Strategy First!

Why Strategy is more important than Cost Cutting

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e-books

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1. Cost Cutting is not Strategy

A look in the business press shows that topics like restructuring, process optimization, lean management etc. are high on the corporate agenda. You get the impression that cost cutting is the most important approach to survive in the competitive arena. A study by the German Association of Management Consultants confirms this impression. The findings show that the main focus areas in the consulting business in 2012 were the following: Organizational and process consulting: 43.8%; Strategy consulting: 24.5%; IT consulting: 21.2%; HR consulting: 10.6%. Without doubt, a low cost structure and efficient processes are key to business success. However, if a company saves money in the wrong place, this can rapidly backfire. Outsourcing is a good example in that context: Toy manufacturer Lego outsourced its production to foreign countries for cost reasons, only to bring it back later because of quality issues and a lack of delivery capability. Chain saw producer Stihl and plush toy producer Steiff made similar experiences.

Interestingly, an analysis of the reasons for business failure reveals that it is not high costs, but a wrong strategy and the related investment decisions which are the number one cause. (Source: Meta Study by A.T. Kearney: Sicher durch die Krise durch nachhaltige Restrukturierung, 2009). In the study, a high cost structure comes second and lack of liquidity is in the third place. A wrong strategy leads to a loss of competitive advantage, which results in decreasing demand and increasing price pressure. The reasons for the decrease include, amongst others, a disorganized product portfolio, lacking focus on attractive markets, failure to react to technological disruptions as well as ignoring trends and new competitors: Neckermann went out of business, because the company reacted too late to the megatrend ´online trade´, Kodak ignored the digitization of photography and Nokia was swept away by the smart phones!

2. The Ying and Yang of Business Success

Business success rests on two pillars: Strategic effectiveness and operational efficiency. They represent the Ying and Yang of business success. Strategic effectiveness means ´doing the right thing´, that means, e.g., serving the right customers with the right products; operational efficiency is about ´doing things right´, that is implementing a strategy in an efficient (economical) way. Successful companies do the right thing right! Nokia did the wrong thing right before it was forced to sell its mobile phone business to Microsoft - and failed: The company produced mobile phones that nobody wanted any more in a highly efficient way. It would probably have been much better, at least in the beginning, to produce the right phones (smart phones) not perfectly than to continue producing the wrong products highly efficiently…

3. The WHO, WHAT and HOW of Strategy

What is strategy? It can be defined as a plan to reach a goal. This plan includes clear decisions regarding what a company does and – above all – what it does not! These decisions concern the WHO, WHAT and HOW: The WHO answers the question as to which target groups the company will focus on; the WHAT describes the organization´s offering (value proposition) and the HOW defines all the processes required to produce and market the offering.

Strategy means saying ´Yes´, but, above all, saying ´No´. Why? Every company has limited resources and economic logic dictates that these should be concentrated where the chances for success (return on Investment) are highest. Saying ´No´ is often the biggest challenge as it means deliberately staying away from a business – in an extreme case by giving it up: Car manufacturer Keiper Recaro sold its core business, manufacturing car seats, to Johnson Controls after four generations of family-owned management. The reason given was that customers are increasingly looking for complete seats and that a global player can better meet this need than a medium-sized company. Now, Keiper Recaro concentrates on airplane seats, children seats and upholstered furniture.

A company´s competitive advantage lies in the unique, difficult-to-imitate combination of the WHO, WHAT and HOW. This combination allows an organization to outmanoeuvre the competition: Ryan Air has stirred up the entire airline industry by leveraging the uniqueness of the HOW: The company has set up its processes to achieve maximum cost efficiency. As a result, it can even realize profits at low prices. Traditional airlines have great difficulty copying this strategy. Therefore, Lufthansa has established German Wings as a separate company to keep the low price competitors at bay.

4. Strategic Success Principles

Are there strategic success principles that transcend particular industries? The answer is ´yes´, but every company has to adapt these principles to its specific situation. The success principles include focus, alignment and consistent follow-through.

Focus means concentrating on clearly-defined, attractive markets and segments. However, the risk of too narrow a focus should not be neglected. An organization that concentrates exclusively on a single market will quickly run into problems if this market is hit by a crisis. This happened to quite a few automotive suppliers during the financial crisis in 2008/9. To avoid becoming overly dependent on a single industry, successful companies diversify into new businesses.

Business practice shows that the closer the diversification is related to the traditional business, the higher the likeliness of success. E.g. automotive supplier and gearbox specialist ZF, Friedrichshafen, has used its know-how to successfully enter the wind turbines market. Diversification and focus don´t necessarily have to contradict each other: When a company diversifies and consistently decentralizes the new business as a separate unit, this can then serve its target market in a highly-focused way.

The strategic principle of alignment requires that all activities contribute to the implementation of the WHO, WHAT and HOW. E.g. if a company targets a high-price premium segment, a sales person should not try to ´strike a deal´ with a price-sensitive customer by granting a generous rebate!

Consistent follow-through means that the management will quickly provide the resources required to implement the strategy and drive the implementation forward. Consistent follow-through also means that all activities which are not in line with the strategy should be closely examined and stopped if required.

5. Strategic Positioning

According to a study published in the Harvard Business Review (Source: Three Rules For Making a Company Great; Harvard Business Review, April 2013), companies that pursue a premium strategy are financially the most successful in the long-term. The stronger a company´s uniqueness based on the combination of the WHO, WHAT and HOW, the better it can realize a high-value positioning and charge a premium price. Thus, Germany´s medium-sized world market leaders can, on average, charge a 10 - 15% price premium compared to the competition. On the other hand, the success of Ryan Air, Aldi und Lidl shows that a low-price strategy can also be sustainable. However, a company which competes on price should also have the lowest costs and sell big quantities. The example of the Do-it-Yourself Chain Praktiker shows what can happen if this is not the case: The strategy of granting a 20% discount on everything except animal food drove the company into insolvency!

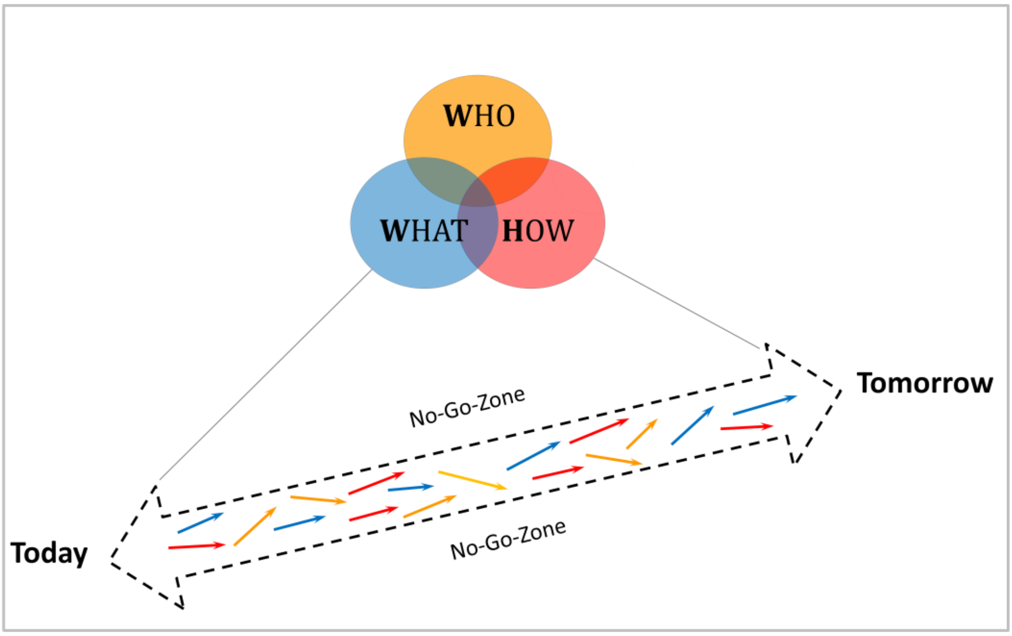
Many companies target different market segments with specific offerings at different price points. The objective is to increase the total market share. When applying this type of strategy, decision makers should make sure that the products/services for the different segments are clearly differentiated from each other. If this is not the case, a company risks cannibalizing itself. In that context, it should also be considered whether to serve the mid- and low-price segments with separate brands to avoid damaging a premium brand: Grohe, the world´s leading provider of sanitary fittings developed the Chinese market with the low-price brand ´Jouyou´. However, Jouyou filed for bankruptcy in Mai 2015, which shows the risks of such a strategy as well.

6. Strategy Development is not Planning

Developing a strategy should not be confused with financial planning, which is about turnover, sales and profit forecasts. When planning, the present is taken as a basis and extrapolated into the future. However, in doing so, planners construct a reality which does not actually exist: Nobody knows exactly what the future will look like, and in many companies the planning cycles take so long that the market has already changed dramatically when the planning figures are eventually finalized! Innovative companies like, e.g., medical products manufacturer B. Braun or automotive supplier Bosch have recognized this weakness and replaced their complex planning systems by a decentralized, rolling forecasting process.

Unlike financial planning, strategy development involves thinking backwards from the future into the present and developing a plan - a strategy to reach long-term goals. Based on the WHO, WHAT and HOW, a company defines its areas of activity (comp. fig. 1) Everything the organization does must take place within this corridor and reflect the WHO, WHAT and HOW. Outside the corridor, there is the ´No-go-Zone´. It includes all those businesses that the company deliberately stays away from. However, this decision is never cast in stone: Leaders always have to reserve the option of entering markets and businesses that are currently located outside the strategic corridor if conditions change.

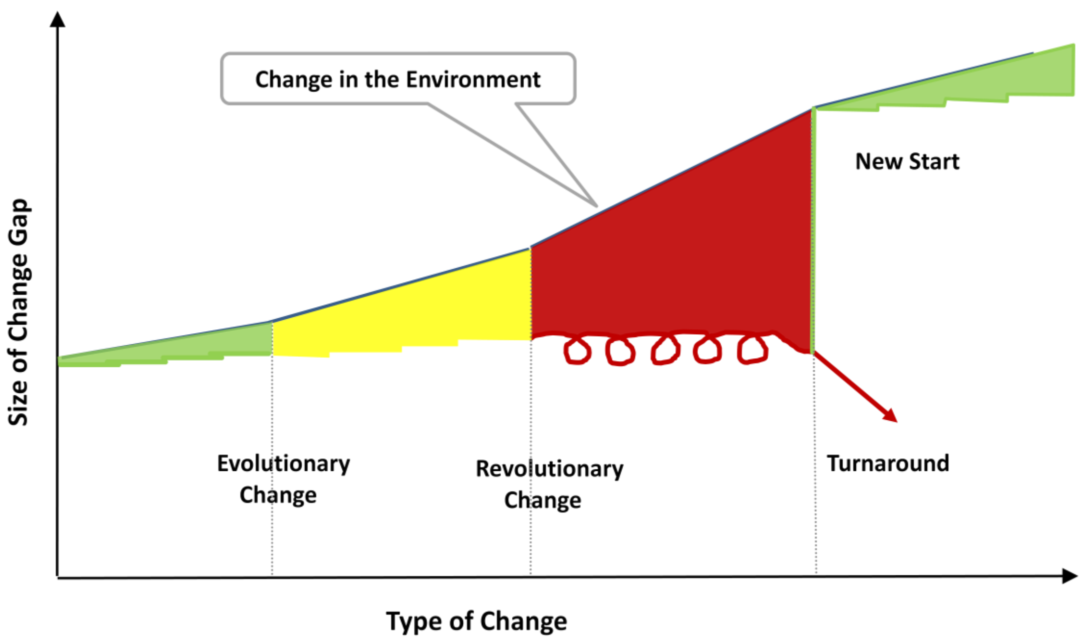
Fig 1: Strategy Development is not Planning



7. The Change Gap

Organizations often fail to adapt their strategy to a changing environment in time (comp. fig. 2). The bigger the resulting gap, the higher the probability that the company will fail! Adaptation is not a choice, but a must! Jack Welsh, the former CEO of General Electric, once said in this context: ´If the rate of change on the outside exceeds the rate of change on the inside, the end is near.´ The longer a company waits, the bigger the gap becomes, and the pressure for change increases. Those who react to late will fall by the wayside!

Fig. 2: The Change Gap



8. Strategy Innovation

Successful companies continuously adapt their strategy to a changing environment and reinvent themselves over and again to stay relevant. Reinvention means strategy innovation – a new combination of the WHO, WHAT and HOW. In these cases, the dominant logic of the industry is often turned upside down and unwritten rules are broken. This requires the courage to ´think outside the box´ and to slaughter sacred cows – at the end of the day it means questioning a company´s very reason to exist. Andy Grove, former CEO of American chip producer Intel once described an organization´s ability to repeatedly reinvent itself in turbulent markets by the sentence: ´Only the paranoid survive´.

In many industries, a key trend emerging in the context of strategy innovation is the transformation of organizations from product manufacturers into service providers. E.g. traditional power tool producer Hilti has established a fleet management scheme which enables it to rent hammer drills instead of selling them. Renting hammer drills requires a completely different strategic HOW – other processes and systems – than selling them! Hilti has successfully met this challenge and strengthened its competitive position through this strategy innovation. Voith, the world´s leading manufacturer of paper machines, provides the innovative service ´Papermaking 4.0´. This offers an analysis of huge data amounts to boost the efficiency, productivity and quality of a customer´s value chain in the paper manufacturing process.

Services are an attractive business for many companies as profit margins here are generally higher than in the product business and long-term contracts lead to stable cash flows.

9. Why think about Strategy?

When talking about strategy, you often here comments like: ´We have not time for strategy, we have to look after our customers´. However, there are strong reasons to systematically think about strategy and to take the time to do so. Here are three examples:

- Panta Rhei, everything flows, is the aphorism of ancient Greek philosopher Heraklit. The world is constantly changing, and the speed of change is increasing! For that reason, CEO´s should constantly re-think how to respond to the change.

- A company´s management or the owner asks the question: ´Where do we want to be with our business in five years from now? To answer this question, a systematic strategy process is established.

- The company is confronted with new strategic challenges, e.g. increasing price pressure caused by the appearance of new competitors, consolidation in the customer industry or an abrupt change in the political environment, e.g. the decision to get out of nuclear power as a source of energy.

10. The Strategy Process

How can a winning strategy be developed? How can a company achieve the best combination of the WHO, WHAT and HOW? Similar to the continuous improvement process (CIP) which many companies apply to improve their operational efficiency, strategy development and implementation include a continuous strategy process (CSP) (comp. fig. 3) to achieve strategic effectiveness. However, this process should not be seen as a ´straitjacket´ - it always has to be adapted to the specific challenges confronting a company, and it helps the people involved to ask the right questions and harness their creativity.

The individual cycles of the strategy process should not take too long. Otherwise there is the risk that the market might have dramatically changed when the strategy is finally agreed. The principle that applies here is: ´Better quick and dirty than paralysis through analysis!´

Fig. 3: The continuous Strategy Process

11. Strategy Development is not a Top Secret Project

Strategy development takes place at different levels of an organization: With small and medium-sized companies it is generally at the level of the entire company. With big organizations it is at the level of a division or a strategic business unit. Strategy development is not a top secret project of Top Management. Rather, it includes tapping into the organization´s collective knowledge, unlocking the creativity of the entire company and harnessing the best ideas of everybody.

Generally, Top Management and selected managers of the second level are involved in strategy development. Ideally, however, all employees should participate, because everybody in the company is directly or indirectly involved in the strategy´s implementation. At first sight, this seems unrealistic. However, by leveraging new media technology, the Indian IT company HCL built an online platform where its 300 leading managers can present their business plans (strategies). This offers the company´s more than 8,000 employees the possibility to comment on the plans and to make their own proposals.

12. Big Goals

Strategy development (comp. Fig.3) starts with the definition of long-term visionary goals. The late German chancellor Helmut Schmidt once said that people who have visions should go to the doctor! If this is true, many successful CEO´s should follow his advice as they generally have big visions, which they ultimately reach. These often include goals targeted at profitable growth and market leadership. E.g. medical technology producer Otto Bock wants to increase its turnover from 690 million euro in 2011 to 1.7 billion euro in the year 2020. Market leadership does not necessarily mean market share leadership, but leading customers, competitors and markets. Striving to boost market share only makes economic sense if the market share is not ´bought´ through margin-eroding discounts. After all, the biggest market share is useless if a company is bankrupt after achieving it!

13. Situation Analysis

The second step in strategy development includes a thorough analysis of the company´s situation. In that context, the following questions should be asked, amongst others: What is the financial situation in the different business areas or product lines? Where does the company earn money? Where does it lose money? How has the business developed in the past 3 - 5 years? To get this information, a well-functioning controlling system must be in place that provides detailed information down to the level of individual products and salespeople. If this information is not available or incorrect, seriously wrong decisions can result.

The situation analysis also includes identifying the company´s core competences – those capabilities that make it unique. Uniqueness can, e.g., result from a high degree of vertical integration, a comprehensive product line or from processes that are difficult to imitate. However, companies should always be aware that competitors never sleep and that they don´t stop trying to copy their uniqueness!

The internal situation analysis is followed by a systematic scan of the company´s environment: Every organization should have a radar to detect weak signals in the environment at an early stage. Decision makers should look through a telescope and a magnifying glass simultaneously: With the telescope, they can spot trends early. The magnifying glass helps them to identify changing needs at the individual customer level and reveals where the market as a whole is going. When analyzing the competition, it is important not only to look at competitors in the same industry, but to include adjacent industries as well: The paradigm shift from the traditional mobile phone to the smart phone originated in the computer industry (Apple), it was not triggered by a player in the mobile phone industry!

14. Black Swans

When analyzing the environment, organizations should be increasingly alert to more or less unforeseeable events which include both opportunities and risks! ´Black swans´ are a metaphor for these phenomena. They represent occurrences that are considered improbable, but that can nevertheless happen. These include, e.g., political upheavals or crises like the global economic crisis in 2008/9. To react quickly, companies need a culture which promotes openness, unconventional thinking and unsolicited, critical questioning. As a result, ´weak signals´ will more quickly come on the strategic agenda and unpleasant truths will not be swept under the carpet. Besides the above-mentioned diversification, measures to reduce risk include a high equity ratio, innovation and flexibility based on redundant resources. However, the flip side of this is that higher flexibility usually also involves higher costs.

Using scenario technique, the possible impact of unexpected events can be simulated and appropriate counter measures can be taken in advance. However, decision makers should be aware that it is impossible to anticipate every potential occurrence and that there is always a residual risk!

15. Linking Strategy with Megatrends

In the analysis of an organization´s external environment, megatrends play a key role. In the study ´Future Fitness 2012 – how fit is the German economy for global megatrends in consumption?´ (Source: FAZ, July 9 2012), the following five megatrends were identified:

- **A shift in global economic power**
  Emerging economies will overtake the industrialized nations with respect to global value creation.

- **Worldwide growth of the middle class**
  Increasing wealth in the emerging economies will boost purchasing power.

- **Demographic change**
  An aging world population will increasingly live in cities; more single households.

- **Scarce resources and sustainability**
  The efficient use of resources will become more important.

- **Digital revolution**
  Increasing digitization will make new strategies and business models possible.

In the study, 71% of the managers interviewed said that an early identification of megatrends and the adaptation of a company´s strategy were important. However, only 45% of the interviewees said they were well prepared for that.

To effectively respond to megatrends, companies should develop several scenarios and formulate strategic options. These will be evaluated based on their financial contribution, feasibility, possible competitor reactions and risk levels. Taking the example of car producer BMW, fig. 4 below shows how a company can use the above-mentioned megatrends as an opportunity to develop growth strategies.

Fig 4.: Linking Strategy with Megatrends

Megatrend		Strategy
- Shift in global economic Power	→	Presence in all 5 BRIC States
- Worldwide Growth of the Middle Class	→	Extra-long BMW 5 in China
- Demographic Change	→	BMW-I for urban Traffic
- Scarce Resources and Sustainability	→	Environment-friendly SNOW-Cleaning
- Digital Revolution	→	Car Connectivity Services

The shift in global economic power leads to higher economic growth in the BRIC countries (Brazil, Russia, India, China) than in the traditional industrialized nations. Therefore, being present in these countries is a must for a global player like BMW.

The growth of the Chinese middle class leads to increasing demand for stretch limos. BMW has seized this opportunity by launching an extra long version of its model 5.

To respond to the demographic change and to the trend towards more single households, BMW has introduced its ´urban mobility concept´ by launching the BMW i.

Scarce resources and the megatrend ´sustainability´ have prompted BMW to apply an environment-friendly SNOW Cleaning method to save energy and water in its production.

Finally, the digital revolution provides BMW with the opportunity to offer added value to customers with its ´Car Connectivity Services´. Based on this technology, e.g., a dealership selected by the driver can automatically be informed if the car is due for the next inspection.

16. The Implementation Gap

A strategy is wishful thinking, a bet on the future. It only becomes reality when it is implemented. Besides the above-described change gap – the failure to adapt to a changing environment – a second gap often becomes obvious in this context: The implementation gap.

Management practice shows that strategies generally don´t fail when developed, but when implemented. A great strategy with a lousy execution is less successful than a mediocre strategy which is excellently implemented.

17. Success Factors in Strategy Implementation

The main reasons why strategies fail include a fuzzy strategy, opposition against change, conflict between the strategy and existing power structures, a lack of communication and unclear responsibilities.

The key factors for a successful strategy implementation are therefore:

- A clear and unambiguous strategy
- Professional management of the change process
- Overcoming power structures which prevent successful execution
- Effective communication among the managers in charge
- Clearly-defined responsibilities

18. Strategy Implementation is a Leadership Task

The strategy has to be convincingly communicated by the leaders and should have the full buy-in of all the people involved. The leadership style required depends on the leader´s personality, the situation of the company and the type of strategic change: Former Nokia CEO Steven Elop – albeit in vain – used the metaphor of a ´burning platform´ to make employees aware of the dramatic situation the company was in and the strong need for change. Not every employee has to know everything, but everybody should understand how he can personally contribute to a successful strategy implementation.

Middle management plays a key role in strategy execution: It is the transmission belt that makes often abstract strategies tangible for the people and translates strategic objectives into personal goals.

19. Inspiring People, overcoming Resistance

The leaders must be able to build people´s commitment across hierarchies and to create excitement for the change. This, however, is a big challenge given the results of the renowned Gallup Institute´s 2014 engagement index: Only 15% of German employees had a strong emotional bond with their employers, according to the study. A total of 85% only had a weak emotional bond or no bond at all.

Strategy execution can fail if the leaders are not able to overcome organizational resistance, which comes up especially when jobs are threatened. Another factor that drives the successful strategy implementation is a well-functioning cooperation among different departments and business units. ´Silo cultures´ and holding back information are counterproductive. What is needed is a culture which promotes team spirit, openness and close cooperation.

People not only have to understand the strategy, they must also be able to execute it. To achieve this, skills training and personal coaching are required. In that context, those responsible for training and development as well as staff managers should make sure that the trainings are fully-aligned with corporate goals. The question that has to be asked with all trainings, seminars and workshops is: How will this event – measurably – contribute to reaching our corporate goals?

20. Aligning Strategy and Organizational Structure

Successful strategy execution requires the entire organization, including its structure, processes and systems, to be fully aligned with the strategy. The ultimate goal is a total customer focus, which can be achieved by replacing functional structures by divisional or target group structures.

21. Establishing an Integrated Market Management

At the end of the day, it is Marketing, Sales and Service that translate high level strategies into on-the-ground results. Success ultimately happens in the marketplace, not in the conference room! However, business practice shows that there is often friction among the three functions. Insufficient communication and silo thinking frequently dominate the daily work and make strategy implementation difficult. Mettler Toledo, a Swiss manufacturer of measurement and precision instruments, has met this challenge by establishing cross-regional teams of specialists from Marketing, Sales and After-Sales Service. The teams are responsible for managing customers within the framework of an ´Integrated Market Management´. According to company information, turnover and profit have increased against market trends at above average rates as a result. (Source: Best Practice im Key Account Management, Redline Wirtschaft, 2005).

22. Developing and implementing Action Plans

Employees´ personal objectives and responsibilities have to be aligned with the company´s strategic goals and need to be translated into action plans; the same applies to the organization´s compensation and incentive schemes. Strategy implementation also includes a large number of individual projects and activities. To build, e.g., the extra long BMW model 5 in China, production plants have to be built. This requires a complex international project management including budgets, responsibilities and milestones.

23. Success Control

If a company does the right thing right, it will eventually be successful. The extent to which it is on target is continuously monitored with the help of specific metrics (Key Performance Indicators). Business success has not only an economic, but also a social and ecological dimension. Business practice shows that objectives can vary, ranging from short-term profit maximization to securing jobs in the long term and quantifying environmental damage in the balance sheet. Götz Werner, innovative founder of the drug chain DM Drogeriemarkt, maintains that short-term profit maximization is not always the number one target. He is satisfied with a 1 - 2 % profit margin – more is not helpful for a healthy growth, he says. His credo is: "Human beings always take the center stage. They are never only a means to an end!“

24. Summary

Strategic effectiveness and operational efficiency are the two pillars of business success. Companies are doomed to fail if they don´t adapt their strategy to the changes in an increasingly turbulent environment in time. Success strategies can be developed applying a structured process. They include clear decisions concerning a company´s WHO (target groups), WHAT (products and services offered) and HOW (processes). Strategy implementation is the biggest challenge. Therefore, leaders have to fully align the entire organization with the strategy and create excitement for the strategic change.

When organizations continuously do the right thing right, at the end of the day, they will be successful not only economically, but also socially and ecologically.

The Author

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Hans Walter Fuchs, MBA, is a Strategy Expert and Lecturer at the Hochschule für Oekonomie und Management, Frankfurt/Main (FOM). He holds a Master´s Degree in Applied Linguistics from the University of Heidelberg and a Master of Business Administration (MBA) from the Henley Business School, UK.

As Head of Marketing Services at Beneo, a division of Südzucker AG, Mannheim, Hans Walter was responsible for the international marketing of sweeteners to the confectionery industry. As a Product Manager for specialty chemicals at Bärlocher GmbH, Munich, Hans Walter managed a profit centre for specialty chemicals. As a Key Account Manager at Lahnau Akustik GmbH, Lahnau, he was in charge of European key accounts and he coordinated a strategic alliance with the US partner.

In 2002 he founded his company, Hans Walter Fuchs International Consulting, which helps organizations to develop and implement international success strategies at the Business Level as well as in Marketing and Sales. The goal is profitable growth and superior business performance in the competitive arena.

Hans Walter is trilingual and offers his services in the same consistent high quality in English, German and French. His practical experience as an international manager enables him to quickly understand his clients´ situation and to develop pragmatic solutions. He has a passion for unconventional "out-of-the box thinking" and challenges his clients to develop and implement innovative approaches to lead their organization into the future.

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