MANAGEMENT

What is Business Strategy?

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ASK 100 BUSINESS EXECUTIVES to define "strategy", and you are likely to get 100 different answers. Some will emphasise market-positioning choices, stating that "Our strategy is to serve these customers in these markets with these products and services." Others will focus on developing and exploiting company skills by arguing that "Our strategy is to build database-marketing skills, entering and growing businesses that leverage these skills." Still others will stress management processes, explaining that "Our strategy is to excel at customer service through application of Total Quality Management principles."

Businesses in different industries and geographic markets face widely divergent strategic challenges, and executives continually search for the "right" strategy definition as their markets evolve. Academics, consultants, and management gurus offer a broad menu of strategy definitions to choose from. Ask 100 of these so-called strategy experts to define business strategy, and you may get 100 new answers to add to your original list. At one level, this is to be expected; if managers face a diverse set of strategic challenges, certainly the strategy experts should offer a diverse set of potential prescriptions. At another level, however, this diversity is confusing and potentially dangerous. The problem occurs when managers, encouraged by overzealous "experts" trying to sell the universal applicability of their approaches, get locked into an inappropriate definition.

Any one of these existing strategy definitions is useful to some executives some of the time, but none is useful to all executives all of the time. Is it possible, or even desirable, to develop a more universally applicable definition of business strategy? Research by management consultant McKinsey & Company recently addressed this question. The McKinsey research identified some common ground in existing definitions: strategy involves making choices, and these choices matter. A business cannot serve all customers in all markets with all products and services, just as it cannot invest in every different form of physical or human resource, or implement every possible management process. Clear and consistent resource development and deployment decisions are at the heart of anyone's definition of strategy. And these choices matter because they largely determine who wins and loses business games. Empirical research has shown time and again that strategy and execution choices made at the level of the business unit largely explain performance differentials across firms.

The McKinsey research further identified four fundamental elements of any business strategy: *strategic posture*, *competitive advantage*, *business concept*, and *value delivery system*.

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Strategic Posture

Strategists must choose between three generic strategic postures: *shaping, adapting,* and *reserving the right to play*. Shapers develop strategies designed to drive industry structure and conduct in completely new directions. Their strategies are about creating new opportunities in a market—either by shaking up relatively stable industries or by trying to control the direction of the market in industries with higher levels of uncertainty. As such, their strategies often generate the highest rewards and risks. The steel and railroad barons of the 19th century and more recent entrepreneurs like Bill Gates and Scott McNealy have been successful shapers at times, but the sober reality is that most companies lack the industry position, assets, or appetite for risk necessary to make such strategies work. These companies might instead choose adapter strategies. Adapters take the current industry structure and its future evolution as givens, and they react to the opportunities offered by the market. In low-uncertainty environments, adapting involves making a strategic positioning choice—where and how to compete in the existing industry. At higher levels of uncertainty, adapters build strategies that facilitate recognition and quick response to evolving market opportunities. Most telecommunication service resellers are adapters, for example, as they react to entry, exit, and regulatory rulings in rapidly changing North American telecommunication markets.

The third possible strategic posture, reserving the right to play, is a special form of adapting. Those that choose to reserve the right to play make incremental investments today that will help them shape the future of the industry later *should they choose to do so*. In essence, they are buying time, information, and positions that will enable them to re-optimise in the future. For example, many pharmaceutical companies are reserving the right to play in the market for gene-therapy applications by making small acquisitions or allying with biotech firms that have already gained the relevant expertise. These investments provide privileged, low-cost access to the latest industry developments at a fraction of the cost of building a proprietary, internal gene-therapy R&D programme.

Be careful not to oversimplify strategic posture choices: many successful strategies blend elements of all three postures, and a company's dominant posture may change as conditions evolve. The Microsoft Network strate-

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gy originally focused on shaping a proprietary electronic commerce network as an alternative to the Internet. As it became evident that this shaping strategy would not succeed, Microsoft adapted its strategy to focus on winning in the Internet environment.

Competitive Advantage

Strategists must also choose the source of sustainable competitive advantage around which to build the strategy. There are three general sources of competitive advantage: *structural*, *front-line execution*, and *insight/foresight*. Structural advantages create entry barriers that make it difficult for competitors to copy your strategy. Such entry barriers include economies of scale, proprietary technology, regulations, brand strength, and privileged access to suppliers or distributors. *Front-line execution* advantages result from superior performance in the execution of day-to-day tasks. In commercial property/casualty insurance, for instance, a few players have demonstrated that superior underwriting and claims handling can overwhelm any structural advantages in the industry. *Insight/foresight* advantages result from possessing knowledge or having insights that others lack. The knowledge may lie in scientific or technical expertise (Hewlett-Packard's continuing superiority in printers), pattern recognition (the ability of some banks to make consistent profits by taking short-term positions in foreign currency), or sheer creativity (Disney's unmatched success in animated films).

Obviously, all three general sources of competitive advantage are important drivers of wealth creation, and no strategist can afford to neglect any one of them for too long. But it is important to set priorities. Rarely does a company have the management talent and financial resources necessary to simultaneously sustain world-class innovation *and* operations.

Business Concept

Business-concept choices begin translating strategic intent (as defined by strategic posture and competitive advantage) into a set of actions. What products are you going to develop and which customers are you going to target through which channels? What investments are you going to make, and when are you going to make them? In low-uncertainty environments, these business-concept choices are equivalent to market-positioning choices. Under higher uncertainty, business concepts are defined by portfolios of *big bets*, *options*, and *no-regrets moves*. Big bets are large commitments, such as major capital investments or acquisitions, that will result in large positive payoffs in some scenarios, and large losses in others. Options, on the other hand, are actions designed to secure the big payoffs of the best-case scenarios while minimising losses in the worst-case scenarios. Most options involve making modest initial commitments that allow companies to easily ramp up or scale back the investment later as the market evolves. Examples include conducting pilot trials before full-scale introduction of a new product, and entering into limited joint ventures to minimise the risk of breaking into new markets. No-regrets moves, as the name suggests, are actions with positive pay-offs in any scenario. Cost-reduction or quality-improvement programmes are often examples, but even major capital investments can be no-regrets moves in some circumstances.

Value Delivery System

Strategists must also choose how to implement their business concepts, including changes in procurement, manufacturing, sales, marketing and distribution. The key to making sound implementation decisions is to ensure that all business activities are aligned with company strategy choices. This alignment creates what McKinsey calls a *value delivery system*—an integrated set of actions designed to create value for the company and its target customers. Consider, for example, when Domino's introduced its 30-minute pizza-delivery strategy. Domino's redesigned standard ovens to accommodate higher-heat, shorter baking times; limited delivery menu items to ensure efficiency; and located its franchises in areas with population densities that could support 30-minute delivery times. Domino's strategy would not have been feasible without these fundamental store location, product definition, and baking changes.

An Integrated Set of Choices

Strategic posture, competitive advantage, business concept, and value delivery system. These four fundamental sets of choices define business strategy. Of course, these choices are not independent of one another. Rather they must be intricately linked. A shaper seeking to build structural advantages in the chemicals industry might make a big acquisition bet to build economies of scale, and focus his implementation plan on capturing synergies from the acquisition. On the other hand, an adapter hoping to leverage front-line execution skills in the multimedia industry might build a strategy around no-regrets skill acquisition and training programmes.

These four choices encompass the multitude of existing strategy definitions currently confusing business executives and strategy gurus alike. Other definitions are narrower, focusing on only a subset of the relevant questions and potential answers, and can be misleading exactly because there is no one "right" answer for all companies. Shapers can win, but so can adapters. Structural advantages allow companies to capture value, but front-line execution advantages can also be sustained. Big bets are sometimes called for, but an option sometimes maintains just as much upside payoff while eliminating the downside risk. Strategists must systematically address these four choices in their own company's strategic context, and develop an integrated set of answers that creates value for their company and its customers. This may be easier said than done, especially under high uncertainty, but tried and true techniques do exist. We will discuss some of these techniques in future *World Economic Affairs* columns. ◆

The ideas in this column are explained in more detail in two articles from McKinsey's Strategy Theory Initiative: "Bringing Discipline to Strategy" in *The McKinsey Quarterly*, 1996:4; and "Strategy Under Uncertainty" in the *Harvard Business Review*, November-December 1997.