AN INTERVIEW WITH

C.K. PRAHALAD

CO-AUTHOR OF "COMPETING FOR THE FUTURE"

BY JOEL KURTZMAN

OVER THE YEARS, C.K. Prahalad, the Harvey C. Fruehauf Professor of Business at the University of Michigan Business School, has earned a distinguished reputation from numerous contributions to academic publications that shed light on strategy, global competition, marketing and corporate structure.

With his most recent co-author, Gary Hamel, a professor at the London Business School, Professor Prahalad has written a number of pathbreaking articles and coined such phrases as the "core competencies of the corporation," "strategy as stretch and leverage" and "strategic intent." The articles were more than just scholarly, well-researched presentations. They also withstood what Professor Prahalad has called the "managerial test" — they were actionable. Indeed, the professor's consistent ability to articulate leading-edge, actionable ideas has made him a popular speaker at gatherings around the world as well as a sought-after adviser to chief executives.

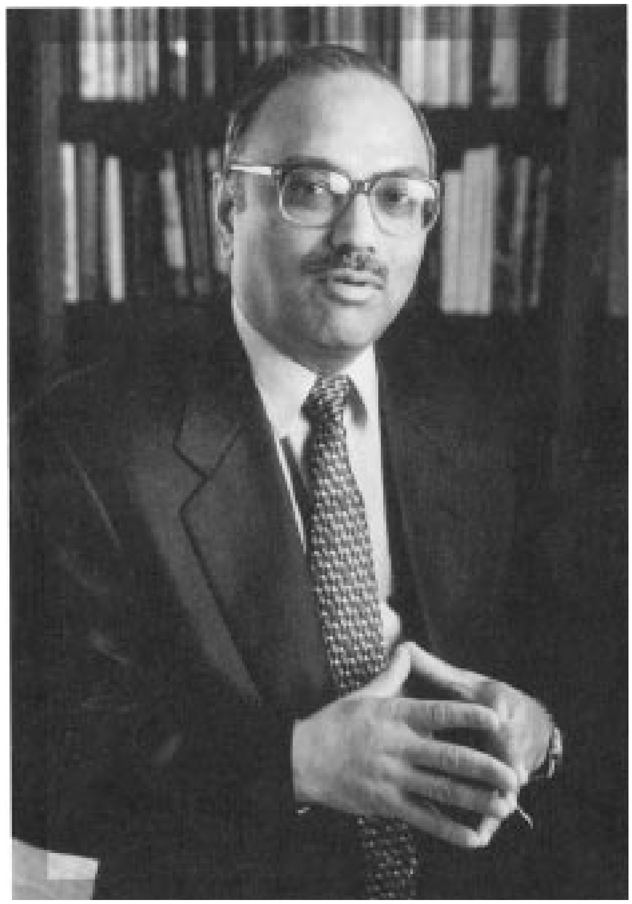
While Professor Prahalad and Professor Hamel drew attention with their articles, it was not until the publication of "Competing for the Future," in 1994, that they attained the level of recognition that their new research deserved. The book, though brought out by an academic publisher, the Harvard Business School Press, immediately attracted the interest of the major media. It also quickly gained a large following among managers and other readers, who have snapped up more than 250,000 copies in hardcover, making it one of the top-selling business books in history. Business Week named it the best management book of 1994 and its insights have since been taught in business schools throughout the world.

Since the book was published, Professor Prahalad, who is 55 years old, has confined himself to teaching, research, speaking and consulting. While he is not yet ready to write another book, his thinking has progressed. One of his major concerns is whether large companies are appropriately governed and adequately managed to compete against new rivals in the future. He is also greatly concerned about the strategy-making process. At most companies, he says, that process is elitist, involving only top-level managers. But strategy is revolution, he says, "and no monarchy has ever fomented its own revolution." Instead, many people throughout the company should be involved, he argues, even those who are at low levels or are new to the enterprise.

What follows are excerpts from a recent conversation with Professor Prahalad at his home in Michigan, along a tranquil river outside Ann Arbor.

Joel Kurtzman is editor of Strategy & Business.

S&B: *C.K., you said recently that one of management's traditional functions has been to break the company into what you call "bite-sized pieces," so that it can be correctly structured and managed. You have also said that the way this was done in the past may not be suited to the future. What do you mean by that?*



C.K. PRAHALAD: These bite-sized pieces are the business unit, national organizations and so forth. They are the basic units of analysis, accountability and resource allocation.

There is, however, a problem with this. The problem is that the basic unit of analysis can be quite different for different tasks. For managing existing businesses and creating accountability, the business unit may be a good starting point. On the other hand, if you want to look at competence building, then you have to transcend individual business units. As a result, one of the really interesting questions is how to define the basic unit of analysis in a large firm. Is one definition appropriate for all tasks? The answer is probably not.

Take, for example, building a global brand franchise, or "share-of-mind" for a company. That is not the task of a single business unit. It transcends business units. Think, for a moment, of Sony. Sony's identity is consistent around the world. This identity is an important asset to protect. Are the Walkman and a broadcasting system both consistent with Sony's overall identity? Yes, they are. But you can't have Sony mean high-end, innovative products in one market, say the United States, and low-end, cheap products elsewhere. The company's identity, its skills, its reputation have to be consistent across all of its products, all of its business units, all of its markets. Is the business unit the unit of analysis in managing Sony's brand franchise? I would argue that it is not.

Now think of Canon. Canon has many, many businesses — cameras, copiers, printers and so on. When you hear "Canon," you have certain expectations, certain assurances, promises of what the product will be like, whichever branch of the company produces it. Is the business unit the correct unit of analysis in Canon's case? Again, I would argue that it is not.

Take also competency building. It too is larger than the business unit, as are management development, skill building and relationships with partners. These issues cut across multiple business lines. If this is the case, who provides the gateway? Who shepherds those relationships?

S&B: *You are not arguing that the era of the business unit is over, are you?*

C.K. PRAHALAD: No. There are many aspects of managing that are still within the domain of the business unit. People have spent a lot of time thinking about how to divide companies into bite-sized pieces. They've done so for reasons that made sense in the past, not necessarily for reasons that make sense for the future. Business units were focused on accountability. They are inappropriate vehicles for corporate resource leverage — creating skills and new business opportunities. I am saying that if we imagine the future, examine management's needs and processes, we will conclude that a total dedication to the business unit approach might be very limiting.

S&B: *So, just how would you change things?*

C.K. PRAHALAD: Let's go back to the basics for a moment. Each layer of management has its function. One of those functions can be termed "consolidation." This is really just collecting and adding up the data. It is purely a mechanical task that moves information about how the business is doing — particularly financial information — up the hierarchy. Then there is the job I call management's "checking-and-cost-correction" function. As part of that function, each layer checks on the levels below to make certain they are following the trajectory that is appropriate and in line with the expectations of the company or the sector as a whole. Then there are the wisdom-and-mentoring roles of management, which are to provide support to people who are on their way to higher levels of management. Finally, there is the function that we just spoke about of "getting-the-company-into-bite-sized-pieces." This enables people to track performance and it creates administrative structure.

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Now, if you think about it, the consolidation role has been made very easy due to the advances in information technology. I can get data on any operation today in any number of ways. I don't need a particular level of management assigned to do the task.

In addition, the checking-and-cost-correction function — making sure the company is on the right trajectory — was quite important when people did not have a shared view of where the company was going. This function was particularly important when communication was poor. However, if we get people to agree to a shared agenda, so everyone knows where the company is going and how they fit in that vision, then there is little need for this layer of management either.

A good example of what I mean is quality. If we have deployed a quality program in a company, and everyone understands its importance, then we don't need thousands of people checking the quality of every product. The deployment of the program eliminates the need for the checkers. So why do we still have management checkers? The only reason we need them is that we have not yet been able to deploy strategies effectively and build a shared agenda within companies. My conclusion is that the more we are able to build a shared mindset within companies, the less we will need this administrative layer of management. This layer can become much smaller.

However, while the other layers shrink, there is going to be an increasing need for the mentoring role of management. Here the question is whether mentoring should be done only by people who have an administrative position higher than one's own, or whether it can be done by counselors and helpers who can provide mentoring even though they are not necessarily in a higher position administratively. That is an open question.

S&B: *They say that Konosuke Matsushita, the founder of Japan's Matsushita Electric, viewed his driver as one of his mentors and never failed to ask him for advice.*

C.K. PRAHALAD: Yes. Mentoring requires special skills, but it does not require hierarchical position.

S&B: *Even so-called flat organizations have some hierarchical layers of management. Are these simply legacies from the past?*

C.K. PRAHALAD: Partly they are legacies of the military system of command, and partly they are the legacy of Taylorism and so-called scientific management, where people were expected to specialize so much that a lot of coordinators were needed. It is also simply an element in the way we think. In the sciences, we tend to take complex problems, disaggregate them into their components — or what we think are their components — and study each component in great depth without understanding too much about the interrelationships across those components.

The goal has been to understand, in great detail, an isolated element, not the place of that element in the totality of the system. Increasingly, however, people are learning that they must understand the big picture and then the place of the elements of their specialization inside that big picture.

S&B: *How do you get people to see the big picture and their place in it?*

C.K. PRAHALAD: You train people to do this. You do it by getting people with different functional backgrounds to work together in common tasks under time pressure. You do it by getting them to achieve goals where they must understand what the other person can contribute and why the other person's contribution is important. This learning has to be experiential, not intellectual.

S&B: *You have spoken about business units. What about the corporate center? Are you in favor, as so many people are, of shrinking it? Some companies, like Britain's Boots, a pharmaceutical and chemical concern, have limited the size of the center to about 100 people. Do you agree with decisions like that?*

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C.K. PRAHALAD: I am always hesitant when people come out with simple formulas for complex tasks, like saying that the corporate center should have no more than 100 people. I don't feel comfortable making a statement like that. My answer to size, structure and role questions with respect to the corporate center is that it all depends.

It all depends on the nature of the business, the complexity of the business and the tasks to be performed. For example, the Hanson Trust can run a large, multibillion-dollar portfolio of companies with only 25 to 30 people at the top. But the reason is that Hanson is a pure conglomerate. Each business has very little in common with the other businesses and the role of the corporate center is to bring fairly strict financial discipline to the companies, most of which operate in traditional, low-tech industries.

That is very different from running I.B.M., or very different from running Hewlett-Packard. In these instances, there are extraordinarily complex relationships that run across a wide range of businesses, with many shared technologies, shared distribution channels and so forth. In order to at least understand the nature of those interlinkages, and to determine what to manage and what not to manage, a very different type of top management from the people running Hanson Trust is required. The question for me is not whether we need 100 people or 200 people, but how the nature of the internal governance process changes, given the nature of the portfolio and the way in which value is created.

S&B: *Are there rules by which you can make those determinations?*

C.K. PRAHALAD: Not rules, exactly. Look at Hanson. I think of it as a "disciplined owner" that has a portfolio of stand-alone businesses. When I think of Hewlett-Packard, it is as a family of businesses, not a portfolio. HP's family of businesses has common competencies, technologies, channels and opportunities. These present different internal governance challenges for the corporate center.

Hanson's internal governance is based on financial discipline, for example. In fact, one of the vice chairmen said he had never even visited the factories of the companies that Hanson owned. He's comfortable with that and I must say I have a lot of respect for Hanson, as a company. On the other hand, if someone in senior management at Hewlett-Packard said he never visited a lab or factory or division, I would be extremely worried.

For these reasons, I have great difficulty in understanding why people look at a company like General Electric, for example, and say we should be like that. G.E. is a unique entity. There is only one G.E.

As you can see, the question of the corporate center has a different answer, depending upon who is asking it.

S&B: *You mentioned internal governance. How do you see that working?*

C.K. PRAHALAD: I have been giving a great deal of thought to a number of closely related ideas. These have to do with strategy and with the processes of governance within companies. I'm less worried about the external governance issue, which is a topic of debate among shareholders, boards and C.E.O.'s. By internal governance, I mean the ways in which things are actually accomplished — or not accomplished — inside companies. It also has to do with who does those things and for what reasons.

The focus of my analysis is the internal governance process. By the time the C.E.O. sees a negative result in the P&L statement, in market-share loss statistics or in the company's inability to deliver new products quickly, it's simply too late. The cancer has already set in and large companies have an enormous amount of inertia when it comes to change. That means the real issue is how do you prevent the cancer from developing in the first place? How do you develop a methodology for assessing the quality of internal governance, especially in a multi-business company?

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I think that question raises interesting issues about the nature of the relationship between headquarters and subsidiaries — which is an old problem — but it does so in a new context. It also raises interesting questions about the future and who should think about it.

S&B: *What is the new context to which you are referring?*

C.K. PRAHALAD: It is simply that today you cannot allow subsidiaries to be totally autonomous — nor can you expect them to be slaves of headquarters. That presents a tension.

S&B: *Is the debate, therefore, about autonomy versus control? Is it, as Charles Handy maintains, about subsidiarity? Or is it about centralization and decentralization?*

C.K. PRAHALAD: I am afraid it is about neither of these. My starting assumption is that the debate gets framed as centralization versus decentralization. But that is the wrong way to look at it. I think the debate ought to be framed in terms of the value that is added by each layer of management. The debate should be about how various groups — staff groups and line groups — at various levels and in various places in the organization really add value to customers and add value to the people who have to deliver a functionality to the customer. The debate should not be about power, nor should it be about egos, span of control, decentralization versus centralization or size. The debate should be about adding value throughout the organization.

If that is the case, then the question really becomes how do you create structures internally so that relationships are based on value creation. If you look at structure from a value-adding perspective, then there is an important issue related to internal governance that must be addressed. I frame it this way: Who has responsibility for competitiveness?

Almost all traditional views of strategy have been very elitist when it comes to this question. The assumption is that top managers develop strategy and everybody else implements it. I don't think that is the correct answer to the internal governance question.

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S&B: *What is the correct answer?*

C.K. PRAHALAD: Let me say the following before I get to my answer. We are in an era of discontinuous change, whether we are talking about telecommunications, health care, financial services, high-volume electronics, retailing or the Internet. As a result, we are no longer talking about fine tuning or improving the organization's efficiency. We are talking about nothing less than reinvention — reinventing the business in fundamental ways.

Reinvention requires a new skill mix and new ways of approaching the business. It may require different business models. It may also require different people. It is not at all clear to me that the same people who are socialized in the standard way of doing business — and who understand a certain recipe for how to manage — can change very quickly and become the inventors of the new business model. As a result, companies have been looking outside their basic industries for people who can thrive in the new environment. Look at George M.C. Fisher — he came from Motorola to run Kodak. Or look at Louis V. Gerstner Jr. — he came from RJR/Nabisco to run I.B.M. They were hired to bring a different perspective to these companies.

Now, to your answer. I have been experimenting with ways to enable people lower down in the organization — people who are closer to new technologies, to customers and to competitors — to create the point of view and dialogue that is needed as a prerequisite for change.

S&B: *How has it worked?*

C.K. PRAHALAD: So far, where we have tried it, the results have been successful. We have found people deep down in the organization to be receptive to change. We have also found tremendous creativity and knowledge there — so much so that senior managers have been quite surprised.

S&B: *It sounds as if you are saying that people lower down in the organization — or from outside the organization — are able to embrace change and are able to lead it, while people at the top are more set in their ways.*

C.K. PRAHALAD: I would rather put it this way: not long ago, it was popular to say that there were no natural constituencies for change inside large companies. But I would now argue that it is not a matter of constituencies, but of forums. There are no natural forums for focusing the energies of people who are waiting for change to happen and who understand that change needs to happen. Almost all of our current management forums, be it planning or budgeting, are status quo oriented, not change oriented.

What we need to create inside companies are forums wherein people can contribute to the changing dynamics of the industry, talk about how they can best add value and then move on from there.

S&B: *How do you create these forums? Who takes part?*

C.K. PRAHALAD: Initially, we create them in an ad hoc way. We select between 16 to 20 people who meet the following criteria: they have four to five years' experience in the industry; they've accomplished something; they're respected by their peers; they have a contrary streak.

S&B: *You want people with a contrary streak?*

C.K. PRAHALAD: Yes. We don't want people who do not think outside of the box or who do not have a natural predilection for creativity focusing on change. We don't want people who are satisfied with the way things are. We want people who are curious, impatient and who are constantly trying to buck the trend of the received wisdom.

"THINK ABOUT STRATEGY AS REVOLUTION, STRATEGY AS DISCOVERY, STRATEGY AS INNOVATION, STRATEGY AS CHANGING INDUSTRY NORMS, THEN ACKNOWLEDGE THAT NO MONARCHY HAS EVER FOMENTED ITS OWN REVOLUTION."

S&B: *Once you have chosen these people, what do you do?*

C.K. PRAHALAD: We give them some training on how to think of the future and then we separate them into two teams so they can compete with each other on developing a point of view about where their industry is going and how the company should position itself. Then we let them make competing presentations to top management.

In this program, top management gets two views of the future, rather than one. The assumption is that some of the critical issues that probably were overlooked or under-emphasized by one team will be captured by the other.

S&B: *Why do you have new, relatively inexperienced managers develop competing notions about the future? Why not have a group of really experienced people leading the teams? Or why not have a mixed group?*

C.K. PRAHALAD: If you think about strategy as revolution, strategy as discovery, strategy as innovation, strategy as changing industry norms and industry patterns, then you must acknowledge that no monarchy has ever fomented its own revolution. In other words, senior management does not have a great propensity for change.

S&B: *Where have you tried this approach and seen it work?*

C.K. PRAHALAD: I have seen it work in a wide variety of companies, in so-called mature industries (a concrete mixing company, for example), in state-of-the-art technology-oriented companies and in service-oriented companies. Companies that come to mind are Marriott, Steelcase, Oracle, Quantum and Eastman Chemical. There are others as well.

S&B: *What you're suggesting sounds similar to the strategy-formulation process of some Japanese companies. In those companies, younger managers get together and propose new directions to older, more seasoned managers. Good ideas go all the way up the organization. If they come down again, and there is consensus about the merit of the ideas,* *they are put into action. Conflicting views are sometimes merged, good ideas are incorporated regardless of where they originated and bad ideas are silently discarded. Is that comparison fair?*

C.K. PRAHALAD: It is fair and not so fair. It is fair in the sense that the process involves active dialogue between multiple layers in the company and multiple functions within the company. It is fair in the sense that there is a great deal of responsibility placed on people at lower levels in the organization for thinking about the overall company — not just their particular functional area. Of course it is fair in that there is a certain humility required of top management. They must listen, after all, to people who are not on their level administratively.

It is not fair, however, in the sense that what I am talking about is not cultural at all. It is a way of managing that rests on the belief that people can think and can be creative, no matter what their nationality. It is also democratic. Democratic in this context means everyone has the chance to contribute to the overall direction of the company. True, ultimately a company has to focus and choose a direction. But at least everyone's voice was heard.

S&B: *Because everyone is heard — including the team that lost the strategy debate — is the result more cohesion with respect to the company's direction?*

C.K. PRAHALAD: Yes, but I do not believe there are winners and losers in such a forum. You start by bringing to the table a discussion about a wide variety of issues. Over a period of time, through discussion and analysis, these issues are formed into your company's point of view. When you finally decide on the company's strategic architecture and strategic intent — when you decide what it should do — the actual individuals who contributed the ideas become impossible to isolate.

S&B: *What you're suggesting puts new demands on lower-level people in an organization. But it also puts new demands on the people at the top.*

C.K. PRAHALAD: Yes. But my experience is that people at lower levels have less of a problem accepting their new strategic roles. True, they may be a little apprehensive at first, but they accept their new roles easily and seriously and they usually do an incredibly good job. The more difficult transition is for senior managers. Their perception is that they lost control and influence because of the process and that their power and influence have been diluted. They have to come to terms with that.

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S&B: *How do you implement this program?*

C.K. PRAHALAD: There are stages. First, you must get broad support for the program, get perspectives from deep in the organization and put together a synthesis of what the teams come up with, which includes the judgments of top management. You must also craft a point of view on how the company is going to compete. Then you have to deploy the ideas throughout the organization so everyone understands the direction the company is taking and where they fit in the new framework.

And once you have done that, you have imbedded the company's strategy within the entire firm. SI

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