

An Essential Step for Corporate Strategy by Tim Laseter

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Though often missing, a formal operations strategy can guide the crucial decisions that build competitive advantage.

by Tim Laseter

After more than a decade of writing articles on strategic operational issues for *strategy+business*, I realized that this column, despite its name, has never defined the essence of an operations strategy. When pressed to articulate their own company's operations strategy, most executives will talk about efforts to reduce costs or improve quality, such as Lean or Six Sigma. Though important, such programs alone rarely produce a competitive advantage by aligning the physical assets and organizational resources in the operations domain to support the overall corporate strategy.

Seeking inspiration, I turned to a *Harvard Business Review* article published in the fall of 1996 by Michael Porter with the provocative title "What Is Strategy?" Porter, creator of the famed "Five Forces" model of corporate strategy, taught in every business school and applied by corporations worldwide, feared that companies had lost sight of the importance of strategy altogether. He argued that a decade of unremitting pursuit of operational effec-

tiveness, aimed at closing the cost and quality gap to catch up with an array of Japanese competitors, had set many industries on a path of competitive convergence. This single-minded pursuit of operational effectiveness would lead to mutual destruction, he said, culminating in industry consolidations in which the survivors were companies that merely "outlasted others, not companies with real advantage."

Porter was so concerned about this trend that he opened his article with a bold-type heading that was intended to grab the attention of every operating executive: "Operational Effectiveness Is Not Strategy." He added sacrilege to provocation by including a sidebar titled "Japanese Companies Rarely Have Strategies." Though Porter never cited the Toyota Motor Corporation by name in the sidebar, it was pretty clear he was attacking that catalyst of the operations revival, the company that institutionalized such vaunted concepts as total quality management, just-in-time production, and *kaizen* (continuous improvement). Could Porter really be so dismissive of the much-admired operations revolution in-



spired by this paragon of manufacturing excellence?

Yes, he could. Because Porter defined strategy in a way that reinforced its separation from operations, as if the quality of operations could simply be taken for granted in any effective company. Strategy was “the creation of a unique and valuable position, involving a different set of activities.” He also noted that “strategy is making trade-offs in competing” — including “choosing what *not* to do.” Finally, he emphasized the importance of

rest of the industry. But the Toyota production system stems from a revolutionary view of the function of a supply chain: It could produce the car that a customer wanted “just in time” rather than “push” cars onto dealer lots and count on dealer financing and haggling to convince customers to buy them. That vision led to the series of operational innovations that allowed Toyota to easily respond to changing customer demands.

Instead of trivializing operational effectiveness and Japanese

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Strategy and operations had more in common than either Michael Porter or his critics were willing to admit.

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.”

Though operations practitioners and academics bristled at Porter’s trivializing of operations, a closer examination of his arguments actually suggests that strategy and operations had more in common than either Porter or his critics were willing to admit. Effective overall strategy, by Porter’s own definition, reinforces the critical need for an operations strategy. Porter dismissed the Japanese focus on cost and quality improvement, but he failed to appreciate the richness of the operations strategy of a company like Toyota in creating a differentiated position, the essence of strategy in Porter’s model. Admittedly, Toyota’s *product* positioning may not be distinctive from that of the

manufacturers like Toyota, Porter should have explained the critical need for an *operations* strategy in enabling the overall *corporate* strategy to succeed. After all, who designs and performs the bulk of a company’s activities and seeks to *integrate among them* (to quote Porter)? Although he mapped the “activity systems” for leaders like Ikea, Vanguard, and Southwest Airlines, he offered little guidance about how to create these self-reinforcing systems that displayed good “strategic fit.” That, however, is the essence of operations strategy.

Defining Operations Strategy

In fairness to Porter, he is not alone in trivializing operations. Strategists have been dismissing the function for decades. Another Harvard professor, Wickham Skinner, attempted to make business practitioners aware that the manufacturing function

warranted more executive attention in a 1969 *Harvard Business Review* article. Titled “Manufacturing — The Missing Link in Corporate Strategy,” the article anticipated Porter’s argument by more than 25 years, noting that “a production system inevitably involves trade-offs and compromises.” But rather than focusing on strategic positioning,

of strategy dates back 50 years to a provocative book titled *The Theory of the Growth of the Firm*, by Edith Penrose (Wiley, 1959). This strategy school, popularized by Jay Barney in the early 1990s, applies a bottom-up perspective that focuses on the firm rather than the industry. Its proponents highlight the need to build capabilities and note

The operations strategy at most companies has been determined on an ad hoc basis.

Skinner highlighted a number of “decision areas” where the operations arena needed to resolve important trade-offs.

Other academics built upon Skinner’s foundation as the concept of a manufacturing strategy evolved into a framework for a broader “operations strategy.” In the late 1970s, Steven Wheelwright highlighted the importance of decisions involving the “manufacturing infrastructure,” which led over time to the distinction between *structural* decisions such as plant location and capacity and *infrastructural* decisions, which involved the increasingly pervasive computer systems like manufacturing resource planning used to manage the facilities.

Ultimately, this emerging focus on the strategic decisions involving business processes found support in a competing strategy framework, the resource-based view (RBV) of a firm. Whereas Porter’s industrial organization economics school considers the choice of industry to be paramount in determining success, the RBV school focuses on capabilities as the central precept of strategy. The resource-based view

that “path dependencies” can limit a firm’s options as it invests in different strategic activities over time.

Porter’s argument that a company must choose a unique set of activities to support its competitive position pays short shrift to the difficulty of building capabilities. His perspective implies that a company need only select among a menu of activity options just as a conglomerate can choose among a set of industries. Thus, the strategist thoughtfully selects the activities that will produce a competitive advantage; the operations leader merely executes. In reality, operations strategy must explicitly consider what capabilities to build and refine over time.

Merging Porter’s positioning perspective, Skinner’s manufacturing decision areas, and Barney’s capabilities-based strategy offers a richer perspective on the appropriate definition of an operations strategy: *An operations strategy should guide the structural decisions and the evolution of operational capabilities needed to achieve the desired competitive position of the company as a whole.*

Structural Decisions

To be sure, the operations strategy at most companies has been determined on an ad hoc basis by the accumulated effect of many small and large operational decisions. Rarely does a company formally design and document its operations strategy in a deliberate fashion. At best, guidance on a few key operational choices might be found in an overall corporate strategy. Looking at a few cases of past decisions at leading companies, however, can highlight the importance of well-designed operations strategies.

Structural decisions define the what, when, where, and how of investing in operations bricks and mortar. The original logic of operations strategy focused on manufacturing plants, but the same issues need to be addressed for distribution plants or call centers. Four interrelated decision areas ultimately influence the size and scope of a company’s operational footprint, and they should be addressed explicitly and collectively in light of the company’s competitive positioning.

1. Vertical integration. The logical starting point is to consider, with competitive advantage in mind, which “activities” (to use Porter’s term) should be conducted in-house versus outsourced. Henry Ford’s original River Rouge complex in Detroit was the epitome of vertical integration in the days when Ford revolutionized the automobile business with the Model T and Model A. Barge loads of raw iron ore fed the plant’s steel mills, which supplied virtually all of the individual parts for the assembly plants. Ford’s system used the new paradigm of mass production and scale economies to dominate the company’s dozens of smaller rivals.

More recently, at its formation in the mid-1990s, Amazon.com Inc. went against the general trend of outsourcing and the dominant pattern among Internet retailing startups by building a vertically integrated network of fulfillment centers that would assemble and ship the orders customers submitted over the Web. Amazon invented and continues to perfect the operating model for Internet fulfillment, and it knew that outsourcing would put its competitive advantage at risk. “We would be the teacher and then they would offer those services to our competitors,” explained a senior operations executive in the early days.

2. Facility capacity. Assuming a company envisions a sufficient competitive advantage from some degree of vertical integration, the specifications for the facility come to the forefront. Should a company aggressively build capacity ahead of demand or take a more conservative path of adding capacity only in smaller increments and only when market uncertainty subsides? Consider the example of Copeland in 1987. Then a division of Emerson Electric Company, Copeland introduced the scroll compressor, a fundamentally new design concept for initial application in residential air conditioning. The company built capacity ahead of demand and even continued with a capacity expansion in 1989 despite initial demand that fell short of forecasts. Management was convinced — correctly, as history showed — that new regulatory efficiency standards would favor the new technology, and it created a competitive advantage that it retains today. Today, the scroll technology dominates the market; Copeland’s design leads the industry, and

Copeland maintains unmatched scale economies.

3. Facility location. Choosing where to site facilities also requires trade-offs in designing the operations footprint, regardless of whether the facility is in-house or outsourced. Inditex (the Spanish clothing company better known by its leading brand, Zara) maintains scale-intensive pattern-cutting operations in-house and subcontracts the labor-intensive sewing to small mom-and-pop facilities in the surrounding region. Most fashion retailers outsource cut-and-sew operations to Asia to tap into low labor costs, but they face long supply chains requiring early design decisions and advanced volume commitments. Inditex’s more responsive supply chain fits its strategy: In-house cutting offers enhanced control and helps offset some of the labor-cost disadvantage of the geographic location of its sewing plants.

Plant location decisions must also balance intellectual property risk and the cost of transportation.

the structural footprint decision should address the process technology used in the facility. Again, consider the case of Copeland’s scroll compressors. A dozen years after the introduction of its new design, Copeland felt compelled to add a Chinese plant to its operations footprint: Many competitors were producing in China by then, and the labor-cost advantage of the region could offset some of Copeland’s scale advantage. Accordingly, Emerson opened a new scroll compressor plant in Suzhou in 2000. But Copeland made distinctly different decisions regarding process technology at this new plant. Concerns over intellectual property protection, for example, led the company to exclude proprietary process technology and import the critical scroll plates from its U.S. plants.

Operations Capabilities

Although the structure of a company’s operations footprint represents a critical set of strategic decisions, management also needs

In the mid-1990s, Amazon went against the trend of outsourcing and built a vertically integrated network of fulfillment centers.

Accordingly, the Intel Corporation builds most of its high-tech wafer fabrication facilities in the developed world to protect its intellectual property, and Chinese appliance maker Haier Group built a refrigerator plant in South Carolina to avoid the prohibitive cost of shipping big refrigerators across the Pacific to the U.S. market.

4. Process technology. Finally,

to focus attention on the use of operations activities to build distinctive, strategically relevant capabilities. Porter properly dismissed the pursuit of operational effectiveness without a clear linkage to the company’s competitive differentiation, but he underestimated the importance of building these capabilities.

In Porter’s defense, many operations executives also do not think

about building unique capabilities, but instead mindlessly pursue “best practices.” In other words, they try to develop the capabilities that their fiercest competitors have already mastered. The concept of “best practices,” in fact, reinforces the flawed mind-set that triggered Porter’s attack on operational effectiveness. There are no universally superior methods that should be applied by all industry participants. Such a model yields competitive convergence and the often destructive model of pure cost-based competition. Instead, capabilities should be nurtured with a clear focus on the company’s desired, differentiated position in the marketplace.

But where does one start? Ideally, the operations strategist should identify the key operations processes for the specific industry in which the company competes. To illustrate the concept, we will look at six

around big-name designers who create the next fashion trend. Its approach of using teams of designers does not represent a general “best practice,” but it provides a competitive advantage given the positioning of the Zara brand. These teams work collaboratively, gathering insight from more than 500 Zara store managers who report daily on what is selling.

2. Customer service management. The auto insurer Progressive Corporation has built its reputation through the way it manages claims processing. The company has developed a competitive advantage through on-the-spot claims settlement with its ubiquitous fleet of white SUVs. More recently, in selected markets, Progressive has taken its customer service a step further. Rather than issuing a claim check quickly, it now offers to take care of the repair. Customers drop

Amazon has built a competitively advantaged capability under the generic banner of operations planning and control. For example, Amazon informs the customer of the precise cutoff time for ordering to receive a delivery the next day. No competitor manages such a broad product range with such precision. To leverage its scale and strengthen its operational competitive advantage, Amazon continues to pursue some of the most daunting Internet retailing challenges, such as selling groceries and shoes.

4. Purchasing and supplier development. Over the past 20 years, Honda of America Manufacturing Inc. has invested heavily to develop its local supply base, leveraging a capability in purchasing and supplier development inherited from its parent in Japan. Given a strategic need to localize and a domestic supply base incapable of meeting its quality standards, Honda had little choice but to invest in supplier development initially, but over time it reaped huge rewards; the suppliers now play a key role in its continual pursuit of affordable, mass-produced cars such as the Accord.

5. Quality management. A company’s approach to quality management also represents an opportunity to build a capability to support a differentiated competitive position. For example, the Palm Restaurant and McDonald’s Corporation both have strong quality management capabilities, but they focus on different quality positionings. The Palm Restaurant chain, with nearly 30 locations from London to Los Angeles, has built its reputation on ample servings of hand-cut, aged steaks cooked to the individual tastes of the customer. McDonald’s quality management

Capabilities should be nurtured with a focus on the company’s desired, differentiated position in the marketplace.

general processes that provide reasonably comprehensive coverage of most operational contexts.

1. Innovation and product development. To generate a competitive advantage, an operations capability must support the firm’s competitive position. Consider again Inditex/Zara, which competes by quickly copying ideas from the Paris and Milan catwalks as well as the nightclubs of New York and Tokyo. Unlike the fashion leaders, Inditex has not built an innovation and product development capability

their vehicle off at a Progressive customer service center and the company returns it with repairs guaranteed for as long as the customer owns the car. Progressive didn’t raise its prices to cover these increased service levels. Instead, it self-funded those capabilities through savings in managing the repair process more effectively than the customer would.

3. Operations planning and control. Amazon made a strategic decision, as discussed above, to vertically integrate into fulfillment. To leverage that structural investment,

process focuses on delivering consistent meals in 31,000 restaurants in more than 100 countries worldwide. In quality management parlance, the Palm competes on “quality of spec” (short for “specification”) and McDonald’s competes on “quality to spec.” Each has tailored its quality management capability to support its quality positioning.

6. Attraction and development of people. Many companies proclaim that people are their most important asset (though few behave as though they believe it). All operations capabilities depend on people, and, accordingly, a comprehensive operations strategy must explicitly address how the company will attract, develop, and retain the right people. Management gurus laud General Electric Company’s Crotonville learning center and its succession planning process for developing executives. GE’s scale and diverse businesses justify its investment in managers who can move around the company to provide fresh energy and perspective. Few competitors can match its ability to develop great executives.

From Theory to Practice?

As Wickham Skinner highlighted 40 years ago, and the examples above reinforce, the operations decision areas require trade-offs. Furthermore, even the best management has bandwidth limitations, forcing prioritization. As Michael Porter noted, strategy involves deciding what not to do as much as it does what to do. An operations strategy offers guidance for decisions related to structural investments as well as investments in capability building. The consistency, or “fit,” among these structural decisions and operational capabilities

determines the company’s effectiveness in achieving the desired positioning articulated by the overall corporate strategy.

Although it is true that most companies do not explicitly articulate an operations strategy, the decisions made by operations executives ultimately produce — or erode — competitive advantage. Are you certain that your operations managers know the right choices to make — or are they mindlessly pursuing “best practices”? If you have not explicitly articulated an operations strategy to guide your managers, odds are they are on the dreaded treadmill described by the Red Queen in *Alice’s Adventures in Wonderland*: “Now, here, I see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!” Give them guidance from your business strategy and perhaps they can create competitive advantage instead. +

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