STRATEGY LEADERS

RITA MCGRATH
INSIGHTS PACK

EXCLUSIVE TO STRATEGY LEADERS FORUM

RITA MCGRATH ON TRANSIENT ADVANTAGE AND TROUBLESHOOTING STRATEGY IN MIDDLE EAST

Ahead of her debut at Strategy Leaders Forum in Dubai this April, Rita McGrath gives you a glimpse into the main themes or her much awaited session on 27th of April.

WATCH THE VIDEO NOW

http://www.strategyleadersforum.com/ritamcgrath/

Why do you think your critically acclaimed work 'The End of Competitive Advantage' resonated so strongly with CEOs and Strategy Leaders in the current, post-recession, global economy?

The reaction by CEOs to the book falls into three buckets, the first bucket of people who are kind of in denial, they are wanting to live in a world that is rapidly changing and they are clinging to the past. I call that "nostalgia as business strategy" and that's not a really good place to stay in.

The second bucket are the people who kind of panicked, "the world is falling and we need to change but we are not sure what to do so let's change everything really quickly" – that's not great either because you need focus, you need to pay attention to the really important signals in your environment.

So the third category of CEOs who I hope will be well represented in the Strategy Leaders Forum are people who see the end of advantage as a real opportunity to create new markets, to explore new technologies, to get into new kinds of customer services, so they have been kind of almost relieved to find its ok not to have a sustainable competitive advantage but if you can build a pipeline of transient advantage, you can still have a very successful organisation.

The ideas behind Discovery Driven Planning are particularly pertinent to businesses in the Middle East, where opportunities are abundant but accurate data is sparse, making option selection challenging. Could you outline how the DDP approach can help businesses in the region?

Discovery Driven Planning is fundamentally an approach that creates a plan to learn rather than having all the information ready for to set out to create a venture or to do a new business.

When I think of the opportunities that are there in the Middle East for businesses to grow there is the dilemma that in a lot of cases you don't have the information that you really like to have for example to project the size of a market or anticipate the customer reaction to some kind of new technology.

What I recommend in those situations is that you set up a set of key checkpoints where a checkpoint is a deliberate moment in time when you are going to learn something and you set out your hypothesis. We call these "assumptions", and when you get to those checkpoints, you try to convert those assumptions into knowledge as quickly and as cheaply as you can. Therefore, step by step as your knowledge increases you can increase your confidence that you are making the right choices. There are many ways that this discovery driven growth idea is extremely relevant to the Middle East.

What do you see as key warning signs that a strategy is outdated or needs to be replaced or reconfigured?

One of the things I talk about a lot in my book "The End of Competitive Advantage" which I will be touching on in the Strategy Leaders Forum is this whole question of how do we find the early warning signs that something is about to go wrong in a strategy.

There are few signs I would really encourage people to think hard about. For instance, are you investing more and not getting back in terms of margin, loyalty or customer interest? Are good people leaving your organisation? Are the best people not willing to work there? Are customers telling you that competing offerings that are maybe cheaper are good enough, they don't really need that level of sophistication anymore?

I think there are ways that you can tackle this but it requires a certain amount of organizational finesse. One of the most successful firms I know that has done a great job of this is Dow Corning, they have two divisions, one is a very bespoke, very innovative, very high science kind of division and that's the Dow Corning brand. But they also have a brand they call Xiameter that sells products that have gone into commoditisation and are no longer the really innovative products. By exploring a low cost model and dual brand strategy Dow Corning have been able to do a great job of managing both healthy growing businesses and businesses that are going into erosion.

Any final words?

I'm really looking forward to sharing some of these ideas and having very high level strategic conversations on how the world is changing and what the opportunities can truly be with some of the most significant leaders in the Middle East when we get there in the spring.

Harvard Business Review

WEBINARS

KEY LEARNING SUMMARY

The End of Competitive Advantage

featuring **Rita Gunther McGrath**

JUNE 24, 2013

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Harvard Business Review

WEBINARS

JUNE 24, 2013

The End of Competitive Advantage

OVERVIEW

The conventional wisdom in business is that companies should seek to gain competitive advantage and keep it as long as possible. Companies are structured to do that; business schools teach how to do that; business analysis tools are used to that end.

But it is all obsolete. That's because traditional business thought is based on a false assumption: that competitive advantage can be sustained. In today's dynamic global business environment, nearly all advantage is transient. The key to business success today is learning to thrive in a transient-advantage economy. This requires a departure from business as usual and a new strategy playbook.

CONTEXT

Professor McGrath explained key concepts from her book *The End of Competitive Advantage: How to Keep Your Strategy Moving as Fast as Your Business* and shared best practices from her playbook to help companies navigate in this new economy.

KEY LEARNINGS

The notion that competitive advantage can be sustained is obsolete. In today's world, advantage cannot endure.

Today's markets aren't static. Constant innovation in the global marketplace and fast-shifting consumer behavior can render entire industries obsolete before players have a chance to adapt their strategies. Companies focused on competing with traditionally defined competitors in traditionally circumscribed markets often don't know what hit them when competitive threats arrive from beyond their industry. The iPhone has siphoned consumer wallet share from retail stores, restaurants, movie theaters, and myriad other consumer discretionary industries by altering consumers' spending patterns.

Many companies get into trouble because they fight to hang onto competitive advantage as it slips away for reasons outside their control. Advantage nearly always slips away as competitors copy innovations and as consumers are lured away by new innovations. The notion of competitive advantage as an enduring prize to be defended is obsolete. In today's world, every competitive advantage is temporary.

The realization that advantage is fleeting leads to different resource allocation decisions than the typical thinking: "We have to keep this going forever; my job is to defend it." A case study comparing Fuji and Kodak is illustrative.

CONTRIBUTORS

Rita Gunther McGrath
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Angelia Herrin (Moderator)
Editor, Special Projects and Research, *Harvard Business Review*

"If you're a steakhouse and you're comparing yourself to other local restaurants, you're missing the point completely."

—RITA GUNTHER MCGRATH

Case Study: Fuji and Kodak

In the 1970s, Kodak and Fuji were similar companies competing in the same photography space. After an early 1980s silver supply scare, Kodak went back to business as usual, but the incident made Fuji's CEO uneasy. Photography was too reliant on the silver market, he thought, and Fuji was overly reliant on photography. He knew that digitization of photography would change everything about the industry.

Fuji began radically changing how it deployed its resources. It invested in developing new technologies using its imaging capabilities. It launched new businesses in new markets (e.g., digital processing kiosks) and industries (e.g., medical imaging), not sure how they would fare. Investment analysts couldn't see the prudence of moving funds from the core business into uncertain ventures. But the CEO knew that this strategy, plus extreme efficiency measures that lowered administrative overhead, was in the company's long-term best interest.

Today, Fuji is a global powerhouse, 400th in Fortune's Global 1000 list; Kodak has been struggling in bankruptcy court. What made the difference? Fuji had leadership that confronted the reality of transient competitive advantage head on.

"Tools like net present value, which we take for granted, actually lead us astray in an environment where advantages are coming and going."

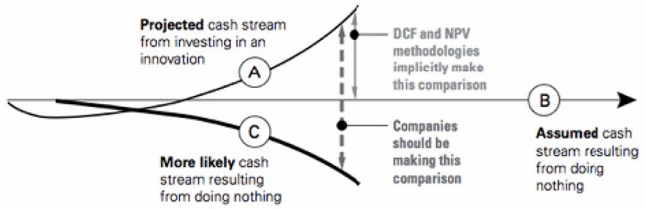
—RITA GUNTHER MCGRATH

Traditional business tools and approaches are ill suited for the reality of competitive advantages that come and go like waves.

Most strategy tools rest on the assumption that competitive advantage can be prolonged indefinitely. Since it can't, these hallowed tools, routinely taught in business schools, are useless. (In cases where the tools still do apply, it is fine to use them; but in more and more industries, they are becoming obsolete.)

Consider:

- The five forces matrix tool requires an industry to anchor it, yet inter-industry competition is increasingly common.
- Market share strategies have limited use in a world where consumer electronics can compete with restaurants, for example, and markets themselves defy definition.
- The classic net present value (NPV) tool is particularly ill-suited for decision making amid today's business realities. One flaw is the assumption that doing nothing entails no costs when inaction in today's environment probably will cause a firm to fall behind (Figure 1).



Source: Clayton Christensen, *Innovation Killers*.

Figure 1
NPV analysis doesn't reflect the real world, where doing nothing has a cost.

Rather than thinking of advantage as potentially permanent, companies need to visualize successive, dynamic waves of advantage that they can ride (Figure 2).

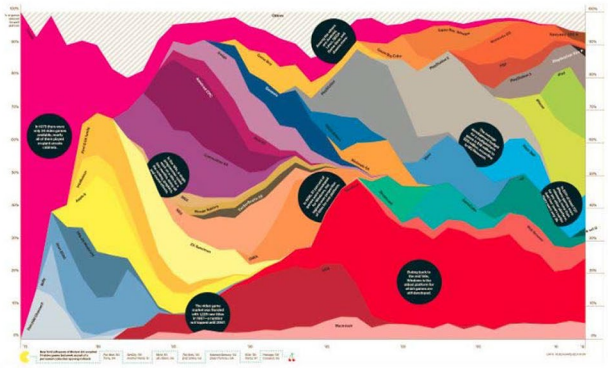


Figure 2
Competitive advantage is fleeting and dynamic, flowing like waves.

Strategy should address not just how to exploit and prolong advantage (the sole focus of most) but also when to disengage because an opportunity is exhausted (Figure 3). Every part of the competitive lifecycle requires strategic attention and the development of particular proficiencies.

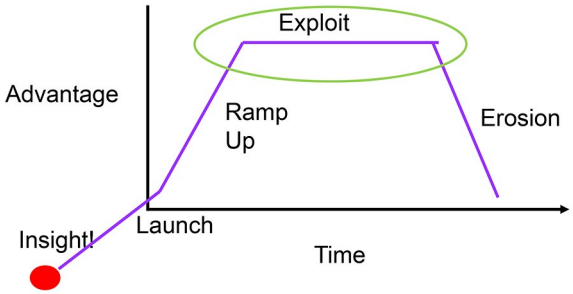


Figure 3
Few companies' strategy addresses disengaging when advantage ebbs.

Moreover, many companies are structured as though advantage were sustainable. Business units feel they must defend their turf; they don't readily hand back funds when it is time to redeploy resources elsewhere. Employees won't take innovation risks that could cost them their jobs, no matter how potentially beneficial for the company.

Companies themselves need to endure, and their people need to feel secure. But what businesses they engage in and the strategies they employ have to become much more fluid.

"Every part of the competitive lifecycle requires a certain kind of proficiency, and many companies have not built those proficiencies up."

—RITA GUNTHER MCGRATH

There is a new strategy playbook for thriving in a world of transient advantage.

Professor McGrath has developed a new strategy playbook to help companies keep their strategy changing as quickly as the world around them. There are six major departures in business as we typically know it:

1. **Continuous Reconfiguration**

   Professor McGrath studied the only 10 companies out of a global list of 5,000 with market capitalizations above $1 billion that managed to grow net income at least 5% every year for the 10 years ended 2009. What these 10 successful firms had in common was their ability to continuously reinvent themselves.

   In most companies, periods of innovation and change are punctuated by periods of stability. The notion that change is episodic, rare, and requires "change management" is common but misguided. Companies proficient in constant change know that at their core, people are actually not naturally averse to change and don't need special change management initiatives to help them cope. They just don't want to lose what they personally have—like satisfying jobs and roles with significance. If the threat of losing these things can be removed, then people aren't terrified about change, and many love the excitement of new ventures.

   It is true that people aren't good in chaotic environments, however. They need stability in the aspects of corporate life that matter most to them. The right recipe for both people and companies is:

   — **Stability** in leadership, strategy, values, talent, customer relationships, and networks.

   — **Dynamism** in resource allocation, budgeting, business portfolio, individual job assignments, and decision making.

2. **Healthy Disengagement**

   Most companies have systematic processes in place for everything except disengaging. When businesses are shuttered, it is typically an extremely unpleasant experience ("bodies all around, careers in ruin"). People are taken by surprise. Disengagement ought to happen in a very conscious, positive, expected way and ideally one that recoups the value that has been created. Professor McGrath's book discusses specific strategies for healthy disengaging under different scenarios.

3. **Deft Resource Allocation**

   Often a company's resources are held hostage in powerful businesses that are in decline. The leader controls that capital and uses it try to defend the old business. So these resources can't be deployed strategically to develop new businesses. To avoid this trap, companies need a resource allocation process by which to move resources out of mature and fading businesses and into promising new ones (as Fuji did, Case Study).

4. **Innovation Proficiency**

   In most companies, innovation happens episodically: Someone decides it is time for an innovation effort; after a while something happens to squelch the effort; before long it is revived. Instead, businesses need to develop innovation proficiency, which requires routine processes for innovation governance, funding, integration with existing businesses, and training.

   Companies should not try to invent their own innovation practices. They would never try to do so for other routine business functions, yet most seem to think they can for innovation. Best practices have been established and are important to use. Innovation proficiency requires a process that yields not just occasional innovations but a constantly refilling pipeline of innovations.

5. **A New Leadership Mindset**

   Developing these corporate proficiencies requires a different kind of leader, more candid and open to perspectives from people throughout the company. Plenty of old-style bosses are still around; e.g., telling people not to bring them problems without proposed solutions. They are blinding themselves to what is going on around them, making it difficult to recognize new opportunities.

6. **Entrepreneurial Career Management**

   All of this has huge implications for hiring and career management. Companies need to hire more for skills and less for specific jobs, which will change. They need people to feel confident that their place in the company will outlast business shifts.

   Younger generations are already creating new ways of working that fit well with companies' changeable skill requirements. They are taking an entrepreneurial approach to their own skill development, looking at employment as a chance to gain new skills to become even more employable. They approach work in a more entrepreneurial way too, less reliant on company resources and more on their personal networks to get projects done.

OTHER IMPORTANT POINTS

- **Shareholders' interests.** Common wisdom holds the interests of shareholders should be paramount. Yet the average length of time that an investor holds a stock is only seven months. Running companies for their own long-term viability makes more sense and rewards faithful shareholders.
- **Additional tools.** Purchasers of *The End of Competitive Advantage* can receive tools (a workbook and presentation) to share with their organizations by emailing their book receipts to preorders@ritamcgrath.com.

BIOGRAPHIES

Rita Gunther McGrath

Professor, Columbia Business School

Rita McGrath is one of the world's leading experts on strategy in highly uncertain and volatile environments. She joined the faculty of Columbia Business School in 1993. Prior to life in academia, she was an IT director, worked in the political arena, and founded two startups.

Rita works with corporate leaders to help them create an entrepreneurial mindset, drive growth, and recognize when and how to disengage. Some current clients include F-Secure, Nokia, Microsoft (and its CEO Summit), AXA Equitable, General Electric, Novartis, PPG Industries, the Stena Group, and the World Economic Forum. She is a popular speaker and consults to senior leadership teams. In 2009, she was inducted as a Fellow of the Strategic Management Society, an honor accorded to those who have had a significant impact on the field.

Rita appears regularly on television and radio and is often cited in the press, including *The Wall Street Journal*, *New York Times*, *Financial Times*, and *Businessweek*. She maintains an active blog (see www.RitaMcGrath.com) and is featured as a discussion leader at *Harvard Business Online*. She has coauthored six articles in the *Harvard Business Review*, including the best-selling "Discovery Driven Planning."

Rita is a member of several editorial boards of prestigious journals and her publications have appeared in *Strategic Management Journal*, *Academy of Management Review*, *Academy of Management Journal*, and *Management Science*, to name a few. She is the author of several books including *Discovery Driven Growth: A Breakthrough Process to Reduce Risk and Seize Opportunity*, *MarketBusters: 40 Strategic Moves that Drive Exceptional Business Growth*, and, her new book, *The End of Competitive Advantage: How to Keep Your Strategy Moving as Fast As Your Business*.

Rita received her Ph.D. from the Wharton School, University of Pennsylvania.

Angelia Herrin (Moderator)

Editor for Research and Special Projects, Harvard Business Review

Angelia Herrin is Editor for Research and Special Projects at *Harvard Business Review*. At *Harvard Business Review*, Herrin oversaw the re-launch of the management newsletter line and established the conference and virtual seminar division for *Harvard Business Review*. More recently, she created a new series to deliver customized programs and products to organizations and associations.

Prior to coming to *Harvard Business Review*, Herrin was the vice president for content at womenConnect.com, a website focused on women business owners and executives.

Herrin's journalism experience spans twenty years, primarily with Knight-Ridder newspapers and USA Today. At Knight-Ridder, she covered Congress, as well as the 1988 presidential elections. At USA Today, she worked as Washington editor, heading the 1996 election coverage. She won the John S. Knight Fellowship in Professional Journalism at Stanford University in 1989–90.

Interview

Rita McGrath explores the risks and opportunities of the transient-advantage economy

Brian Leavy

Brian Leavy is AIB Professor of Strategic Management at DCU Business School, where he has been working since 1981. Prior to his academic career he spent eight years in the IT industry as a manufacturing engineer with Digital Equipment Corporation, now part of Hewlett Packard. He holds a BSc in Physics and Maths and an MBA from NUIG and a PhD from the University of Warwick. His teaching and research interests centre on strategic leadership, competitive analysis and strategy innovation, and he has published over 100 articles, chapters and book reviews on these topics, nationally and internationally. He is also the author/co-author off our books, the most recent being Strategic Leadership – Governance and Renewal , with Peter McKiernan (Palgrave, 2009), and he is a contributing editor of the international journal Strategy & Leadership . He has been teaching on the DCU MBA since it started in 1990.

Almost a decade ago, in their landmark book The Future of Competition (2004), the late C.K. Prahalad and his co-author, Ventkat Ramaswamy, presented a remarkably prescient vision of a rapidly changing and radically different competitive landscape. They predicted that, fuelled by the ''discontinuous changes brought about by digitalization, ubiquitous connectivity, and the convergence of technologies and industry boundaries,'' our traditional view of how value is created would have to change, and change fundamentally. Increasingly in the business world of tomorrow, value would be interactively co-created by companies and consumers rather than merely exchanged between them and the level of value created determined more and more by the richness and variety of the personalized consumer experience. This new context they also saw as having implications for strategy and how it is developed. Strategy increasingly becomes ''a process of continuous experimentation, risk reduction, time compression, and minimizing investment while maximizing market opportunity,'' in short, ''a process ofi nnovation and discovery.''

In her new book, The End of Competitive Advantage: How to Keep Your Strategy Moving as Fast as Your Business (Harvard Business Press, 2013), innovation guru, Rita Gunther McGrath offers her own perspective on the new competitive landscape, which she refers to as the ''transient advantage economy,'' and she sets out to help strategists more fully understand its implications and better navigate its major challenges. In a world where strategy development itself needs to become more and more a process ofi nnovation and discovery, few are better qualified to offer deep insight and practical help. A co-pioneer, with Ian MacMillan, of ''discovery-driven planning,'' a highly effective framework for strategy development in new business venturing, they later extended their discovery-driven perspective to strategy innovation more generally in their 2009 book Discovery-Driven Growth.

Rita McGrath is a professor at Columbia Business School and a globally renowned expert on strategy in uncertain environments. Prior to her academic career, she was an information technology director, worked in the political arena and founded two start-ups. This interview with Strategy & Leadership highlights some of the main ideas in her latest book.

Her interviewer, Brian Leavy, is the AIB Professor of Strategic Management at Dublin City University Business School (brian.leavy@dcu.ie) and a Strategy & Leadership Contributing Editor.

Strategy & Leadership : In your new book you herald the arrival of the ''transient-advantage economy.'' What does this mean for managers, why is it a game changer and how will they have to operate differently?

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Rita Gunther McGrath: When I started in the strategy field, there were two foundational assumptions that we took almost as gospel, the first was that industry structure matters most and is relatively stable, and the second was that competitive advantages, once achieved, are relatively sustainable. Many time-honoured management practices are rooted in these assumptions. The problem today is that the deeply ingrained structures and systems designed to extract maximum value from a competitive advantage become a liability when the environment requires instead the capacity to surf through waves of short-lived opportunities. Yet, the assumption of sustainable advantage, and therefore, stability, is so deeply rooted in our fundamental ways of operating organizations that executives often don't realize it, and even if they are aware that things are changing and the pace is quickening, their behaviour doesn't change. This is why the ''transient advantage economy,'' that promises to leave few if any businesses unaffected, calls for an entirely new strategy playbook.

Take budgeting, for instance. In many organizations the executives in charge of large, cash-generating businesses are allowed to control their own budgets. That's great if the business has a long-term future, but potentially deadly if it doesn't. The executive has little incentive to divert resources to another area, even if it would be better for the company in the long run. There is a temptation to hang on to the advantage and eke out as much additional running room as possible. Instead, companies need to be creating a pipeline of advantages so that as old ones fade, there is always something fresh to replace them.

So, from the way we handle innovation, to resource allocation, to change, to the leadership mind-set and even the management of individual careers, the transient advantage economy calls for a radical rethinking of how we create strategies and manage organizations.

S&L: What types of companies thrive in this new environment and how do they do it?

McGrath: In the book, I report on a study that I did of a very unusual group of firms that I call ''outliers'' because there were only ten of them out of nearly 5,000 companies that I analyzed. The study population was every publicly traded firm on any stock exchange with a market capitalization of over $1 billion. Of that whole population, only ten companies were able to grow their net income by at least 5 percent a year for ten years in a row. Among the interesting things about these outliers is that they are very different from one another – from a Chinese beer company (Tsingtao Brewery) to an Internet service provider (Yahoo Japan) to a massive construction oriented firm (ACS in Spain). Yet, what they seemed to do that was different from what I observe in many firms is that they combine elements of stability with elements of dynamism. Thus, leadership, culture, values and people are pretty stable, while resource allocation, job assignments, market explorations and assets are moved around dynamically. Another interesting thing about them is that you see very little large-scale downsizing or much drama. They seem to continually shift around so that massive firings and change is unnecessary.

S&L: The primary premise of your book is ''that strategy is stuck,'' and the old assumptions informing our most commonly used strategy models no longer hold. In what ways does strategy need to change for the world of ''transient advantage?''


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McGrath: For one, companies have to start thinking about a different focus than their traditional obsession with industry analysis, and to revisit the assumption that

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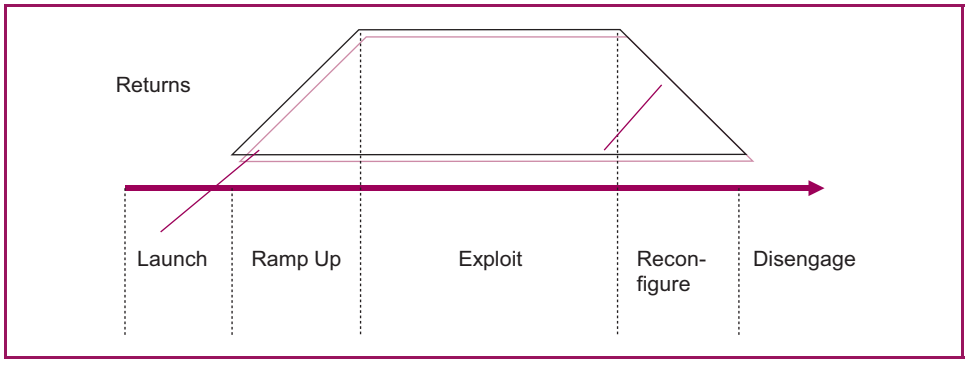
within-industry competition is the most significant competitive threat. It isn't that industries have stopped being relevant, but this level of analysis is no longer fine-grained enough to capture the dynamics of competition as we increasingly need to understand them. In more and more markets, we are seeing industries competing with other industries, and different business models competing with each other even within the same industry. This is most obvious in markets that have embraced the digital revolution. So today, it's more likely to be some new entrant from some other industry that comes in and eats your lunch. For another, we need to leave behind the traditional preoccupation with barriers to competition – even though Berkshire Hathaway CEO Warren Buffett likes to talk about acquiring firms with a ''moat.'' In more and more places those moats are getting pretty shallow. Also, a lot of formal assumptions in strategy come from industrial organization economics, which by definition does its work ''at equilibrium.'' When there is no equilibrium, a lot of those models simply stop working, and the presumption of stability and sustainable competitive advantage that goes with such equilibrium thinking tends to create all the wrong organizational reflexes for today's highly dynamic competitive environments.

S&L: Two ideas central to your perspective are the need to focus on ''arenas'' rather than industries, and to think in terms of a ''wave of transient advantage'' and strategize accordingly. Can you expand briefly on what these concepts mean to managers?

McGrath: Let me start with the concept of the ''wave'' (see Figure 1.1). This is a shorthand way of thinking about the life cycle of a competitive advantage. Advantages begin with some kind of insight that a company has about where it might meet a customer need, or invent something new. As Peter Drucker said, ''the purpose of a business is to create a customer.'' From that insight, there will be a period of incubation and experimentation which you can think of as the innovation process. When an innovation is ready, it gets ramped up and brought to scale. The next phase is ''exploitation'' in which the firm gets to enjoy the fruits of its labor and enjoy having an advantage. Eventually, in many industries, however, competition matches the advantage, customers get bored or something new comes along and the advantage goes into a period of erosion. Between the exploitation and the erosion phases, the firm needs to have developed a new advantage. Since the process is on-going, I liken it to surfing through successive waves of competitive advantage.

I also think that arenas – rather than ''industries'' – are what more and more firms are contesting today. An arena consists of the combination of a customer segment, an offer and

Figure 1.1 How to compete: the wave of transient advantage



> **"Deeply ingrained structures and systems designed to extract maximum value from a competitive advantage become a liability when the environment requires instead the capacity to surf through waves of short-lived opportunities."**

a physical or virtual space of some kind. The job of a manager these days is increasingly to orchestrate the firm's behavior across multiple arenas or competitive spaces, many of which may also be at different phases in the competitive advantage wave. For instance, take the language-training firm Berlitz. In Brazil, Berlitz focused on the high end customer and positioned its language training accordingly, with images of ladies in expensive clothing getting out of fancy foreign cars as they headed to their lessons. In the United States, in contrast, language training is more mass-market, so Berlitz has introduced different offers, such as Berlitz Connect which allows the company to teach customers online in virtual classes. The overall strategy of the company – to become not just language trainers, but to teach cultural and leadership concepts – is consistent, but the way they operate in the different arenas will be different.

The new strategy playbook

S&L: Can you give us an overview of the main elements in your new strategy playbook and how they work together to promote advantage?

McGrath: The first element of the new playbook is a process I call ''continuous reconfiguration.'' In a rapidly changing environment a firm needs to be able to change rapidly as well. So rather than getting settled in a particular configuration, in the new playbook companies must learn to manage constant motion. I might go so far as to say that change is not the dangerous thing – stability is. The second element of the new playbook I call ''healthy disengagement.'' That refers to the way in which companies that can operate with transient advantages get out of an advantage that is exhausted in order to free up resources to invest in new advantages. In far too many firms, there is either no process for disengaging, which means they cling to exhausted businesses for too long, or disengagement is painful and approached reluctantly. A related element of the new playbook is moving resources around an organization in such a way that it can deftly grasp new opportunities even as it pulls resources out of old ones. Another pillar of the new playbook is systematic innovation. In a world of stability, you don't need constant innovation. In a world of transient advantage, you need continuous innovation to replenish exhausted advantages, so it needs to become a systematic process, similar to quality control or supply chain management. Transient advantage also places a premium on candor, transparency and tough thinking. You mustn't analyze an opportunity to death, so when it comes to making decisions, ''roughly right and rapid'' will tend to trump ''overly ponderous and precise.''

S&L: You describe the reconfiguration process as the ''secret sauce'' in the new strategy playbook, and argue that the challenge will be to ''escape the competitive advantage trap'' and learn to combine dynamism and stability in new ways that facilitate continuous reconfiguration. Can you explain what this means to leaders and how they and their managers will have to change their practices?

McGrath: Reconfiguration means that you are pulling resources away from the past and dedicating them toward the future. A way to illustrate this is to contrast the different cases of Fuji Film and Kodak. In 1979, the plot to corner the world's silver markets by the Hunt brothers came to light. All the photography companies panicked, because the price of this crucial raw material suddenly shot up by orders of magnitude, and also there came to be uncertainty about supply. Well, the scheme collapsed a few months into 1980. Everybody heaved a sigh of relief and went back to business as usual. Except for Minoru Ohnishi, who

had just become the CEO of Fuji. He remained uneasy about his company's dependence on film processing which was linked to the supply of silver. His unease was validated again in 1984 when Sony introduced the first commercial digital camera, the Mavica. As Ohnishi told a reporter later, this was the moment at which he could envision a future of photography without film. He then began the reconfiguration process – pulling resources away from film and redirecting them into research and development of digital capabilities. By the late 1990s, the company had spent over $2 billion to get into the digital world. Fuji, moreover, moved its resources into a variety of other industries besides photography and today is in such segments as specialty chemicals, medical systems and optical devices. Kodak never managed to reconfigure itself and ended up going bankrupt.

So reconfiguration is the secret sauce because it is through this dynamic process that assets, people and capabilities make the transition from one transient advantage to another. Organizations that get this right are typically able to embed change into their normal routines, and they also tend to use an options-oriented approach to exploring new opportunities, both of which help to foster agility. At the same time they are able to balance this agility with stability, but stability rooted in ''softer'' areas like vision, process and culture rather than in static competitive positioning or rigid resource alignment patterns.

S&L: In the new world of transient advantage, ''stopping things'' will be ''every bit as critical as starting things,'' something most companies have traditionally found very difficult to do. How can companies get better at disengagement? Are there particular strategies they can follow?

McGrath: I think the first requirement for getting good at disengaging from businesses requires a timely willingness to consider that it may be necessary – a lot of people in companies live in denial of problems for years, as happened in Kodak. Yet the evidence that a business or business model is going into decline is usually quite clear long before a situation becomes critical. Companies need to be ever on the alert for the right kind of warning signs, such as increasing commoditization or diminishing returns to innovation and capital employed. Having made the decision, companies can choose among six possible approaches. These are determined by the nature of the capability in question and by time pressure. In some cases, the capability is core to the future of the business. In others, a capability may still be valuable to someone, but it is no longer interesting to our firm. And finally, sometimes a given capability is simply in decline. Leaders then need to consider how much time they have – if your company is under relatively little time pressure, you have different options than if there is more urgency around making your decision, as Table 3.2 shows.

Overall, the most distinctive elements of the new playbook's approach to disengagement include a willingness to end advantages quickly rather than try to defend them to the bitter end, to look on exit as a normal ongoing business process rather than a cathartic event, and to value and retain the learning as a gateway to future opportunity even as each declining advantage is being left behind.

S&L: As you point out, the resource allocation process plays a central role in shaping how organizations behave strategically. How should companies approach this key process differently to promote the kind of deftness and agility required for the new competitive landscape?

> **"The 'transient-advantage economy,' that promises to leave few if any businesses unaffected, calls for an entirely new** strategy playbook."

Table 3.2

	Capability core to the future of the business	Capability has value, but not for us	Capability is in decline
Relatively little time pressure	Orderly migration Transition aspects of the business from today's configuration to tomorrow's	Garage sale Get reasonable prices for assets we are no longer interested in	Run off Be well paid to maintain support for customer while decreasing investment
Intense time pressure	Hail Mary Divest formerly core capabilities and find a solution to migrate to the new core fast	Fire sale Sell non-core assets we are no longer in a position to exploit	Last man standing Spark consolidation or otherwise try for a profitable end game position

McGrath: The first principle is that resources can't be held hostage by powerful interests within the firm. Managers with control over resources tend to use them to support the status quo, not to innovate. A second principle is that the people who do control the resources must move them around adroitly. At Infosys, one of the growth outlier firms in my study, budgeting and re-budgeting are done quarterly. Further, managers aren't rewarded for hanging on to more resources than they need; instead they are punished with bonus cuts. Moreover, increasingly, transparent and world-class IT that provides leaders with a line of sight into what is going on in the various arenas is going to be a competitive differentiator. Beyond these, organizations will have to learn to approach resources with a more entrepreneurial mindset, using options-oriented thinking when it comes to innovation investment and to value access to assets over ownership as speed of asset re-configurability becomes a competitive imperative.

S&L: Traditionally strategy and innovation have tended to be managed almost as separate processes, and one of the main premises behind your new strategy playbook is that they need to become more integrated. How might companies go about this and what challenges will they face in trying to become more strategic and proficient at innovation?

McGrath: Companies seeking to build an innovation capability need to recognize that innovation is a system with specific processes that need to interact. Continuous innovation isn't a lone genius having Eureka moments in the lab. It isn't a skunkworks. It isn't even a new ventures division. Instead, companies need to have a systematic way of identifying opportunities, a governance and funding process that is separate from business as usual, a balanced portfolio of initiatives that support the core, build new platforms and invest in options, enough patience to systematically go through all of the assumption testing, experimentation and learning that bringing an innovation to market requires and managers who are comfortable with ambiguity. Initially, it is usually faster to build this capability by first working with those who have the right skills, then eventually transitioning to mostly internal resources.

As an example, Brambles, an Australian company that moves pallets around the world's supply chains, used a six-step approach to innovation: 1) define the growth gap that innovation would need to fill; 2) align senior leaders around the importance of innovation; 3) creating a governance and funding process; 4) begin to design supporting systems; 5) Learn by being coached through innovations by an external consulting firm and 6) make the management of innovation a routine.

One of the core ideas that is vital to the innovation process is thinking about projected financial returns. At Brambles, my colleagues Ron Pierantozzi and Alex Van Putten successfully introduced the idea of ''opportunity engineering'', an approach they developed, in which the value of holding options is added to the net present value of potential projects. This approach clarifies the true potential of some new ideas.

> **“Companies need to be creating a pipeline of advantages so that as old ones fade, there is always something fresh to replace them.”**

S&L: How will the corporate leadership mind-set need to change to be effective in this new competitive landscape? What will CEOs and top managers most need to learn to do differently?

McGrath: Probably the biggest change is to recognize that one can get trapped into an exploitation oriented mind-set very easily. Instead, leaders want to be paying attention to each phase of a competitive advantage, starting with the assumption that existing advantages will come under pressure, and making sure that all of the processes that need to be adopted and developed for the new transient advantage context are in place and working effectively within their organization. What is also required is a leadership that is willing to foster conversations that candidly question the status quo and the direction in which the organization is currently heading, including the active search for disconfirming evidence, and to broaden the constituencies involved in the strategy process, valuing diverse inputs. There are also major implications for how future leadership talent should be identified and developed, with more of a premium to be placed on the ability to learn and acquire new skills rather than just primarily on experience. I think examples of leaders who get this are those that are currently managing in difficult or fast-paced environments.

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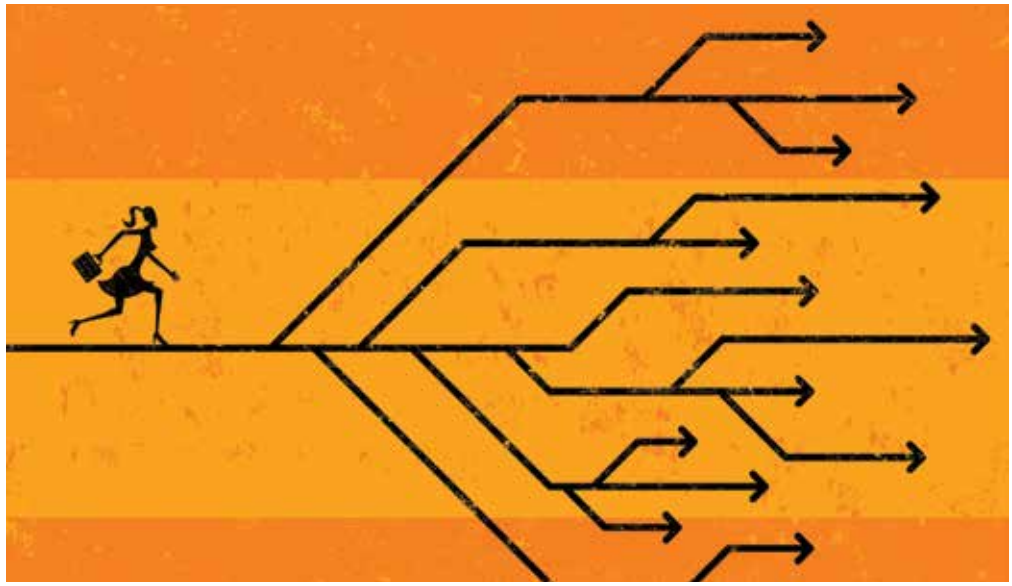

The End of Competitive Advantage

By Rita McGrath

Businesses are competing in increasingly volatile and uncertain global situations. Below, Rita McGrath suggests that stability, not change, is the state that is most dangerous in dynamic competitive environments, and argues that the end of competitive advantage means that the assumptions that underpin much of what we used to believe about running organisations are deeply flawed.

Minoru Ohnishi, who became CEO of Fuji Photo Film in 1980, sensed that a fundamental change was potentially afoot in the photography business. The introduction of Sony's first digital camera, the Mavica, in 1984 created the reality of photography that could do without film. He said later, "That's when I realized film-less technology was possible."[1] He wasted no time moving on this insight. He invested heavily in building up expertise in digital technologies to prepare for the next round of competition in the photography business. His determination for the company to make this transition was described as "single-minded" by a writer for *BusinessWeek*, who observed that if one were to tally up Fuji's investments by 1999 in research and technology dedicated to digital products, it would easily top $2 billion. The article went on to note a "mystical" belief among the company employees in the correctness of this strategy. This attitude was reflected by chief scientist and senior advisor Hirozo Ueda, who told the reporter, "We're not going to quit, and we're not going to lose this battle."[2] By 2003, Fujifilm had nearly five thousand digital processing labs in chain stores throughout the United States; at the time, Kodak had less than a hundred.[3]

Ohnishi was determined not only to keep his company relevant in digital technologies for photography, but also to extend its reach to opportunities outside the photography business. He pushed the company to establish a sales channel for new products such as magnetic tape optics and hybrid electronic systems. It became the first non-US company to produce videotape. Later diversification efforts took the firm into biotechnology and office automation. It entered floppy disk manufacturing. Ohnishi was an innovator in business processes at Fuji as well. In a Japanese context famous for its long-tenured "salarymen," Ohnishi championed a lean headquarters staff, even going to great lengths to benchmark how well Fuji compared with forty other Japanese companies with respect to how many staff were involved in overhead functions. Although Fuji came in at 9 percent (and the average of the rest was 16.7 percent), Ohnishi was determined to bring this ratio down to 7 percent by asking the organization to cut its workload significantly and to eliminate 50 percent of the time-consuming consensus building and documentation that were standard business practice at the time.[4]

The reconfiguration of the company continued after Ohnishi was replaced by Shigetaka Komori, with sometimes-painful transitions as jobs were lost and facilities closed. The firm aggressively pulled resources from the photographic film business, reportedly cutting more than $2.5 billion in costs in order to invest those resources in new businesses.[5] Today, Fujifilm has significant

health care and electronics operations and obtains some 45 percent of its revenue from document solutions and office printers.[6] All this was accomplished during several decades in which Japan's domestic industries were moribund and the country seemed unable to escape stagnation. In 2011, Fujifilm generated $25 billion in revenue, employed more than 78,000 people, and ranked 377th on *Fortune's* Global 500 list. Kodak has gone bankrupt.

Fuji's story suggests that simply managing well, developing quality products, and building up well-recognized brands is insufficient to remain on top in increasingly heated global competition. The stakes for the company were huge—it risked undermining its existing advantages, and had to make a bet on a highly uncertain future. Yet, ultimately, it was Fuji's approach—investing in new advantages and pulling resources from declining ones—that proved to be more robust in the face of change. It didn't get it right every time, and sometimes the transitions were painful. But the company didn't get trapped by its past.

> "It was Fuji's approach—investing in new advantages and pulling resources from declining ones—that proved to be more robust in the face of change."

When competitive advantages don't last, or last for a much shorter time than they used to, the strategy playbook needs to change. Leaders have inherited a lot of ideas that may have made sense at one point but aren't keeping up with the pace of strategic change today. Although executives realize that rapid change is the norm, the strategies they use to compete still draw on frameworks and practices that were most effective decades ago. Executives need a new set of strategy frameworks and practices for winning over the long haul, even as sustainable competitive advantages have become a thing of the past.

Your Strategy Is Based on Old Assumptions

Sony. Research In Motion (RIM). Blockbuster. Circuit City. Even the New York Stock Exchange. The list of once-storied organizations that are either gone or are no longer relevant is a long one. Their downfall is a predictable outcome of practices that are designed around the concept of sustainable competitive advantage. The fundamental problem is that deeply ingrained structures and systems designed to extract maximum value from a competitive advantage become a liability when the environment requires instead the capacity to surf through waves of short-lived opportunities. To compete in these more volatile and uncertain environments, you need to do things differently.

When I got my start in the strategy field, there were two foundational assumptions we took practically as gospel. The first was that *industry matters most*. We were taught that industries consist of relatively enduring and stable competitive forces—take the time and effort to deeply understand these forces, and voilà, you can create a road map for your other decisions that is likely to last for some time.

For instance, the traditional network television model in the United States was successful for many decades because the limited and expensive broadcast spectrum meant that a few players (in this case the major networks) dominated the few channels to customers. Over the last thirty years, the constraints that held this model in place have eroded. This relaxation of constraints has fundamentally undermined the networks' business model. Indeed, the most important dynamic wasn't network-to-network competition but an invasion from other industries.

The second assumption was that *once achieved, advantages are sustainable*. Having achieved a solid position within an industry, companies were encouraged to optimize their people, assets, and systems around these advantages. In a world of lasting advantage, it made sense to promote people who were good at running big businesses, operated with greater efficiency, wrung costs out of the system, and otherwise preserved the advantage. Management structures that directed resources and talent to strong core businesses, often called "strategic business units," were associated with high performance. The core assumption here was that you could optimize your systems and processes around a set of sustainable advantages.

There are indeed examples of advantages that can be sustained, even today. Capitalizing on deep customer relationships, making highly complicated machines such as airplanes, running a mine, and selling daily necessities such as food are all situations in which some companies have been able to exploit an advantage for some time. But in more and more sectors, and for more and more businesses, this is not what the world looks like any more. Music, high technology, travel, communication, consumer electronics, the auto-mobile business, and even education are facing situations in which advantages are copied quickly, technology changes, or customers seek other alternatives and things move on.

The New Logic of Strategy

The assumption of sustainable advantage creates a bias toward stability that can be deadly. Stability, not change, is the state that is most dangerous in highly dynamic competitive environments.

When competitive advantages don't last, or last for a much shorter time than they used to, the strategy playbook needs to change. Leaders have inherited a lot of ideas that may have made sense at one point but aren't keeping up with the pace of strategic change today.

Table 1

Where to Compete: industry perspective versus arena perspective

	Industry	Arena
Goal	Positional advantage	Capturing territory
Measure of success	Market share	Share of potential opportunity spaces
Biggest threat	Intraindustry competitive moves	Interindustry moves; disruption of existing model
Definition of customer segment	Demographic or geographic	Behavioral
Key drivers	Comparative price, functionality, quality	"Jobs to be done" in total customer experience
Likely acquisition behavior	Within-industry consolidation or beyond-industry diversification	Bolt-on for new capability acquisition, often across industry boundaries
Metaphor	Chess	Japanese game of Go

Where to Compete: Arenas, Not Industries

One of the biggest changes we need to make in our assumptions is that within-industry competition is the most significant competitive threat. Companies define their most important competitors as other companies within the same industry, meaning those firms offering products that are a close substitute for one another. This is a rather dangerous way to think about competition. In more and more markets, we are seeing industries competing with other industries, business models competing with business models even in the same industry, and entirely new categories emerging out of whole cloth.

It isn't that industries have stopped being relevant; it's just that using industry as a level of analysis is often not fine-grained enough to determine what is really going on at the level at which decisions need to be made. A new level of analysis that reflects the connection between market segment, offer, and geographic location at a granular level is needed. I call this an *arena*. Arenas are characterized by particular connections between customers and solutions, not by the conventional description of offerings that are near substitutes for one another.

To use a military analogy, battles are fought in particular geographic locations, with particular equipment, to beat particular rivals. Increasingly, business strategies need to be formulated with that level of precision. The driver of categorization will in all likelihood be the outcomes that particular customers seek ("jobs to be done") and the alternative ways those outcomes might be met. This is vital, because the most substantial threats to a given advantage are likely to arise from a peripheral or nonobvious location.

This further raises the issue that a firm may not have a single approach that holds for all the arenas in which it participates. Instead, the approach may be adapted to the particular arena and competitors it is facing. For example, consider the strategy of language-teaching firm Berlitz. As Marcos Justus, their former Brazilian president, told me, in Brazil, competition for the mass market was fierce, but competition for customers in the upper income brackets was less so. There, a strategy of focusing on the upper echelons and positioning the brand as an elite product made sense. In the United States, where the majority of customers are somewhere in the middle, a different positioning featuring convenience and flexibility made sense. These are two different strategies, responding to the exigencies of the two different arenas. Both of these strategies, however, drive Berlitz's evolution toward the cultural consultancy it aspires to become.

The imagery of arena-based strategy is more that of orchestration than of plotting a compelling victory, and implementation on the ground by those actually confronting conditions within a specific arena becomes increasingly important (table 1).

The New Strategy Playbook

The end of competitive advantage means that the assumptions that underpin much of what we used to believe about running organizations are deeply flawed. Some of the new playbook is well understood already, such as the need to pursue innovation (although firms still struggle to get it right in practice). Other elements of the new playbook have received little emphasis in conversations about strategy, such as the practice of continuous reconfiguration and disengagement.

"Continuous Reconfiguration" explores how companies can build the capability to move from arena to arena, rather than trying to defend existing competitive advantages. Companies that can do this show a remarkable degree of both stability and dynamism. Moving from advantage to advantage is seen as quite normal, not exceptional. Clinging to older advantages is seen as potentially dangerous. Exits are seen as intelligent, and failures as potential harbingers of useful insight. Most important, companies develop a rhythm for moving from arena to arena, with each one being managed as its particular life cycle stage suggests. And rather than the wrenching downsizings and restructurings that are so common in business today, disengagements occur in a steady rhythm, rather than in high dramas.

It isn't that industries have stopped being relevant; it's just that using industry as a level of analysis is often not fine-grained enough to determine what is really going on at the level at which decisions need to be made.

One of the most significant differences between the assumption of sustainable competitive advantage and more dynamic strategy is that disengagement—the process of moving out of an exhausted opportunity—is as core to the business as innovation, growth, and exploitation are. Particular arenas are evaluated for withdrawal regularly, rather than advantages being defended to the bitter end. Early warnings are paid heed to, rather than ignored. Disengagement is seen as a way to free up and repurpose valuable resources rather than a dismaying signal of lost glory.

"Continuous Reconfiguration" explores how companies can build the capability to move from arena to arena, rather than trying to defend existing competitive advantages.

Is Your Company Trapped in a Competitive Advantage?

Good companies can be trapped into aging advantages and be surprised when things change. The diagnostic in table 2 can help pinpoint areas in which you might be at risk of being blindsided and suggest changes that you might want to make. Simply position your organization's current way of working on the scale between the two statements in the assessment. Those areas that fall to the left of the scale are the ones you might want to take a good hard look at.

Table 2

Our organization's current way of working		
Focused on extending existing advantages	**Scale**	**Capable of coping with transient advantages**
Budget, people, and other resources are largely controlled by heads of established businesses.	1 2 3 4 5 6 7	Critical resources are controlled by a separate group from those who run businesses.
We tend to extend our established advantages if we possibly can.	1 2 3 4 5 6 7	We tend to move out of an established advantage early, with the goal moving on to something new.
We don't have a systematic process for disengaging from a business.	1 2 3 4 5 6 7	We have a systematic way of exiting businesses.
Disengagements tend to be painful and difficult.	1 2 3 4 5 6 7	Disengagements are just part of the normal business cycle.
We try to avoid failures, even in uncertain situations.	1 2 3 4 5 6 7	We recognize that failures are unavoidable and try to learn from them.
We budget annually or for even longer.	1 2 3 4 5 6 7	We budget in quick cycles, either quarterly or on a rolling basis.
We like to stick to plans once they are formulated.	1 2 3 4 5 6 7	We are comfortable with changing our plans as new information comes in.
We emphasize optimization in our approach to asset utilization.	1 2 3 4 5 6 7	We emphasize flexibility in our approach to asset utilization.
Innovation is an on-again, off-again process.	1 2 3 4 5 6 7	Innovation is systematic, a core process for us.
It is difficult for us to pull resources from a successful business to fund more uncertain opportunities.	1 2 3 4 5 6 7	It is quite normal for us to pull resources from a successful business to fund more uncertain opportunities.
Our best talent spends most of their time solving problems and handling crises.	1 2 3 4 5 6 7	Our best talent spends most of their time working on new opportunities for our organization.
We try to keep our organizational structure relatively stable and to fit new ideas into the existing structure.	1 2 3 4 5 6 7	We reorganize when new opportunities require a different structure.
We tend to emphasize analysis over experimentation.	1 2 3 4 5 6 7	We tend to emphasize experimentation over analysis
It isn't easy to be candid with our senior leaders when something goes wrong.	1 2 3 4 5 6 7	We find it very easy to be candid with senior leaders when something goes wrong.

About the Author

Rita Gunther McGrath, a Professor at Columbia Business School, is a globally recognized expert on strategy in uncertain and volatile environments. Her thinking is highly regarded by readers and clients who include Pearson, Coca-Cola Enterprises, General Electric, Alliance Boots, and the World Economic Forum. She is a popular instructor, a sought-after speaker, and a consultant to senior leadership teams. She was recognized as one of the top 20 management thinkers by global management award Thinkers50 in 2011.

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