

# Michael porter on how to marry strategy and operational effectiveness



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The Harvard management guru argues that operations & strategy must fit to create a sustainable competitive advantage.

For almost two decades, managers have been learning to play by a new set of rules. Companies must be flexible to respond rapidly to competitive and market changes. They must benchmark continuously to achieve best practice. They must outsource aggressively to gain efficiencies. .

. Positioning — once the heart of strategy — is rejected as too static for today's dynamic markets and changing technologies. According to the new dogma, rivals can quickly copy any market position, and competitive advantage is, at best, temporary. . .

But those beliefs are dangerous half-truths, and they are leading more and more companies down the path of mutually destructive competition.

### Distinguishing Between Operational Effectiveness and Strategy

Operational effectiveness and strategy are both essential to superior performance, which is the primary goal of any enterprise. But they work in very different ways. . .

Operational effectiveness (OE) means performing similar activities better than rivals perform them. Operational effectiveness includes but is not limited to efficiency. It refers to any number of practices that allow a company to better utilize its inputs by, for example, reducing defects in products or developing better products faster. In contrast, strategic positioning means performing different activities from rivals or performing similar activities in different ways.

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Constant improvement in operational effectiveness is necessary to achieve superior profitability. However, it is not usually sufficient. Few companies have competed successfully on the basis of operational effectiveness over an extended period, and staying ahead of rivals gets harder every day.

Strategy is the creation of a unique and valuable position, involving a different set of activities.

If there were only one ideal position, there would be no need for strategy. Companies would face a simple imperative — win the race to discover and preempt it. The essence of strategic positioning is to choose activities that are different from rivals'. If the same set of activities were best to produce all varieties, meet all needs, and access all customers, companies could easily shift among them and operational effectiveness would determine performance.

#### Developing Strategic Fit Across Activities

Strategic positions emerge from distinct sources, which often overlap.

First, positioning can be based on producing a subset of an industry's products or services. I call this variety-based positioning. A second basis for positioning is that of serving the needs of a particular customer group. I call this needs-based positioning.

The third basis for positioning is that of segmenting customers who are accessible in different ways. I call this access-based positioning. Positioning choices determine not only which activities a company will perform and how it will configure individual activities but also how activities relate to one

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another. While operational effectiveness is about achieving excellence in individual activities, strategy is about combining activities.

### Fit Sustains Competitive Advantage

The importance of fit among functional policies is one of the oldest ideas in strategy. Gradually, however, it has been supplanted on the management agenda.

Rather than seeing the company as a whole, managers have turned to core competencies, critical resources, and key success factors. In fact, fit is a far more central component of competitive advantage than most realize.

Strategic fit among many activities is fundamental not only to competitive advantage but also to the sustainability of that advantage. It is harder for a rival to match an array of interlocked activities than it is merely to imitate a particular sales-force approach, match a process technology, or replicate a set of product features. Positions built on activity systems are more sustainable than those built on individual activities.

Finally, fit among a company's activities creates pressures and incentives to improve operational effectiveness, which makes imitation even harder.

Fit means that poor performance in one activity will degrade the performance in others, so that weaknesses are exposed and more prone to get attention. Conversely, improvements in one activity will pay dividends in others. Companies with strong fit among their activities are rarely inviting targets. Their superiority in strategy and in execution only compounds their advantages and raises the hurdle for imitators.

## What is Strategy?

Strategy is creating fit among a company's activities. The success of a strategy depends on doing many things well — not just a few — and integrating among them. If there is no fit among activities, there is no distinctive strategy and little sustainability. Management reverts to the simpler task of overseeing independent functions, and operational effectiveness determines a company's relative performance.

Improving operational effectiveness is a necessary part of management, but it is not strategy. In confusing the two, managers have unintentionally backed into a way of thinking about competition that is driving many industries toward competitive convergence, which is in no one's best interest and is not inevitable.

## Both Strategy and Operational Effectiveness Are Critical to Success

Managers must clearly distinguish operational effectiveness from strategy. Both are essential, but the two agendas are different. The operational agenda involves continual improvement everywhere there are no trade-offs. Failure to do this creates vulnerability even for companies with a good strategy. The operational agenda is the proper place for constant change, flexibility, and relentless efforts to achieve best practice.

In contrast, the strategic agenda is the right place for defining a unique position, making clear trade-offs, & tightening fit. It involves the continual search for ways to reinforce & extend the company's position.

Strategic continuity does not imply a static view of competition. A company must continually improve its operational effectiveness and actively try to shift the productivity frontier; at the same time, there needs to be ongoing effort to extend its uniqueness while strengthening the fit among its activities. Strategic continuity makes an organization's improvements more effective. The Competitive Advantage of Nations and Regions

Michael E.

Porter continues to extend his study first reported in *The Competitive Advantage of Nations*. Porter has published books and studies of other countries, states, and cities, including Canada, New Zealand, Portugal, the Commonwealth of Massachusetts, and India. A book on Japan (with visiting professor Hirotaka Takeuchi), tentatively titled *The Two Japans*, is expected to be completed in 1999.

Porter is extending his microeconomics-based theory of competitiveness in a variety of ways. He is exploring the shifting role of various microeconomic influences as a nation's economy becomes more advanced, and the relationship between macroeconomic conditions and microeconomic conditions in development.

Porter's examination of the problems of early-stage economic development includes research with Pankaj Ghemawat on India, as well as studies on Central American, South American, and Asian countries.

Porter is also conducting statistical research on the microeconomic foundations of economic development. An initial paper *The Microeconomic*

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Foundations of Economic Development (in The Global Competitiveness Report 1998, Geneva, Switzerland: World Economic Forum, 1998) examines the role of microeconomic variables in explaining per capita income differences among 52 countries. A paper with Mariko Sakakibara (UCLA) examines the link between domestic rivalry and international competitive success in a sample of Japanese industries.

Porter is also conducting research into appropriate forms of economic cooperation within regions (including countries), for which a major project involving the presidents of seven Central American nations is serving as a laboratory.

### Clusters and Competition

Porter is conducting ongoing research on the theory of clusters, or geographic concentrations of interconnected companies and institutions in a particular field. This work includes further development of cluster theory and its implications for management and public policy (see *On Competition*, Boston: Harvard Business School Press, 1998 and *Clusters and the New Economics of Competition*, Harvard Business Review, November-December 1998). Porter is also conducting statistical research on the incidence, growth, and decline of clusters in the U. S. economy. With Claas van der Linde of St.

Gallen University in Switzerland, he is also conducting a meta-study of clusters drawn from almost 350 known studies of individual clusters.

### National Innovative Capacity and the Ideas Production Function

Joint research with Scott Stern (MIT) is exploring the determinants of innovative capacity across countries using time series/cross-section data (Measuring the Ideas Production Function: Evidence from International Patent Output, draft working paper, July 1998). Using international patenting as a weighting variable, Porter and Stern have devised an index of national innovation capacity. The data has also been employed to directly estimate critical parameters of the ideas production function, a central element in economic growth theory.

### Sustainable Inner-City Economic Development

Michael E.

Porter is using the framework he developed in *The Competitive Advantage of Nations* to examine the economic development problems in distressed inner-city areas. He seeks to understand the potential of inner-city businesses, government policies, and private-sector initiatives to contribute to sustainable economic development. Porter's project has yielded a series of articles (see *The Competitive Advantage of the Inner City*, *Harvard Business Review*, May-June 1995) and led to the development of a private-sector organization called the Initiative for a Competitive Inner City, which is catalyzing inner-city development efforts across the nation.

### Environmental Policy and Competitiveness

Michael E.

Porter has been exploring (with Claas van der Linde of St. Gallen University, Switzerland) the relationship between environmental regulation, industry <https://assignbuster.com/michael-porter-on-how-to-marry-strategy-operational-effectiveness/>



competition, and international competitiveness. He finds that many forms of environmental pollution reflect inefficient resource utilization and poorly developed technology, suggesting that better environmental performance is often consistent with enhanced competitiveness. This perspective recasts the role of governmental regulation, highlighting the importance of regulatory and corporate approaches that foster innovation and improve resource productivity rather than simply abate or prevent pollution

### Capital Markets, Investment, and Competition

Michael E.

Porter's research into issues of capital allocation, first published in the report *Capital Choices*, is the basis for continuing research that examines how U. S. capital markets distort competitive behavior and investment. A report to the Competitiveness Policy Council, *Lifting All Boats*, contains recent research and policy recommendations.

### Competitive Strategy

Porter is engaged in a major new body of work on the theoretical foundations of competitive positioning and the underpinnings of sustainable competitive advantage. This research highlights the distinction between positioning and operational effectiveness; the fundamental role of differences in company activities in positioning; and the central importance of tradeoffs in delivering different types of customer benefit to the sustainability of differences in positioning; the role of fit among a firm's activities (or activity systems);

competitive advantage and sustainability; and the relationship between strategy, organizations, and incentives.

He is exploring his ideas in theoretical papers, mathematical models, and company studies. An early discussion of this body of work appears in *What is Strategy?*, Harvard Business Review, November-December 1996 and *Activity Systems as Barriers to Imitation*, Harvard Business School Working Paper #98-066.

Porter's next book on strategy, focusing on these ideas, is nearing completion.

Michael Porter and Anita McGahan are completing a series of statistical papers on the sources of company and industry profitability.

Based on large new database on the profitability of U. S. business segments between 1981 and 1994, their research examines topics such as the relative importance of industry; business segment positioning; corporate parent effects on superior or lagging profitability; the persistence of profit differences over time; and how high and low performers differ along such dimensions. For the full interview with Harvard Business School Professor Michael Porter, see the Oct.

1, 1995, issue of CIO.

Competitive advantage is one of the three golden aspirations of any ambitious CIO. Along with adding value and setting strategic agendas, creating competitive advantage remains a pipe dream for many a CIO. That's

because information systems departments are too often pigeonholed into an internally focused operational support mode.

But it doesn't have to be that way, says one of the most influential modern theorists in competitive strategy.

Michael E. Porter, the Roland E. Christensen professor of business administration at the Harvard Business School, wrote the landmark 1980 work, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. In that book, and in later works, Porter reconciled historical views on competitiveness and defined the concepts of unique positioning.

Porter's more recent research has been a reaction to what he sees as the last decade's worrisome infatuation with operational improvement efforts — something he contends does little to sustain competitive advantage. In effect, Porter tells CIO Managing Editor Richard Pastore, IS and the businesses it serves are both missing the strategic mark.

What concerns you most about the way companies today are looking at competitiveness?

As companies emerge from the last decade, many have been preoccupied with operational effectiveness — restructuring, reengineering and improving efficiencies. These improvements are a necessity in today's competition, but they alone are not enough. They are approaching a point of diminishing returns.

If companies are going to sustain competitive advantage, they can't do it by being more efficient at running the business. They have to have a distinctive way of competing.

The necessity of carving out a distinctive competitive position is not understood as well as it needs to be today. In a lot of companies, there is a mistaken sense that there is only one right strategy for that industry, and if one company can be the first to discover and implement it, they'll win. We've found from our research over the years that this way of thinking is ultimately self-destructive. If everybody's racing to discover one right strategy, nobody wins.

What's behind your new theory of complementary activity systems?

Rarely does sustainable advantage grow out of a single activity in a business. A company doesn't get sustainable advantage simply because it has some unique product design or a unique sales force. Those kind of advantages tend to be visible targets to imitate. If it relies on one activity as its key strength, all its competitors are going to work very hard to match that—especially if it is dubbed a best practice against which everybody else is benchmarking.

Sustainable advantage comes from systems of activities that are complementary. These complementarities occur when performing one activity and gives a company not only an advantage in that activity, but it also provides benefits in other activities.

For example, if a company has a very good inventory management system, it can also offer faster delivery and do so cheaper than a company without the inventory management system. Companies with sustainable competitive advantage integrate lots of activities within the business: their marketing, service, designs, customer support. All those things are consistent, interconnected and mutually reinforcing.

As a result, competitors don't have to match just one thing, they have to match the whole system. And until rivals achieve the whole system, they don't get very many of the benefits. It's like climbing a cliff; until you get to the top of the cliff, you can't stand and begin to walk again.

Where does IT fit into these concepts? Can it promote the creation of these complementarities?

Yes.

In many cases, achieving complementarities across activities is heavily affected by information technology. A production process can benefit a company's after-sales service if there is effective information exchange. If IS people need a new rallying cry for how to create competitive advantage, maybe it ought to be around the idea of tying activities together and achieving complementarities.

What can chief information officers specifically contribute toward competitive positioning?

CIOs understand the enabling technologies to allow distinctive positions to be created, so the CIO has an important role to play.

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But that doesn't mean that systems should be built internally, and it doesn't mean that the CIO should control all the systems activity in the company.

There will continue to be a need for integration and certain standards and protocols, but that's getting easier because the software itself is pushing it. The idea of central IS as traffic cop and enforcer is less important, and the CIO's role should increasingly turn to supporting competitive advantage.

Teaching Note 7: The Competitive Environment and Competitive Advantage

1.

There are two fundamental issues, according to Michael Porter. First, is the industry/market attractive? - i. e. capable of delivering a healthy profit stream. Second, how might advantage be obtained and sustained?

2. Porter argues that five forces determine the profitability of an industry.

The threat of new entrants; barriers to entry  
The bargaining power of suppliers  
The bargaining power of customers  
The threat of substitute products/services

Rivalry within the industry.

At the heart of the industry are rivals and their competitive strategies linked to, say, pricing or advertising; but, Porter contends, it is important to look beyond one's immediate competitors as there are other determinants of profitability. Specifically there might be competition from substitute products or services. These alternatives may be perceived as substitutes by buyers

even though they are part of a different industry. An example would be plastic bottles, cans and glass bottles for packaging soft drinks.

There may also be a potential threat of new entrants, although some competitors will see this as an opportunity to strengthen their position in the market by ensuring, as far as they can, customer loyalty.

Finally, it is important to appreciate that companies purchase from suppliers and sell to buyers. If these forces are powerful they are in a position to bargain profits away through reduced margins, by forcing either cost increases or price decreases. This relates to vertical integration.

Any company must seek to understand the nature of its competitive environment if it is to be successful in achieving its objectives and in establishing appropriate strategies.

If a company fully understands the nature of the five forces, and particularly appreciates which one is the most important, it will be in a stronger position to defend itself against any threats, and to influence the forces with its strategy. The situation, of course, is fluid, and the nature and relative power of the forces will change. Consequently, the need to monitor and stay aware is continuous.

### 3. Competitive advantage

Competitive advantage implies a distinct, and ideally sustainable, edge over competitors. It is more than the idea of a competitive strategy, which may or may not prove distinctive.

Porter has also shown how companies can seek broad advantage within an industry or focus on one or a number of distinct segments. He argues that advantage can accrue from:

i. cost leadership, whereby a company prices around the average for the market (with a middle-of-the-road products or service) and enjoys superior profits because its costs are lower than those of its rivals; ii. differentiation, where value is added in areas of real significance for customers, who are then willing to pay a premium price for the distinctiveness. A range of differentiated products (or services), each designed to appeal to a different segment, is possible, as is focus on just on a segment. There are, consequently, four generic strategies: cost leadership, differentiation, cost focus, differentiation focus.

An organization (according to Porter) should concentrate on just one of these and not be stuck in the middle.

Speed (say, quicker new product development) and fast reaction to opportunities and threats can provide advantage, essentially by reducing costs and differentiating.

Real competitive advantage implies companies are able to satisfy customer needs more effectively than their competitors. Because few individual sources of advantage are sustainable in the long-run, the most successful companies innovate and seek continually new forms of advantage in order to open up a competitive gap and then maintain their lead.

Achieving this successfully is a cultural issue, as we have seen.

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#### 4. Achieving competitive advantage

Competitive advantage, then, does not come from simply being different. It is achieved if and when real value is added for customers.

This often requires companies to stretch their resources to achieve higher returns. Improved productivity may be involved; ideally, employees will come up with innovations, new and better ways of doing things for customers.

#### 5. Porter's Value Chain

Porter has provided another framework for examining the sources of added value.

He argues there are five primary activities and four support activities - listed below. Each of these is a cost and, therefore, a potential source of cost leadership; each activity can also be the source of any differentiation. The linkages between the activities are particularly important. Primary activities  
Inbound logistics  
Operations  
Outbound logistics  
Marketing and sales  
Service  
Support activities  
Procurement  
Technology

Human resource management  
The firm's infrastructure  
Sustainable  
Competitive Advantage

Profit

A well-designed business strategy is designed to make money for the owners, by competing in markets and selling products at a profit. In some

cases, however, business leaders may decide that their market is no longer attractive or a product line is no longer profitable. At that point, it is appropriate to harvest the business<sup>1</sup> and extract as much value from the enterprise as possible.

Exit strategies can be very lucrative, if managed properly.

### Long-term Strategy

By merely imitating your competitors, you cannot prevail. You must offer your customers an advantage that differentiates your products from competitors. Michael E. Porter wrote, The fundamental basis of above average performance in the long run is sustainable competitive advantage .. . Without a sustainable competitive advantage, above-average performance is usually a sign of harvesting. (see footnote)

Business writers talk about three types of advantage. You might be the low-cost producer, attracting customers by underselling competitors.

Alternatively, you might offer features or options which attract customers through value.

Finally, you might operate in a market segment that gives you an advantage.

### Low cost

Typically, the low cost producer is also a high-volume producer, offering standard products, commanding a large share of the market. While providing

the lowest price, you must maintain approximately the same quality as your competitors.

### Product Differentiation

Customers might find value from features, customized designs, operating advantages, immediate availability, service or maintenance experience, high reliability, training, or good resale value.

Non-economic considerations, such as brand loyalty, image, or even nationalism may be significant elements of product differentiation. The customer must be willing to pay extra for the features that differentiate your product. Furthermore, you must be able to produce the higher-value product for less than the sales price.

### Market Segment

Specializing in a small portion of a large market or operating across related markets can create structural advantages over competitors who are trying to serve other customers.

### Commercial Airplane Strategy for Boeing

Consider the low-cost strategy.

We heard recently that our products were mature - approaching theoretical perfection. Additional differentiation was not justified. We waged a fierce campaign for market-share based on cost. The results were not satisfying.

Many customers claimed that competing products approached theoretical perfection more closely than ours. Our business strategy remains weighted toward cost. In DCAC language, a low-cost strategy encourages Tailored Business Stream 1 features, and discourages TBS 2 and TBS 3.

We might consider a strategy weighted toward product differentiation. How would we use our resources? In a product differentiation strategy, we would encourage TBS 2 and 3, relying on the options in DCAC to provide value to customers.

Furthermore, we would need highly-effective financial systems, so that we could price options properly. Another key resource would be awareness of our customers needs and preferences, and an accurate means of computing the value our options would have in our customers business operations. We claim all these elements as key initiatives or core competencies.

Looking at a market-segment strategy, I can imagine focussing on business jets, airplane modification, airport ground operations, air traffic control, or some other market segments, looking for competitive advantages through interactions among business units.

Interactions between commercial, military, space, and communications operations are traditional examples of this.

## Resources

I am not really familiar with Lean Manufacturing, or platform teams, but I believe they could serve a range of business strategies. Two weak links, from my point of view, are our highly sub-optimized Theory X management <https://assignbuster.com/michael-porter-on-how-to-marry-strategy-operational-effectiveness/>

culture and our glaringly backward employee relations practices. Our Theory X culture is at its best in standard, well-established stable operations.

It is particularly ill-suited to changing environments and evolving conditions. Both the product differentiation strategy and the market segment strategy would require excellent communication, committed employees who understand their role in the business, and a general ability to respond quickly to changing markets and customer requirements. We are at a distinct competitive disadvantage in those areas.

### Decisions

The first major decision, of course, is whether to compete or harvest. Our share of the commercial airplane sales could easily drop from leader to follower this year.

US Steel concluded that its steel markets were fundamentally unattractive. Their shareholders made a great deal of money harvesting their steel business, then shifting to other market segments. Other examples come to mind readily.

If we intend to compete, then we should compete! For the first time in many months, I am starting to see a return of interest in product development and process improvement. I hope we continue to regain our focus on customers, products, and processes.

As employees, we are ready to build on our strengths and work toward a common goal: building long-term value for shareholders, customers and employees.

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