

StrategyLetter[©]

AN OCCASIONAL REPORT ON GLOBAL TRENDS AND NEW MANAGEMENT THINKING

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A new era

Futurists have a terrible track record. At the best of times they call things wrong more often than they get them right. There's no reason to think they know what lies ahead now.

But business is about laying bets. No matter how much information you gather, no matter how much analysis you do or how many scenarios you concoct, you sooner or later have to call a halt, pick one story about the future, and put your money on the table.

In turbulent times, managers need big balls. While it's sensible to have "Plan B" in your bottom drawer and to keep discussing a range of possible futures, you must have the courage to commit to "Plan A" and go all out in pursuit of it. As Russian Poet Yevgeny Yevtushenko wrote a decade ago, "Half measures can kill when on the brink of precipices..." Doing nothing is not an option. Waiting won't work.

Denial is equally dangerous. And it will hurt many companies.

At a leadership conference I attended in London in October, Jack Welch, the recently-retired chairman of General Electric, warned against "seeing the world as you want it to be." It was essential, he said, to look the world in the eye, to face reality, and to deal with the facts – no matter how unpleasant they might be.

Most economists failed to admit recession was on the way before the horrific events of September 11. Though the signals were there (see next article), any downturn was likely to be shallow and brief. Interest rates were falling and oil prices were staying low. Consumer confidence – and spending – remained buoyant. The fact that many dot-coms had become dot-bombs was just a hiccup, a return to sanity. Soon, the good times would be back. Executives, too, were reluctant to acknowledge what was happening. Many complained about "a lack of visibility" but no one seemed especially worried about the long term.

But then came that fateful Tuesday, and suddenly everything changed. The world is now a different place. As U.S. President George W. Bush likes to say, "The first war of the 21st century is under way." Life will never be the same.

Clearly, this is no time for business as usual. But nor is this a time to curl up and abandon all hope. There are opportunities ahead. They may not be the ones you expected, and they may be hard to seize. But they will be there.

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The economic outlook

On November 13, two things happened that caused stock markets to shoot up. First came the view from investigators into the crash of American Airlines flight 587 that the tragedy was probably an accident rather than a terror attack. Then Afghanistan's Northern Alliance troops took Kabul. But it's precisely this kind of good news that can cause managers to make bad mistakes. One swallow doesn't make a summer. *The global economy is sick and unlikely to recover fast.*

Not surprisingly, a lot of managers now blame the attacks on the World Trade Centre and the Pentagon for all their woes. And yes, September 11 was a "strategic inflection point" – a moment of dramatic, structural change. But as I pointed out in my last *StrategyLetter*, trouble was brewing from way back.

On September 10 *The Wall Street Journal Europe* carried the following headlines:

- "U.S. Jobs Data May Dent Consumer Confidence"
- "Wall Street's Decline Spreads Beyond The Technology Sector"
- "Moulinex Falls Victim to Downturn"
- "Computer Demand Hits 4-Year Low Among U.S. Buyers"
- "Anglo American Net Sinks 7% on Commodities Downturn."

On September 11 the *Financial Times* hit the street before the hijacked jets hit their targets. Some of its main stories:

- "Central bankers gloomy on US"
- "Business chiefs fail to banish the gloom"
- "Central Europe's economies start to feel chill wind of global slowdown"
- "Japan's battered economy hit by data blows"
- "Hotels hit by drop in visitor numbers."

Since then, the news has gone from bad to really serious. While some economists, analysts, and executives try desperately to put a positive spin on the data that's coming in, and to sound convincing when they talk of an upturn in the next few months, many more are less sanguine and a lot are downright pessimistic. Some reasons:

- In October the U.S. Conference Board's index of economic indicators showed the biggest one-month drop since 1996. In the same month, American firms shed 415,000 jobs, a 20-year record. Consumer confidence is 40% below its peak in January 2000.
- The International Labour Organization says 24 million jobs could be lost around the world in 2002.
- A survey by the Institute of Directors in the U.K. has business confidence in Britain at a three-year low. In September the manufacturing sector reported its biggest monthly contraction in a decade. The Chartered Institute of Purchasing and Supply reported the biggest-ever October contraction in the service sector. Consumer confidence has held up, but retail sales fell in October for the first time in 18 months.
- The September 19 Ifo index of German business confidence showed the steepest monthly fall since 1993. Manufacturing output in October was at a six-year low.
- A study for the *Financial Times*, *FT Deutschland*, and *Les Echos* sees growth in the eurozone economy falling from about 1.2% in the third quarter to 0.5% in the fourth, with year-on-year growth of 0.4% in the first quarter of 2002.
- Japan is in its fourth recession in a decade, with unemployment at its highest level

since the 1950s. The Bank of Japan said in late October that the economy would keep shrinking through 2003. More recent government forecasts warn of the fastest decline in 20 years. Deflation and problems in the banking system are a dark cloud.

- Singapore is in the worse slump since independence in 1965. Taiwan's export orders fell 26.6% in September against last year, the biggest drop since 1981. China's export growth has slowed from 27.8% last year to 7% in the first nine months of 2001.
- Argentina has been in recession for four years. Early in November the government announced the biggest national debt restructuring ever, but bond-rating agencies denounced it being no less than a default. The big worries: what happens to neighbouring countries in South America if this domino falls, and what will be the impact on investment in other emerging markets? (Bolivia, Indonesia, Pakistan, the Philippines, Thailand and Turkey also have dodgy debts.)
- The IMF has cut its forecast of global growth for this year (from 2.6% in its October report) and next (from 3.5%) to 2.4%. Anything under 2.5% is seen as recession.

Growth is stalling just about everywhere. *Corporate profits are falling fast as a result of a triple whammy: (1) lower sales volumes, (2) declining prices, and (3) rising costs.* Fears of further terror attacks will haunt the world for the foreseeable future, and introduce unwelcome friction into what was seen a short while back as a "friction-free" economy. New security measures will slow the movement of people, goods and information, and make it more expensive. Companies that rely on the mail to do business – mail order merchandisers, on-line retailers – will take strain from anthrax attacks and threats.

Some industries – IT, airlines, and tourism – are in deep trouble. Investment banks are desperate for deals. Paper and steel companies are bleeding. Sales of luxury goods will stay slow (not least because airports account for about 10% of sales). Polaroid has gone bust and Eastman Kodak reports a fall in film sales (U.S. theme parks bring 5% of volumes). Media owners and advertising agencies are feeling the pinch as promotional budgets are cut. Management consultants and executive search firms report a sharp fall-off in assignments.

Only a short while back, the tech slump was seen as the prime cause of wider economic softening. So it was easy to be optimistic about a rebound. But the story is more complicated.

The conditions which led to more than a decade of unprecedented global economic growth have been radically altered. There are uncertainties on every front.

Yes, there is good news

Is there any good news around? Of course there is. Think about this:

- Central banks are cutting interest rates faster than at any time in history. The U.S. government is pumping money into the economy.
- Wholesale prices in the U.S. plunged 1.6% in October, the biggest monthly drop since 1946. Key drivers of price deflation: *gasoline and energy costs* which fell by the biggest amount in 12 years.
- Already, countries that weren't speaking to each other just a short time ago are now in bed together. Russia and the U.S. are having conversations about nuclear arms that were impossible until September 11.
- Some countries will score handsomely from their response to current events. They will gain stature (and legitimacy) in the community of nations, forge new relationships, win strategic support, and benefit from trade and aid.
- Some firms will emerge from these difficult times in better shape and with bigger market shares. Some will take advantage of the turbulence to kill off competitors or snap them up at bargain prices. The hype of recent years and the obsession with

management fads will give way to a more down-to-earth view of how things work and what needs to be done to get results. Companies will shed people and functions they should never have had. They will pay more attention to customers. And they will become more innovative, because the pressure to do so is immense.

- Many individuals will find ways to further their careers, to grow, to care better for their families, and to contribute more to their communities. Some will become entrepreneurs, because they are cynical about corporate life, or tired of it, or lose their jobs. Some will go back to school, and reinvent themselves intellectually. Many will take up sports and become more mindful of their health; they will engage in hobbies alone or with their loved ones; and – believe it or not – they will travel more, to learn more about their world and to pack more adventure and experience into their lives.

We are living in extraordinary times. We need to be grateful for the opportunity, and constructive and positive in dealing with it.

Create a context for performance

The evidence is everywhere: corporate performance is a result of what happens *inside* rather than *outside* an organization (Figure 1). Management's attitude and behaviour are more important than the state of the economy, competition, or any of the other usual scapegoats.

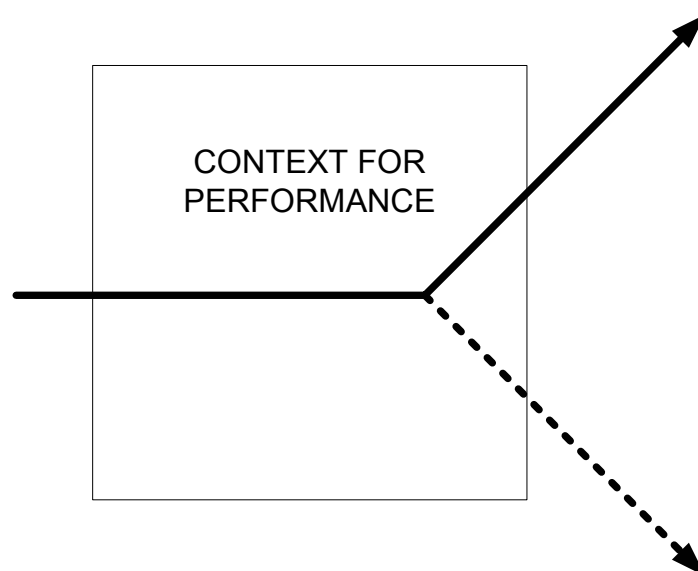


Figure 1

Executives like to say they produce results. In a one-person operation, or even in a very small firm, that might be so. But *once there are more than a few people the best a leader can do is create the conditions – the context – in which other people will produce results*. In fact, this is the ultimate leadership task.

This is a powerful insight, because too many business people see trouble outside and bring it inside. They assume they're constrained by external circumstances, and they respond by saying and doing things that constrain their people.

If external conditions mattered, two factors would play a part: 1) the *industry* in which a firm operated, and 2) the *current environmental situation* (politics, economics, society, technology, competitor behaviour, customer behaviour). Let's look at them separately.

1. One school of strategy argues that industry does matter: that some industries are inherently more profitable to be in than others. But studies by business academics

such as Richard Rumelt, Charles Baden-Fuller, and John Stopford, and by many economists have shown that this is just not so. The statistical link is weak.

Gary Hamel and CK Prahalad (*Competing For The Future*, Harvard Business School Press, 1994) provide many examples of companies that have broken free of their "industry shackles" to become star performers. For more proof, just check the rankings in the *Fortune* 500 lists.

2. There is no arguing that there are good times and bad times for business. But what's good or bad for one company is not necessarily the same for all. So some firms do well only when things go their way, but under-perform otherwise. A few perform through thick and thin; they seem to thrive on adversity.

In a review of the performance of British firms in the recession of the early '90s, economists Paul Geroski and Paul Gregg (*Coping With Recession*, Cambridge University Press, 1997) concluded that all of them weren't equally affected. Profits of the bottom 10% fell by almost £30 billion while those of the top 10% grew by £10 billion (most in the middle hardly changed). And a new book by Jim Collins (*Good To Great*, Harper Business, 2001) confirms that performance has less to do with environmental factors than with management choices.

Add up the facts, and you come to a simple conclusion: *there are "good time" managers and there are "all-weather" managers. The first lot create organizations that are buffeted by the slightest change in the wind; the second sail through everything.*

All-weather managers are team players. They know they can't do everything themselves, and they work hard to make their teams effective. They do this not by sending them out on wilderness courses, beating drums, or letting their emotions hang out with the help of psychologists, but by (1) selecting for "stardom" and (2) engaging their people in a rich, purposeful, and robust strategic conversation. **(For more on this important topic, see my latest book, *Making Sense of Strategy*, Zebra Books 2001.)**

Careful selection is vital. People are not all the same. Some are natural performers and can be largely left to "get on with it." They don't need micro-managing. Others must be supervised constantly. The first give you a head start; the second cost you dearly.

The context in which people function can be either *nourishing* or *toxic*. Which it is depends 100% on the "strategic conversation" of the leader/s. What they say, to whom, and how has more impact on performance than all the incentives in the world.

Companies like to boast that "our people are our most important assets." Yet executives will also complain that "You can't rely on them" ... "There's no loyalty anymore" ... "The work ethic is gone." All not true, and all easy to fix.

What does "think strategically" really mean?

Almost every discussion about strategy comes down to this dilemma: Should we focus on *direction* or *performance*? Questions of direction address who you sell to (customers), what you offer (products and services), and how you do it (your business model). Performance is about improving quality, productivity, costs, speed, and satisfaction. (Figure 2.)

Managers get together to talk strategy for various reasons. Sometimes, it's because they intend selling or closing a company or exiting a market. More often, it's to find new growth opportunities or to make the current business more effective, or both.

New opportunities call for a change in direction. Effectiveness is a performance issue. These are two sides of the strategy coin, and both are vitally important in the creation of shareholder wealth and long-term survival. So in most strategy workshops, it's quite natural that conversation should swing from one to the other. Yet when it tends towards performance, there'll always be someone to say, "Stop! That's operational. Let's get back to strategy."

To a start-up business, direction is obviously the thing that matters most. (After all, you can't improve a business you don't have!) Mature organizations, on the other hand, must constantly review both their direction and their performance, and explore possibilities for change in each of them. And of course, you have to make judgements: sometimes it will be most appropriate to adjust your direction, while at other times performance improvement will be best.

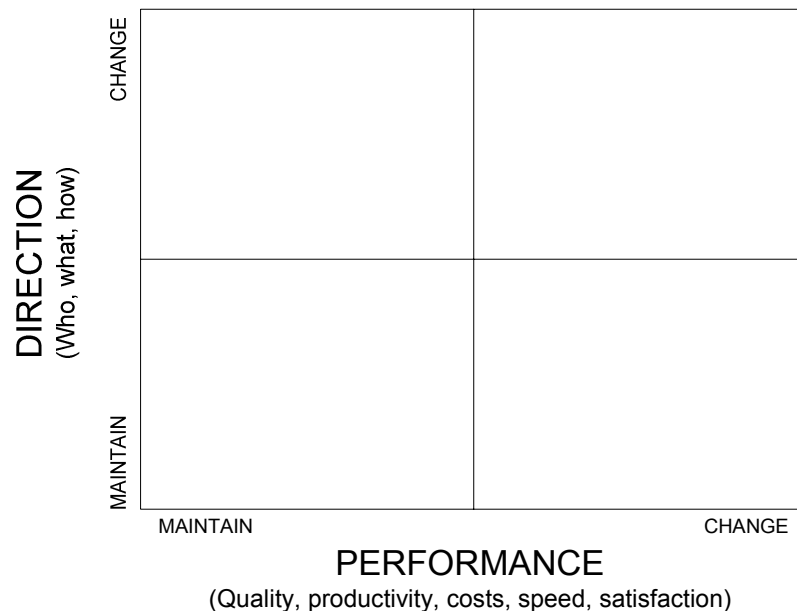


Figure 2

When a company is in trouble, the priority must be to *stop the bleeding*. Costs are an obvious target for urgent action. But while it's tempting to put your head down and home in on operations, and to forget about everything else, this is never enough.

Every company needs to keep an eye on "the basics." In hard times, it's especially important to "get back to basics." But these include more than just performance issues.

Many companies I've worked with have under-performed – or got into serious trouble – not because their costs have run out of control or their quality has deteriorated, but because *they've lost focus in the marketplace*. They don't know who their customers are. They don't know what those customers buy, how they define "value," or who else they buy from. And their business models don't give them a competitive advantage.

Executives in these firms must get back to basics on both the direction and the performance fronts. Tackling one while ignoring the other can make a bad situation worse.

But executives in *healthy* firms face exactly the same challenge. They too, must reinvent themselves in both ways. Anything less is to concede opportunities to an enemy.

For too long, there has been too much talk of "strategy" vs. "tactics," of "strategic" issues vs. "operational" ones. To make these distinctions is nonsensical. It adds nothing to any management conversation. *Companies that aim to be world class have no choice but to push the limits in terms of both direction and performance.*

Use my matrix in your next strategy debate. It'll help you decide rapidly what your priorities should be and where to aim the conversation. Even more important, it will help your team see that strategy is a complex matter, that competitiveness depends on getting a lot of things right, and that *balance* is a necessity.

10 Ways to capture customers

Since businesses rely on customers for their lifeblood, it's hardly surprising that customer service has become a hot topic in recent years. What is surprising is that so few managers (a) see capturing and keeping customers as the central issue in strategy and (b) exploit the many opportunities for doing it.

Strategy is about connecting a company and its customers. This interface happens in various ways and at various levels. Obviously, the more links you can make, the better. Plug into one need, and you may win a sale and maybe even some repeat business. But add links and you start to embrace the customer; future sales become more likely and competitors have a harder time finding a gap.

A best-selling book of 1995, *The Discipline of Market Leaders*, suggested a simple framework for market domination. According to authors Michael Treacy and Fred Wiersema, the trick was to seek absolute leadership in one "dimension of value" – product leadership, operational excellence, or customer intimacy – and to deliver "threshold standards" in the other two.

Now Fred Crawford and Ryan Matthews have come up with research (*The Myth of Excellence*, Crown Business, 2001) showing that every business transaction hinges on five factors: price, service, access, experience, and product. Great companies, they say, select one and aim to be best at it, even when there is little real difference in the actual product or service.

These are simple formulas, and they help ensure that value propositions are clear, focused, and based on one "big idea." But as I pointed out in my own book *Radical Strategy* in 1998, there is a simple flaw with them: what if your competitors don't realise they have to lead in just *one* area, and instead push the limits on more ... or even *all of them*? (Examples: Dell Computer, Amazon.com, Bell Equipment.)

When customers buy almost anything, they weigh up many factors. So while it's important that you make your "unique selling proposition" single-minded and easy to understand, you also need to be sure of hitting *all* the buyer's hot buttons. Depending on what you're selling, there are as many as 10 of these (Figure 3):

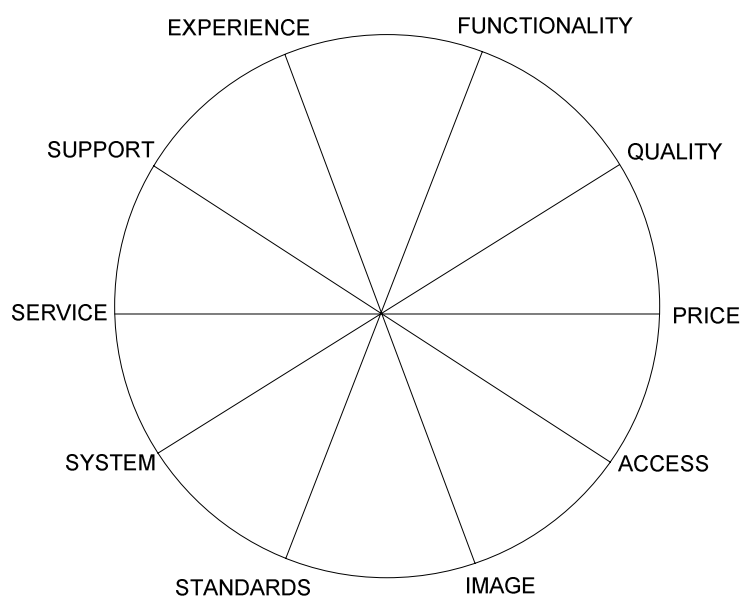


Figure 3

1. FUNCTIONALITY – How well does the product/service do what's expected of it?
2. QUALITY – How closely does it conform to specifications and satisfy customers' expectations?
3. PRICE – How expensive is it relative to other offerings?
4. ACCESS – How easy is it to find/buy/use it?
5. IMAGE – What is the customer's level of awareness of it, and how favourable is their perception?
6. STANDARDS – Does it set or conform to industry standards/is it the benchmark in its category? How important are those standards to customers? What effect do they have on the actions of competitors and on providers of substitutes?
7. SYSTEM – Is it part of a system which offers complete value? How critical is it for customers to buy into the system?
8. SERVICE – How easy/pleasant is it to buy and own this product?
9. SUPPORT – What systems and structures are in place to ensure future satisfaction?
10. EXPERIENCE – How easy/entertaining/satisfying is the customer's overall purchase/ownership experience?

These factors are not mutually exclusive. The fact that you rate high on one doesn't mean you can't also do well on the others. Rather, you should strive to do just that – to push the limits on each of the 10 areas.

Simplicity is important, otherwise you may hurt your own efforts. But *the more complex your attack, and the harder it is to implement, the more difficult it will be for competitors to fight.*

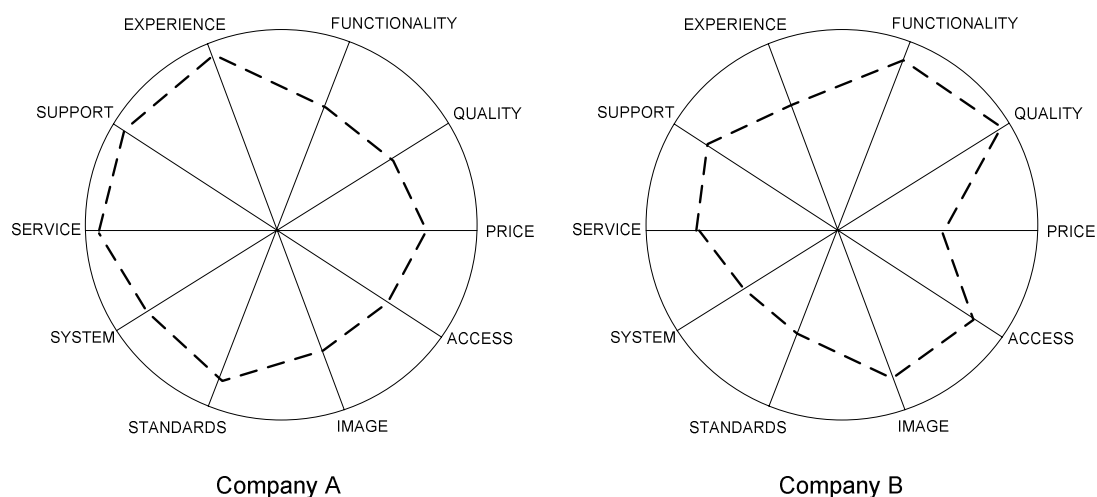


Figure 4

By rating your performance in each area against that of your key competitors, you can gain useful insights into where tomorrow's positioning opportunities lie (Figure 4). You'll also identify where you need to make more effort and where competitors are likely to attack you.

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