Keeping up with the Jones

A fresh look at the definition of strategy is required for organisations to achieve a competitive advantage.

by Graham Kenny

Everyone likes to use the words strategy or strategic, as if it makes something sound more important. But are we in danger of confusing ourselves about what strategy really is and of kidding ourselves that we're developing strategy when, in fact, we're not?

One CEO told me that strategic planning had become a process clouded in mystery. As he saw it, the term had been overused in management literature as well as in his organisation, to such an extent that it had become meaningless. The worry was that without clarity about the meaning of strategy, his organisation would never produce an effective strategic plan.

Another case concerns an organisation whose management had "given up on strategy and gone back to tactics". Its management, like the CEO, had become burnt out by the failure of their strategic considerations to produce anything of value. But my concern was that, in focusing on 'tactics', as they called them, they'd merely be returning to a focus on operations, and thus be outmanoeuvred by their strategically-focused competitors. Strategic plans drawn up by organisations often focus on the activities of departments such as marketing, finance, human resources and corporate service, rather than on the organisation's key stakeholders. This operations focus fails to produce a strategic plan—it's just an operational plan in masquerade.

It's important to return to basics. In his various publications, Michael Porter, the Harvard Business School-based professor in strategy, distinguishes between "two basic types of competitive advantage: lower cost and differentiation". Lower cost, he explains, "is the ability of a firm to design, produce and market a comparable product more efficiently than its competitors. At prices at or near these competitors, lower cost translates into superior returns".

Porter contrasts this type of competitive advantage with differentiation. In terms of product quality, for instance, the basis of strategy here is special product features and service. A combination of such features allows a firm to command a premium price, yet still provide superior value to the buyer.

This framework has influenced many managers' thinking and can be found in numerous textbooks. But has Porter got it right? What is competitive advantage? There are important practical implications that flow from the answers to both questions.

To define competitive advantage effectively, we must take an external frame of reference. We'll use that of customers here, but we could just as easily have chosen other stakeholders, such as employees or shareholders. It's a reference point we describe as "outside-in": viewing an organisation from the outside looking in, not from the inside looking out.

Customers are not interested in operations—activity within an organisation. They're not concerned with how efficient a company is. But they are interested in how internal operations impact on them—in terms of price, customer service, delivery and product quality, among other factors.

It's this outside-in view that raises the issue of differentiation. A business achieves a competitive edge by differentiating itself on items such as the above. We call these items strategic factors, and a different set exists for each of an organisation's key stakeholders—its customers, suppliers, employees, shareholders and so on.

Competitive advantage is achieving superior performance on the strategic factors relevant to key stakeholders. For customers of a car manufacturer like Ford, these include product quality, product features, customer service, product availability and price. When, as customers, we weigh up price—an indication of what we'll pay in dollars, with all the other strategic factors like product features (an indication of what we'll receive for our dollars)we determine value. In other words, value is determined by balancing strategic factors. It follows, then, that competitive advantage becomes equivalent to delivering value on strategic factors superior to that of our competitors.

Approaching competitive advantage and differentiation in this way makes it impossible to see lower cost as anything but a change in the frame of reference. Through the lower-cost lens, we're looking at competitive advantage not from the outside-in, as we do with differentiation, but from the inside-out—not from the customer's point of view, but from the organisation's. In doing so, we've converted competitive advantage into an internal operations concept. And operational efficiency, while important and capable of improving profits by cutting costs, is not competitive strategy.

If we equate 'lower cost' to 'lower price'—which wasn't Porter's original intention but which many commentators do—then this becomes just another form of differentiation: differentiation on price.

To sum up, an organisation achieves competitive advantage by differentiating itself on strategic factors relevant to its key stakeholders. It takes a position on these factors and delivers superior value. However, it can only sustain its position through operational efficiency, one form of which is cost containment. To maximise long-term profit, a firm must produce effective competitive strategy and achieve lower cost. But lower cost is not competitive strategy.

Let's take a look at that great Australian icon, David Jones. It has 35 department stores across Australia, sales of $1.6 billion and is a household name. Most Australians know it as a 'quality' store, with all that that conveys.

Despite the company's recent bad press over the failure of Foodchain and online shopping, it has recorded a success story. Both the success and failure stories are based on competitive strategy and strategic factors. One, the department store, got it right, and one, Foodchain, completely wrong.

The department store's competitive strategy is focused on a target customer: a 30- to 54-year-old, high-income woman. David Jones has built competitive advantage on the strategic factors relevant to her. These include: image, through its in-store product brands and advertising; customer service, which it monitors vigorously via a mystery-shopper program; store presentation, by having clear lines of sight, by not being overstocked and by general ambience; and product range—many of the branded products are exclusive to David Jones. This combination of strategic factors allows David Jones to be competitive on price, but it doesn't aim to be a discounter.

We can see Porter's influence at work. Peter Wilkinson, until last year the CEO, addressed the Australian Financial Review Boss Club in November, 2002. He described how management queried "whether you should go for price leadership, differentiation or for a very focused program". What he's really asking in our terms is: how should we differentiate ourselves on the strategic factor, price, or on other strategic factors such as product range and customer service? And should it be for a broad target market or a narrow one (a focused program)? Fortunately, they got the answers right for David Jones' core business. Not so in the case of Foodchain.

Foodchain was established by David Jones about three years ago to overcome the cyclical nature of department-store retailing and to achieve David Jones' growth ambitions. These stores are stand-alone gourmet food outlets, located in shopping centres. Several were opened in Australia's major capital cities, and leases were signed for others yet to be developed.

An article in the *Sydney Morning Herald* (21–22 September 2002), reviews the Foodchain venture without ever using the term 'strategic factors', and yet the writer evaluates Foodchain precisely on its ability to obtain competitive advantage on those factors. Among the ones listed are location, product range, hours of operation, price and store presentation (especially design and layout). David Jones misread each of these for Foodchain and suffered the consequences. Its competitive strategy left much to be desired, since it failed to address effectively Foodchain's position on each.

The result, as the Sydney Morning Herald (18 September, 2002) announced: "The meagre net profit [of David Jones] did not reflect the continued improvement in the core department and credit businesses, which increased earnings before interest and tax by 20.5 per cent to $17.4 million". At that time, David Jones had to write down $19.5 million on Foodchain. It has since decided to exit the Foodchain business entirely and has taken a "$78 million hit" on its venture (*Australian Financial Review*, 4 June 2003).

On the surface it may seem an academic question: what is competitive strategy? Yet not distinguishing between strategy and operations is the source of many business failures. It trips managers up time and time again, as they get sucked into operations and operational thinking.

Knowing precisely what competitive strategy is has far-reaching implications for other Australian and New Zealand organisations as well. Our research shows that they are not reaching their competitive potential—on average, they're achieving only 15 per cent of it.

This occurs for two reasons. Firstly, they don't develop strategy that is truly competitive— strategy that will give them a competitive advantage. Secondly, they don't implement whatever competitive strategy they do develop.

If, as we've found, only 30 per cent of their strategies are really competitive, what are the other 70 per cent? The answer is operations—individual activity and organisational programs. Managers habitually mistake operational improvements for competitive strategy. The results? A persistent miscalculation of competitive advantage and a serious overlooking of strategic opportunities.

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