
- The business's *positioning* still did not change during this period. VCR-owning consumers continued to be the target customers, renting movies to view at home from neighborhood stores was still the core service offer, and the original successful operating system continued.
- Although the business positioning remained the same, this did not mean that its strategic management stopped. *Steering* the strategy continued to require on-going decisions on the same key decisions as before – product range, pricing, staffing and marketing – with just some minor changes to store design and branding. However, policy and strategy regarding which store locations to open and how to do it fast and effectively became still more critical.

The strategic management of the business during this period, then, did not feature any significant change of objectives or positioning, but was exclusively devoted to the third element – steering the strategy and performance from period to period. Three significant extensions were however added to the strategy during this period, each of which is an example of the occasional, large initiatives that also contribute to steering strategy.

1. Business growth was accelerated through adding a *franchising* scheme, in which independent store owners would invest up to $1million to open a Blockbuster store, using the firm's systems and marketing in return for a share of revenue.
2. The aggressive growth was supplemented by a determined program of *acquisitions*. Other significantly sized video rental chains could be bought up for a price that was attractive to the sellers, but which still made sense to Blockbuster because of the operating improvements, marketing impact and buying power of the ever-expanding network.
3. Lastly, the same successful business formula was copied *internationally*, with acquisitions in the United Kingdom, Australia, Japan and other countries.

By 1995, store numbers hit 4500, including 1000 franchised outlets. Nearly a third of the business was outside the USA. Revenues hit $2.4bn and operating profits $785m – over 30% return on sales!

Maturity. With everything going so well in 1995, how come profits stalled and then fell back so sharply between 1997 and 2001? There are a number of possible explanations.

- It could have been that the positioning and value proposition of the business no longer worked, perhaps because of some substitute service. It could also have been that stronger competitors emerged, offering the same service in the same way, but doing it better and on a large enough scale to hurt what was by now a very large business.

- This was also the era of explosive expansion of the internet – Blockbuster launched its own website in 1995, and 1997 saw the launch of Netflix.com[iii], a DVD rental service that allowed consumers to rent on-line from home and receive movies by post. Perhaps this created new pressures that hit Blockbuster's profitability?

Commentary from the time suggests that neither of these explanations were significant. Instead, the business suffered a serious loss of operational effectiveness, following its acquisition by Viacom and the departure of Huizenga as CEO. [*This is a useful warning of a common danger in corporate strategy – paying heavily for a business with strong profits growth, only to see that growth fail to be sustained. We will return to this issue in chapter 12*]. Although the fall in profits after 1995 looks rather severe, it is unlikely that the very strong profitability up to that point could have been sustained in any case. Blockbuster might have been the biggest, strongest player in the market, but it was far from alone, and would have struggled to sustain the price levels needed to maintain such high profit margins.

There were also new pressures from consumers – 1999 saw the day when the number of people online in the US first exceeded the number watching network TV. Watching TV or movies was not just competing for share of consumers' wallet, but share of their *time* too. But let's not mistake the early impact of Netflix and other internet-based services. Although extremely successful, its total revenues in 2001 were still only $74m, barely a rounding error compared with Blockbuster's $5bn.

What, then, might the three elements of strategy have been during the late 1990s and into the next decade?

- Blockbuster's *objectives* still focused on growing the store network and revenues, rather successfully it seems. Of course, the business kept trying to deliver profit growth as well as sheer scale, though conditions made that increasingly hard. When its profits dropped to just $310m in 1997, no-one realistically expected them to jump back over $700m the following year.
- The business's *positioning* <u>still</u> did not change significantly. DVDs replacement of video cassettes did not alter the basic value proposition, target market or operating model. Nor is it obvious that this choice of position *should* have changed. Apart from the Netflix-type alternatives, which Blockbuster did itself add to the business model, there were no obviously better strategic positions that management should have chosen during that period.
- Again, then, by far the dominant strategic management activity through this period consisted of *steering* the strategy from quarter to quarter. The new profitability challenges would have adjusted the focus of policy in some areas. The severe drop in overall profitability pushed some stores into losses, for example, so for the first time management had to look at rationalizing unprofitable stores, rather than exclusively focusing on new openings. Otherwise, policies towards product range, marketing, staffing and so on remained the major strategic management activities.

<u>Decline</u>. Figure 1.1 shows by 2007 the first signs of the final phase of strategy's life-cycle –

the possibility of decline and ultimate closure. This is not always inevitable, by any means, but this case shows how it can arise. Netflix.com revenue for 2007 hit $1.2bn – no longer a rounding error in Blockbuster's sales, and similar services from Amazon.com and others in the US and other markets took large chunks out of the company's store-based revenues.

Blockbuster's adding of a similar postal DVD-rental service from 2000 slowed the erosion of sales, but not sufficiently to prevent further profit pressures. Not only were profits hit by the simple loss of sales volume, but two other effects started to become severe.

First, the postal-rental market for DVDs became very price-competitive. If consumers only have one local rental store, there is little they can do to save money by switching to another provider. For internet-based services, on the other hand, choosing a lower-priced supplier is only a click away. Blockbuster and Netflix engaged in ferocious price competition in a desperate attempt to capture and hold on to consumers against each other.

Secondly, Blockbuster's long-term source of advantage – its stores – started to become a liability. It is very costly to operate retail stores, and profitability is only possible if they pull through strong sales. As revenues fall, the heavy fixed costs continue, pushing stores into loss, which explains the first signs of real contraction of the store network by 2007.

It is hard to see how this situation would not worsen further. Even if Blockbuster could fight off the threat from Netflix-type rivals with its own similar service, consumer behavior was moving relentlessly against store-based movie rental, so that part of the company's activity faced a slow death, with falling revenues pushing more stores into losses and closure. On top of that, improving broadband technology was making video-on-demand a practical reality, threatening not only its stores revenue but postal-service sales too. Indeed, there were doubts about Netflix' prospects too.

Nevertheless, a big strategic management job remained. We like to admire great strategic innovations, such as Netflix and, back in 1990 Blockbuster itself, but rather ignore the important and challenging task of managing businesses in maturity and decline. Better strategic management at Blockbuster from 1995 to 2005 could have sustained stronger profits. Going forward from 2007, strong strategic management could deliver a gradual rationalization of the stores, and a moderate decline in revenues and positive, rather than a disorganized collapse leading to early bankruptcy and liquidation.

Note, by the way, that for Blockbuster to move into the business of delivering movies on-line with video-on-demand does *not* remove the need for sound strategic management of the core stores business. Some senior executive will still be tasked with maintaining profitability in that declining segment, even as the company itself pursues efforts to cannibalize its sales, just as it had to do with its postal service. It is important not to under-value the contribution made by the skilled management of businesses in decline.

Strategic management: positioning vs. delivery

The Blockbuster story illustrates the major activities that make up the work of strategic management and the balance between them. One observation in particular stands out:

Choosing a strategic 'position' is a *very* rare event.

It should not be surprising that organizations do not often change their choice of who to serve, with what and how. If you have found a position that works today, something quite substantial must change for it to stop working tomorrow. If your positioning does *not* work, then you will need to find one that does, fast, before financial losses put you out of business. We certainly do not observe businesses – or indeed voluntary or public service organizations – constantly shifting their position, despite what you may read in business papers and journals about strategic innovation and transformation (not to be confused with product innovation, see chapter 6).

Blockbuster is far from unusual in featuring a strategic position that has remained essentially unaltered for decades. Its success in that position may have wavered in recent years, but apart from the one big shift, to a postal-service model, there is no case to be made that it should have significantly repositioned itself. Other businesses also demonstrate great longevity in their successful positioning. Low-fare airlines such as Southwest in the US and Ryanair in Europe have maintained a strategic position just as stable as Blockbuster.

Nor is this stability of strategic position limited to old business models. In the internet era, firms such as Amazon.com, eBay and Expedia quickly found and exploited a position that worked. They may have made small adjustments, such as Amazon's addition of affiliates into its business. They may also have added layer upon layer of extensions to their basic proposition – in Amazon's case by adding to their initial book-supply focus with moves into CDs and DVDs, followed by more and more products sufficiently valuable and non-perishable for their sales and delivery model to work. Nevertheless, what these and most successful businesses actually do is find a successful position, and then relentlessly drive it forward. They do *not* keep changing their minds.

This is not to say that the positioning question never recurs. It may be appropriate to evaluate a strategic position for either positive or negative reasons.

Extending strategy into new positions.

Businesses often see new opportunities, whether to serve new customers, to provide new products or services, or to deliver those in a new way. In most cases, such extensions of strategy are relatively small, compared with the existing business. Google's 2008 launch of a browser software may have some significant impact on that market, but will long remain dwarfed by the company's vast search-engine business. Europe's low-fare airline easyJet has added further low-price business models, in car rental, cruise-holidays, bus-travel and hotels, but all of these remain trivial, relative to the vast scale of its airline business.

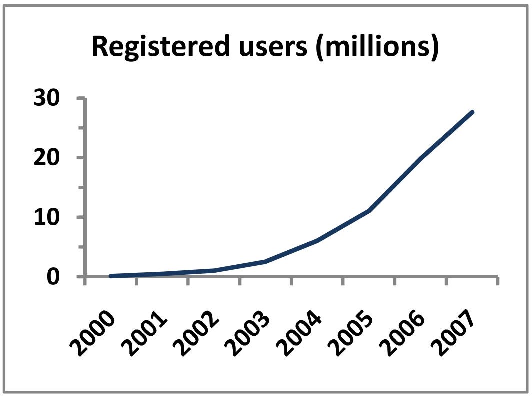
Extending into new positions may be achieved by acquisition or by organic internal development. In 2005, eBay chose to acquire Skype to strengthen its global marketplace and payments platform[iv]. Cisco Systems takes this mechanism much further, having acquired over 100 companies in its strategy development[v]. These two cases also highlight that success is not guaranteed – Cisco has benefited strongly over many years from this stream of purchases, while eBay's acquisition of Skype proved disappointing.

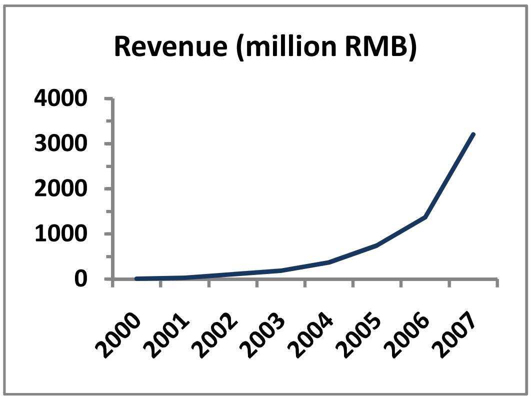
Alibaba.com[vi], in contrast, is an example of a company choosing to extend its strategic positioning largely by internal development, although some acquisitions have also occurred (see box).

Strategy extension at Alibaba.com

Alibaba.com started in 1998, offering eBay-like trading services to smaller Chinese firms who wanted to grow business globally but found existing options too expensive. In spite of the apparent potential from serving either consumers or larger firms, Alibaba maintained this focus on SMEs, and limited itself at first to simply connecting buyers and sellers. Having initially not charged for the service the company started selling advertising space and research reports to users in 2000, but revenues were still just $1million. It started charging for its core service in 2001, but its well-known quality kept membership climbing, passing 1 million in 2002 (Figure 1.2).

From this focused start, however, the company was able easily to extend its activities in several directions, first establishing a within-China service in the local language, but then making a major thrust to develop business-to-consumer (B2C) and consumer-to-consumer (C2C) services, taking eBay head-on. By 2007 the group was serving 24 million users and had effectively sealed victory over eBay, who exited the market.





Avoiding threats to an existing position.

The Blockbuster case illustrates two major examples of such threats – [a] the emergence of postal-service substitutes to its store-based proposition, then [b] the increasing viability and availability of online streamed delivery of movies and other media content. Management has no choice under such circumstances except to review the viability of its established position and look for ways to add or even substitute a new choice of strategic position. Technology changes are not the only source of such threats. Powerful new competitors can also force a rethink, sometimes a withdrawal, or else an effort to replicate the challenger. Many established airlines, such as British Airways and American, started up low-fare operations in response to the burgeoning growth of Southwest, Ryanair and the like. Others simply withdrew from the short-haul routes these innovators threatened.

Occasionally, the threat to a strategic position may be so serious that it is ultimately abandoned. This has certainly been the fate of many store-based travel agencies and music stores, and may yet be the fate of Blockbuster's stores. If Blockbuster is lucky and strategically well managed, it *may* be possible to implement an on-line video-supply service, although the technological discontinuity may be so severe as to make it impossible to win in this effort against different rivals with other advantages. It is not clear, for example, why the movie studios need intermediaries such as Blockbuster or Netflix at all if technology allows them to supply consumers directly.

Although very rare, it is not completely unknown for organizations to move to a substantially different strategic position, though the process can take some time.

- For the first half of its 140-year life, cell phone maker Nokia was a paper producer before moving into rubber products, then cable manufacture. Its move into telecommunications only really started in the 1970s[vii].
- To take a contrasting example, UK brewing companies had until 1980 been mostly vertically integrated[1], owning the distribution and retail outlets (public houses) through which they sold beer. Some had pursued this positioning for over 200 years. However, this practice is illegal under European Union competition law (as it is in the US), and had been granted limited exemption up to that time. UK regulation changed in 1989, however, forcing the largest companies to separate much of their supply and retail businesses. Most had seen this coming, and were already moving to reposition their retail operations by offering wider ranges of products, especially food. Whitbread PLC took this repositioning furthest, and by 1995 had a dominant position in the restaurant market, as well as substantial other hotel and leisure operations. In 2001, it sold its brewing operations completely to Belgium's Interbrew (now InBev), completing an almost total repositioning that had started some 20 years earlier[viii].

A principal reason why strategic repositioning is so rare and so difficult lies in the very factors that made a business successful in its original position. It must build up, usually over many years, some critical resources and capabilities to operate effectively. By 1995, Blockbuster had a massive estate of key retail stores in great locations, thousands of skilled and motivated staff to run those stores, a constantly appealing product range, efficient systems for managing customer membership and store inventory, and millions of those members who valued its service. To build and sustain all this had required the learning of powerful capabilities in managing its range of movie titles, hiring and developing staff, acquiring and developing stores, and running and upgrading its information systems.

Of these resources and capabilities, some are quite irrelevant to a postal-based service, such as the stores and the capability to open in new locations, plus the store staff and the capability to hire and develop those people. Those resources and capabilities become still more irrelevant when trying to provide movies directly over the internet. Yet the business is still stuck with them. What *had* been critical resources and capabilities become burden, or 'rigidity' – something that has to be wound down, even while new resources and capabilities

[1] 'Vertical integration' refers to situations where the same company owns one business that supplies another that it also owns. This will be discussed in chapter 12.

are being developed[2].

Generalised strategy life-cycle

From Blockbuster's strategic history and the other example discussed above, it is possible to extract a general model for the life-cycle of organizations' strategy. Figure 1.3 shows the four broad phases of that life-cycle, together with the impact made by [a] initiatives to add to the original strategic positioning, both by acquisition and extension, and [b] a revision of that position when it becomes unsustainable and threatens collapse.

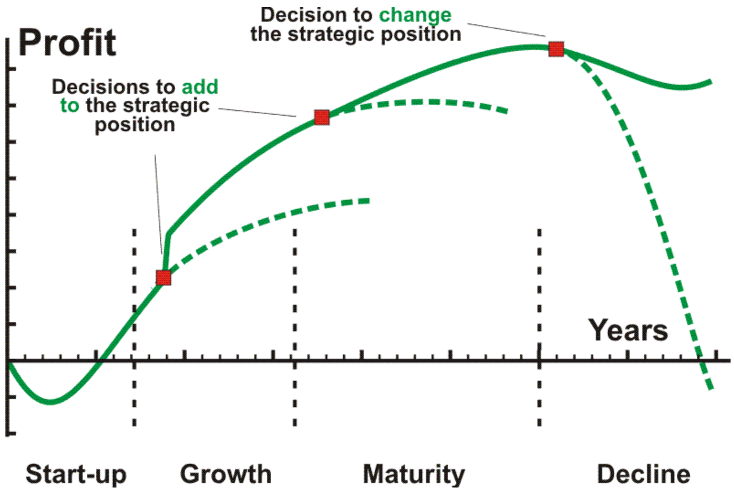


Figure 1.3: Generalized strategy life-cycle, with extensions and strategic change events

What is most striking about this life-cycle is that, given the extreme rareness of changes to strategic position:

The majority of management's strategy work consists of *delivering* the strategy
(also referred to as strategy *implementation*).

As the Blockbuster case shows, delivering the strategy features two kinds of activity:

1. *Steering* strategy and performance with the continuous stream of decisions, from period to period, on everything from product development to marketing, staffing, and pricing.
2. *Taking large initiatives* to move the business to a new level or onto a new path. Acquiring other companies in the same business, or closing unsuccessful operations are examples of moving the business to a new path – the business immediately becomes larger or smaller. Examples of moves that put the business onto a new growth path include launching major product lines, licensing or franchising, entering new markets, or adding new sales channels.

The second of these activities is sometimes referred to as 'strategic decision-making', implying that only these large, occasional actions are of strategic importance. However, as later chapters will show, seemingly small decisions can also have serious impacts on performance. It therefore seems we need a definition of what exactly the term 'strategic' means.

Actions, choices and decisions by people in the organization, and changes in market conditions, competitive activities and other external events are

[2] Chapter 10 will discuss rigidities in more detail.

> **'strategic' if they might have significant impact on an organization's medium- to long-term performance.**

This definition implies that attention must also be given to the first kind of implementation activity above – steering strategy and performance from period to period.

This critical dimension of strategic management is frequently overlooked, or even dismissed as mere 'operational effectiveness'. In an influential article[ix], Michael Porter states that a company can only out-perform by either "… performing *different* activities from rivals, or performing similar activities in *different ways*." Yet Shell's strategic performance problem in this example is not attributable to either of these issues.

To take a positive example, the successful low-fare airlines mentioned earlier, Ryanair and Southwest, have both been frequently cited as examples of superior positioning choices, but the reality is that countless competitors have tried making exactly the same choice, most with little success. Two principles emerge from these and other examples:

- Companies can out-perform (or under-perform) competitors by performing activities on a different *scale* or level, or at a different *rate* from competitors.
- Operational effectiveness can substantially impact on companies' ability to out-perform on this basis and is therefore inextricably embedded in strategic management.

To illustrate the importance of scale decisions, consider furniture retailer IKEA[x] (www.ikea.com), a well known example of a so-called 'category killer' in retailing. Toys"R"Us in children's toys and Staples in office products are other examples. IKEA's success has been attributed to its superior choice of position on the issues of *who* to serve (mid-income home-owners and renters), with *what* (quality self-assembly furniture, plus related smaller items) and *how* (from large suburban stores, with wide variety, from long-term suppliers, and customer self-service in stores). A further critical factor in the question of 'what' to offer is price level, and IKEA chose pricing that was not especially cheap compared with other self-assembly retailers, but good value relative to the high quality design and build of its products.

But this position had also been chosen by many furniture retailers before IKEA. Its strategy was unique for the *scale* it chose on key dimensions, in particular, a rather wider product range than similarly positioned stores, and a much larger store format. Steering this strategy well also required critical and continuing scale/level and rate choices.

- A wider product range – but *how* wide?
- Large stores – but *how many* square metres, and with *how many* car park spaces?
- Limited customer service – but with *how many* staff per store before waiting times became unacceptable?
- Prices offering good value for the quality – but *what* price level?
- At what *rate* should new products be introduced to the range?
- Rapid store openings would deliver sales growth, which in turn would drive down manufacturing cost. But at what *rate* should and could IKEA open stores each year without causing problems, and how many would any market support?

IKEA also illustrates the importance of operational effectiveness. Its positioning relied heavily on low-cost manufacture (no-one is likely to prefer 'high cost manufacturing' in its strategic choices!), which needed close cooperation with suppliers. It required also that the furniture be of high build-quality – a factor that caused the demise of former rivals. Choosing suburban locations with enough parking was always important. But finding *good* locations, *cheaply* and opening them *fast* ensured that capital investment led quickly to additional sales and returned better profits than would have been the case with less effective operations. (*Chapter 10 examines how these three dimensions of capability – quality, cost and speed – operate and drive strategic performance in some detail*). The resulting strong cash-flow then enabled faster store openings and geographic expansion. Without the many elements of operational effectiveness, the company could never have achieved the profitability and cash-flow that has been fundamental to its domination of the strategic position it chose.

Choosing the wrong rate for some activity can have powerful consequences, as the example of staffing problems experienced by Shell oil company illustrates (see box). In this case, there is no evidence of ineffectiveness. Shell has always been a highly effective recruiter of engineering talent. It simply chose not to do so as fast as proved necessary to ensure long term performance.

Ryanair's success, which has eclipsed even that of Southwest, has been driven by a rapid rate of expansion in its route network. It did pick a specific positioning choice – in addition to copying most elements of the Southwest model, it used remote airports where it could get low, or even *negative*, landing fees – but that choice had been seen and used by other airlines before, and was quickly replicated by others.

Ryanair's ability to expand so fast was critically dependent on its operational effectiveness. Keeping costs well below competitors' allowed it to drive key development rates far faster than others could match. First, low costs allowed Ryanair to start profitable operations on low-volume routes that less efficient rivals could not justify. Secondly, the stronger cash-flows from its efficient operations allowed it buy planes to serve those new routes fast, and to do so without borrowing.

Continuing decisions with strategic impact - Shell oil company's hiring.

After a 2005 controversy over its reporting of oil reserves, Royal Dutch/Shell announced aims to hire 1000 experienced petroleum engineers. It simply had too few of these key staff to develop its reserves at the necessary rate. Following years of under-recruitment dating back to the 1980s, the company, like others in the industry, faced both a shortage of these key staff and an aging workforce, the average age rising to 48. Industry commentators and rival companies alike expected that the company would find it extremely difficult to find so many experienced staff.

This example will be explained further in chapter 6.

Strategic management *integrates*

The last issue that makes effective *strategic* management distinctive is that it cannot simply be the sum of effective *functional* management of the various parts of an organization.

The Shell staffing case illustrates the point. The human resource function (HR) was entirely effective in hiring the people at the rate it wanted, as evidenced by the company's strong reputation amongst graduate petroleum engineers and the high ratio of applicants to appointments. The problem was that this was the wrong rate to aim for! This is not something that the HR function alone can know, but needs close cooperation with the departments that would be deploying and developing those people, not just immediately but over future years.

The low-fare airlines we have discussed demonstrate many similar requirements for implementation decisions to be mutually consistent. They would be in difficulties, for example, if they opened new route services faster than they acquired aircraft or hired staff to enable those services to be delivered reliably. IKEA would face difficulties if it expanded its product range so much that it was not possible to display each item well and ensure each was in stock. These may seem rather simple coordinations to achieve, and indeed they are for organizations that are well-developed and operate a relatively standard, simple business model (which is why these examples were chosen). However, the constant, accurate coordination of multiple functional strategies and policies across a more diverse business becomes far less straightforward.

Finally, note that increasing complexity leads to strategic coordination across functions being beyond the capability of one individual leader. Leaders of functional departments as well as CEOs require strategic understanding, because they must participate in developing a strategy that can constantly be consistent amongst the functions.

NOTES.

[i] For a clear discussion of these three elements of strategic positioning, see Markides, C. (2000) *All the Right Moves*, Harvard Business School Press, Boston, MA

[ii] Case studies covering the story of Blockbuster's strategy include:

Blockbuster Entertainment Corp. Southern Connecticut State University. 1994.

Blockbuster Video. Kellogg School of Management. 2005.

Blockbuster acquires Movielink. ICFAI Business School. 2008.

[iii] Case studies discussing Nitflix.com and its rivalry with Blockbuster include:

Blockbuster Inc and Technological Substitution. Harvard Business School. 2003.

Netflix. Stanford Graduate School of Business. 2007

A Challenge to Innovation: Can Netflix Sustain Growth? ICFAI Business School. 2007.

[iv] http://about.skype.com/2005/09/ebay_to_acquire_skype.html

[v] www.wikipedia.org/wiki/Cisco_Systems_acquisitions

[vi] http://www.alibaba.com/aboutalibaba/aligroup/index.html

[vii] http://www.about-nokia.com/history/

[viii] http://en.wikipedia.org/wiki/Whitbread

[ix] Porter, M.E. (1996) What is Strategy? *Harvard Business Review,* **74**(6), 61-78.

[x] Case studies tracing the development of IKEA's strategy and operational details include:

Ingvar Kamprad and IKEA. Harvard Business School. 1990.

IKEA: Managing Global Expansion. ICFAI Business School. 2003.