Strategy is critical to every company's success. Here's a short list of essential elements that all managers have to get right.

Three Pillars of Strategy

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Charles Dudley Warner observed, "Everybody complains about the weather, but nobody does anything about it." In many companies, the same could be said about strategy.

When I ask about strategy in executive programs at MIT, two things quickly become apparent: everyone participates in strategy development, and there is a pervasive lack of clarity on what strategy is and why it's so important.

In my experience, three core principles capture the essence of strategy:

1. *It's all about customer value.*
2. *Strategy is defined by what you say "no" to.*
3. *You have to be best at something.*

If you get these right, chances are strong that you'll succeed.

It's all about customer value

It's almost a cliché that companies exist to serve their customers. Yet, it's amazing how many company strategies seem to take the customers for granted, and focus almost exclusively on themselves.

All too often, there is a tacit assumption that the customers' businesses and customer needs are static and well defined, and the essential business problem, therefore, is optimizing the company's process for filling these customer needs.

This assumption is one of the core errors of strategy. The starting point in strategy development must be creating value for the customers by deeply understanding their real underlying business needs, and developing innovative ways to meet them.

In fact, customer needs are a moving target. This may be the most important and overlooked element of strategy in most companies. You can almost always create a radical improvement in your positioning and prospects by shifting your strategic focus from optimally meeting existing customer needs, to partnering with your customers to identify and fulfill new needs.

This is what Procter & Gamble did in its extremely successful partnership with Wal-Mart. P&G moved far beyond simply selling products to Wal-Mart, and focused instead on deeply understanding Wal-Mart's business. This enabled both companies to jointly create intercompany improvements that had a huge positive impact on Wal-Mart's profitability. In fact, a top P&G executive once told me that Wal-Mart's CFO was actually P&G's target customer.

By shifting the domain of value creation to within the customer, P&G redefined its business, radically improved its competitive positioning, and greatly increased its sustained profitability. More value, more opportunity for value capture. In the process, P&G changed its industry structure (technically speaking, it created a new "strategic group"), and thereby altered its "5-forces" equation in its favor.

What's more, customer innovations very often yield competitive advantage for long periods of time. Successful customer innovations require both deep customer knowledge, and the ability to create change within key customers. This change management ability creates enormous barriers to entry through customer knowledge and customer trust. Competitors may be able to replicate product innovations and business process innovations, but they usually can't supplant a competitor embedded in a deep, productive relationship with a key customer.

Note that customer needs often are very different from customer wants. This is why you can't just interview customers and get a meaningful answer.

I've written two columns that explain how to analyze real underlying customer needs and develop innovative new customer relationships by "walking in the customer's shoes": *Out of the Box Customer Service* and *Profit from Customer Operating Partnerships*.

Strategy is defined by what you say "no" to

Over the past two decades, I have reviewed many company strategies. The explicit objective of most of these strategies is to create a set of initiatives that will capture all customers, and potential customers, in every nook and cranny of the market. Within the company, various managers are responsible for these customers, and each of these managers has an inexorably increasing revenue quota. This is both unrealistic and counterproductive.

Try this thought experiment. Imagine that the top executives of your company are sitting around a table, and that each has a piece of paper in front of him or her. Someone asks them to each write down five customers that the company should not serve, five products that the company should not produce, and five services that the company should not offer.

If each list is different from one another, the company does not have an effective working strategy.

The reason why strategy is so important is that it enables a company's management team to do two critical things extremely well: aim the company at a "sweet spot" in the market, and align all the functional areas of the company to reach and own that part of the market. Enormously effective companies have both focus and alignment. The essence of a great company is achieving maximum "pounds per square inch" of market power. If you think about the great companies of our era, they do this extremely well.

It's impossible to achieve focus and alignment when a company tries to be everything to everyone. Many managers instinctively are drawn to this counterproductive objective because they do not want to say "no" to potential business. Ironically, it is this attitude that condemns the company to substandard performance.

A manager only can develop a winning strategy if he or she is willing and able to define crisply and clearly what is "out of bounds."

Think about your sales compensation system. What does it tell your sales reps to maximize? Revenue dollars? Probably. Gross margin? Maybe. If all sales dollars are equally desirable, you don't have a strategy.

Ironically, in virtually all companies, the number one way to increase operations or supply chain productivity is not simply to optimize the fulfillment of the current business inflow. Instead, it is to discipline the sales system to bring in business that fits the operation and supply chain. Doing this yields 30-50% productivity increases, rather than 10-15% that optimization typically yields.

Conversely, in most companies, the fastest and most powerful way to increase sales is to select a set of key customers and radically improve their profitability through innovative intercompany operations, as I described in the previous section.

Again, the key to success is focus and alignment: Having the clarity and courage to make choices by defining a strategy that has an explicit target and a meaningful set of “out of bounds” conditions that the whole organization understands.

In this way, strategy acts like a laser, bringing the whole company into phase, and enabling the company to “burn a hole” right through its target market.

You have to be best at something

The third pillar of strategy may seem so obvious that it is hardly worth mentioning. Yet surprisingly few companies have taken to heart that “you have to be best at something.”

Everyone knows that if you are not best at something, someone better will beat you. So why does this happen to so many companies?

The answer lies in the preceding section of this column. Many managers are so reluctant to let go of any business opportunity, that they cannot make the choices necessary to create a focused strategy. They cannot say “no.”

Instead, they dissipate their go-to-market resources across too broad a customer/product/service base, and fail to achieve meaningful traction in any one area. Because the incoming business stream is so diverse, they cannot focus their operation and supply chain to achieve the quantum gains in productivity and accelerated sales that come from aligning sales and operations.

It all comes back to the core reason for strategy: focus and alignment.

Companies that fall into the trap of trying to be everything to everyone almost by definition cannot be best at something. This leads to a vicious cycle.

When a more-focused competitor takes business away in one area, the company tries to increase its capabilities in that area to recapture the business. A short time later, another focused competitor takes business away in another area, and again the company expends its resources to try to stem the tide.

Soon, the company is so busy defending itself against an array of more focused competitors that it has spent all of its resources to little avail. Time and time again, the sales force is exhorted to sell their way out of trouble, and the operations managers are forced to constrict their operations to the point where they lose important capabilities. In the endgame, both the company’s market share and resources evaporate, and its managers are left wondering what happened to them.

By failing to focus and align the company, these managers forfeited the opportunity to be best at something, and thereby they created a situation in which their company was systematically overtaken by more focused competitors.

Effective strategy

Consider Wal-Mart’s strategy evolution. Initially, Wal-Mart’s strategy centered on locating stores in relatively small cities and towns of about 50,000 to 100,000 population in the South and Midwest. In each location, Wal-Mart could provide enough value as a volume discounter to supplant the “mom and pop” businesses, but there was not enough business to support a second, competing discounter.

In these locations, Wal-Mart could be best at providing clear and unique customer value: it offered “everyday low prices,” which were extremely important to the folks in smaller cities and towns, where pay typically was lower. At the same time, however, Wal-Mart's managers clearly understood which locations "didn't fit." The company carefully avoided larger cities and instead focused its resources on the markets where it had a clear advantage.

After Wal-Mart developed a critical mass of stores, it focused its attention on utilizing its large and growing volume of business to tailor an extremely efficient supply chain. This enabled Wal-Mart to drive down its costs even more, and to offer its customers even lower prices for quality merchandise.

With this newly-developed supply chain advantage, Wal-Mart could underprice other retailers, continuing to develop innovative new ways to be best at providing great customer value and convenience. This dynamic allowed the company to supplant other discounters and expand its chain into a host of new locations.

In a third phase, Wal-Mart's enormous volume made it the partner of choice for major suppliers. This led to the P&G partnership described earlier, and others like it, which again enabled Wal-Mart to lower its costs and lower its prices even more.

Today, Wal-Mart is one of the great success stories of modern business, and its strategy evolution illustrates the three pillars of strategy:

1. *It's all about customer value.*

2. *Strategy is defined by what you say "no" to.*

3. *You have to be best at something.*

If you get these right, the rest will naturally fall into place and you will achieve enduring success. JB

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