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ONLINE AUGUST 14, 2014

Where Are the Sinkholes in Your Strategy?

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BY KEN FAVARO

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Formerly Booz & Company

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My firm was once asked by a CEO to assess the strategy of his company, one of the world's largest. He wanted to know if there were any holes that he and his board should address. I've always thought this showed great leadership and confidence. (Strategy is a lot like IQ for many people: to challenge their strategy is to question their intelligence.) It also revealed his keen awareness that no strategy is perfect.

We started by asking two questions:

1. What distinctive capabilities make the company better than any other at how it adds value to its individual businesses, and how those businesses meet their promises to customers?

2. Are changes happening in the company's world that could render its distinctive capabilities obsolete or insufficient?

The first question requires you to be clear about the capabilities that make your company special. Consider, for example, Frito-Lay's direct-to-store delivery capability, Inditex's fast-fashion supply chain, and Toyota's production system. When company leaders understand their defining capabilities, they can make smarter decisions about what businesses to buy and sell, which markets to enter and exit, what customers to target and value propositions to promise, how to prioritize new product development and costs, where to invest, and all the other choices that are inherent in sustaining a great company.

All too often, though, answering the first question reveals a poor definition of the company's ideal customers, an insufficiently compelling value proposition for a particular target market, or a lack of clear-cut choices about how to enhance the competitive advantage of individual businesses. In one case, for instance, it became clear that a company's upstream "suppliers" should really be its target customers and that its strategy fell short of having a distinctive value proposition for those customers. Company leaders could not articulate the capabilities they needed to realize a great growth opportunity.

This takes us to the second question. The corporate landscape is littered with companies whose strategies became obsolete faster than they were able to reinvent themselves. For example, deregulation killed off icons in the airline business such as Pan Am and TWA. Digital technology overwhelmed Kodak's formidable business in photography. The emergence of e-commerce obliterated the likes of Borders, Circuit City, and Blockbuster. Smartphones put Nokia's cell phone business into a death spiral, and sleek, touch-screen smartphones did the same to BlackBerry's core product.

In fact, few companies in any sector can afford to ignore the second question. Consider credit cards, big-box retailing, and the U.S. healthcare system.

All the major card companies are seeking to move from traditional payments to digital commerce. In pay-

Ken Favaro
ken.favaro@strategyand.pwc.com
is a senior partner with Strategy& based in New York. He leads the firm's work in enterprise strategy and finance.

ments, core capabilities are tied to driving card usage because the economic model is based on card transaction fees. But as they move into digital commerce, these companies need a new set of capabilities: the ability to generate, analyze, and use customer data in order to drive sales and loyalty for their primary customer—the merchants that accept their cards.

In big-box retailing, most players have run out of room in their home markets for laying down more super stores, so they are seeking growth by using a small-store format to penetrate pockets of geography their bigger stores cannot reach. But the capabilities needed to succeed in these smaller formats, such as merchandising, managing store staff, and operating supply chains, are very different from the capabilities required for large-format retailing.

For healthcare providers in the United States, the push for more accountable care will require new business models in which sharing medical risk with private and government insurers increasingly becomes the norm. And, of course, such models will demand a set of capabilities now alien to most of them.

There are a handful of leaders who successfully managed the obsolescence of their capabilities, and in the process breathed new life into their companies. Andy Grove famously pivoted Intel from a memory-chip company to a smart-chip company, Lou Gerstner turned IBM from a hardware OEM to an IT services provider, and Phil Knight transformed Nike from a sneaker company to a sports licensing company.

Most strategies have sinkholes. Some are obvious; you just need to know what you are looking for. Others develop more slowly, becoming apparent only when it's too late. The former often come from confusing "strategy" with vision, mission, and purpose statements, or with plans and goals. Companies that suffer from this confusion usually have little to say about that first question above. The latter arise from ignoring the second question until it's too late. These sinkholes result in strategies that are too static relative to the pace of change in most companies—where the ever-evolving world of customers and competitors threatens to make their capabilities obsolete or insufficient. +

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