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THE ESSENCE OF BUSINESS STRATEGY

Developing a robust planning framework

BTM Center
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Booklet 1

The Essence of Business Strategy

Developing a robust planning framework

In this booklet, we discuss the role that business strategy planning plays in a company in addition to outlining the core components of a business strategy. Presented first are the most important factors that need to be determined prior to developing a business strategy before revealing the key global developments that affect multinational companies. In addition, we identify the main difficulties in implementing business strategies and reveal how they might be overcome. We conclude by presenting an initial overview of the counter strategies that are examined in more detail in the other booklets of this series.

MISUNDERSTANDINGS

As an electrical engineering graduate, Roman Ley took his first step on the career ladder as a trainee at an international technology company. He then worked there for three years as a sales engineer in the industrial turbines business unit, which was part of the group's energy division. After spending two years in Asia, he was promoted to the role of sales manager. Five years later, he became the head of the industrial turbines unit. Shortly after that, the energy division welcomed in a new CEO, who asked Roman to outline his unit's business strategy in a half-hour presentation.

The meeting took place on a Monday morning. On the Sunday evening prior, Roman went through his PowerPoint presentation one more time and was confident that he had covered all the key aspects. On Monday morning, he met with the new CEO, the CEO's assistant, and the CFO of the energy division in a conference room. Roman started with the financial targets that he aimed to meet within the next five years. Bernd Jacob, the new CEO, interrupted him after a few sentences and asked him to move on, as the financial targets were due for revision by the Group's management. He added that he considered plans extending beyond three years to be pointless, considering the market's fast-paced dynamics.

Chastened, Roman moved on to the next point, addressing precisely those market dynamics and their trends. He assumed this would help him make up for his unfortunate false start. ''Please don't,'' Jacob said. ''I invited you to present your business strategy, not to list well-known results of market research. I'm not interested in the dynamics of your market – I want to know how you intend to act in this environment.''

Perturbed, Roman clicked through to the slide summarizing the specifications for the latest turbine model. ''This data is irrelevant to me,'' the CEO interrupted. ''If anything, I would like to hear how our customers view this new development, which of its functions differ from rival products, and how significantly. Perhaps you could explain these aspects to me?''

Apologizing, Roman promised to submit this information after the meeting, as he did not have it available then and there. Nervous and confused, he moved on to the final part of his presentation and explained the communications campaign lined up for the new turbine model's launch on the market. Jacob sighed. ''Excuse me, Mr. Ley, but these are operational issues. I do not want to get involved with these. I thought that you were going to enlighten me on your business strategy today,'' he said, looking at his watch. ''Please arrange a new appointment with my secretary.''

Roman went back to his office, slammed the door shut, and wondered for what he had done all that work. For his part, as he made his way to his next meeting, CEO Jacob was wondering whether Roman was really the right man to head industrial turbines.

Unfortunate meetings like this occur in many companies throughout the world, in one form or another. The heart of the problem is misunderstanding. Although both parties want to discuss a business unit's strategy, they understand the task differently – whether it be planning the timescale for business strategies, deciding to what extent targets form part of a strategy, or finding the dividing line between operations and strategy. This means that they are approaching the issue from two different perspectives. As a result, both sides feel misunderstood, and they end up annoyed and disappointed with one another.

For this reason, we start this booklet by defining the basic terminology. A framework is then constructed for business strategy that is both scientifically robust and proven in practice. This does not cover all of the support beams and crossbeams involved, but rather the load-bearing elements. We also examine new strategic growth opportunities and how to implement business strategies.

WHAT IS STRATEGY?

In very general terms, strategy is a plan for achieving goals. It does not need to have anything to do with markets or companies. The term was first used in military circles. The pioneers in military strategy are considered to have been the Chinese General Sun Tzu and Prussian General Carl von Clausewitz. The term only migrated into business management during the 1960s, due primarily to the American economic historian and economist Alfred D. Chandler and his book on *Strategy and Structure: Chapters in the History of the Industrial Enterprise.*[1] Chandler's key message was that organizational structures have to align themselves to strategies, not vice versa – a message that remains as relevant to practice as ever.

Our understanding of strategy is based on three key assumptions:

1. A target has already been set. The financial target for a business unit is generally defined by a company's owners or management. The strategy describes how this target is to be met.

2. It is a plan and, thus, an abstract concept. This is why Peter Drucker, one of the fathers of business administration studies, referred to strategy as "the theory of the business." The practical implementation of strategic measures, although important, does not form part of the strategy.

3. Strategy focuses on the key aspects that go toward reaching the target. It is limited, in other words, to a plan's most important elements.

For us, solid growth is the most important goal of a company. Growth is a developmental process beyond sales and profits and includes the interests of employees and society. Solidity is part of this goal and clarifies that these developmental processes shall have a long-term impact.

Strategic planning in a company can address different elements – the entire company, a strategic business unit, or a function. Here, we are primarily concerned with strategic business units. This is an area that operates in a defined market environment and is responsible for its own profits and losses. If a company operates in just one market environment, there is no difference between the corporate and business unit strategies.

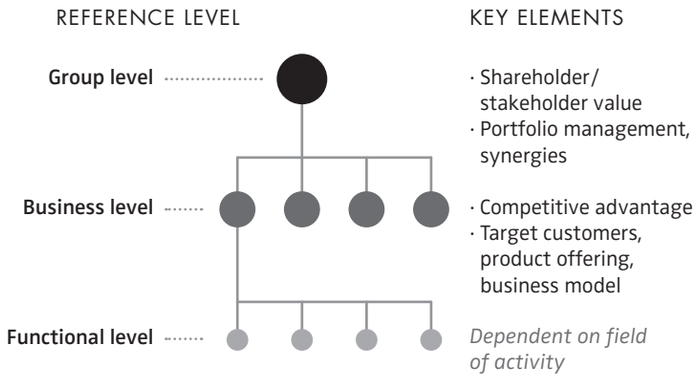


Figure 1.1: Strategic hierarchy in a company

The different levels and their respective strategies are interdependent (see Figure 1.1). The targets for lower levels are derived from the strategy of those above. Elements that represent a key strategic statement at a lower level might be too insignificant to play a role at a higher-level.

This leads us to draw a distinction between strategic and operational planning. The former is less specific than the latter. In practice, the easiest way to distinguish between the two is to remember that the question ''Are we doing the right thing?'' refers to strategic matters, and ''Are we doing it right?'' refers to operations. Having said that, the answers often overlap, which means that they cannot always be clearly differentiated. Among other things, this depends on the specific level in the company's hierarchy, as well as on the different opinions of those involved as to what constitutes strategy. (See the above example of Messrs. Ley and Jacob, who each had very different opinions about whether the new communications campaign was a strategic or operational issue.)

When it comes to setting targets, which should always precede strategy development, the terms ''mission'' and ''vision'' are frequently used.

- A vision paints an inspiring picture for the future. It aspires to reach a target state that goes beyond financial figures. Famous examples include Bill Gates' vision to put a PC on each desk and in every household, or Wikipedia's desire to create a world ''in which all knowledge is freely accessible to everyone.''

- A mission explains the reason for pursuing this aim. It is the higher purpose behind an organization. The Red Cross has a very striking mission: ''To serve the most vulnerable.'' So does the BBC: ''To enrich people's lives with programs and services that inform, educate, and entertain.''

Together, the vision and mission form a company's guiding principle.

Yet, this raises the question of why we should define a guiding principle and strategy in the first place? The answer is that both provide orientation. First and foremost, this orientational function is important to the managers of companies. They often have to make their business decisions under immense operational pressure, which can obscure their view of the company's overarching aims. In situations like these, a glance at the guiding principle and strategy can point them in the right direction. Henry Mintzberg likened strategy to setting course in a sailing ship.[2] The ship represents the company, and the strength of the wind the attractiveness of the market. The stronger the wind blows, the faster the boat moves forward. The captain – or management – not only sets the course but also steers the ship and navigates with the aid of the information available about the relative position. Whereas the technical tools required for sailing a ship are a sextant or radar, in a business context these are financial controlling and market research.

A strategy's orientational function affects other employees in a company, not least those whose interests extend beyond their immediate working environment to include the aim and purpose of their activities. The strategy – along with the company's guiding principle – provides them with answers and boosts their motivation. It has a similar effect on the company's owners, motivating them to invest. A strategy helps them to estimate whether a business unit will be successful in its competitive environment in the future and whether it is worth investing capital. The motivation for publishing a strategy is not always obvious, given the general tendency to not disclose the plans for beating competitors. Yet, doing so shows other stakeholders, such as suppliers, customers, and political representatives, the direction that the company wants to take.

Is it still worth setting a specific course if the environment is in a constant state of change? Particularly in recent years, this question has cropped up a lot, as it is believed that major and rapid changes are shaping our lives. The acronym VUCA is often cited in this regard. It stands for volatility, uncertainty, complexity, and ambiguity – phenomena that seem to be on the increase in current times.

The situation is not quite as dramatic as this might imply. This is not the first time that market conditions have been subject to such extreme change. During the first half of the 16th century, for example, merchants in Europe had to grapple with an inflation crisis. At the same time, they had to deal with the rampant spread of power of the Fugger and Medici families, the prospects of a New World on the other side of the Atlantic, and the political turmoil caused by the religious uprising now known as Protestantism. The geopolitical, social, and economic upheavals during and after the World Wars show that these disruptive dynamics are not unique to the present.

Nevertheless, any changes in the market require reorientation. Changes that occur in rapid succession can put pressure on the planning time frame. They can require a greater readiness to modify plans on short notice. This does not eliminate the need for strategic planning. The battles that General von Clausewitz fought were fraught with uncertainty, referred to as ''friction.'' They could not be solved by having plenty of information about the enemy, either. In any case, such information was unreliable in earlier periods. Thus, the strategies adopted by von Clausewitz required a great deal of flexibility from the commanders and the ability to identify, think through, and correctly assess the range of options for action based on extraordinary ''mental prowess.''[3] These very same requirements can be applied to present-day managers, especially given that current forecasts given by economist and market researchers are about as reliable as the military intelligence was in the day of von Clausewitz.

Today, the ability to adapt to environmental conditions is often referred to as "agility." However, agility becomes meaningless if it is applied without a strategy or purpose. The maritime metaphor above illustrates this well. Sailing without setting a course would mean drifting haphazardly in the hope of reaching the desired destination by chance.

All the same, setting a course for a sailing ship does not guarantee reaching the intended destination. This applies equally to strategic planning. The first voyage Columbus undertook to find a nautical passage to India is a well-known example. Albert Einstein's words that "planning replaces coincidence by error" are also applicable in this case. There is more to be learned from mistakes than from coincidences.

WHERE DOES OUR COMPETITIVE ADVANTAGE LIE?

For business to take place, both the supplier and the customer must stand to benefit. Each party receives and gives something. In the broadest sense, it is a cost-benefit equation. Both the supplier and the customer assume that they are receiving more than they give. This can be portrayed in the form of two sets of scales (see Figure 1.2), on which the costs and benefits are placed in the opposing pans.[4] Before making a decision to buy or sell, both parties expect the benefits of the transaction to outweigh its costs, so that the scale tips in their favor.

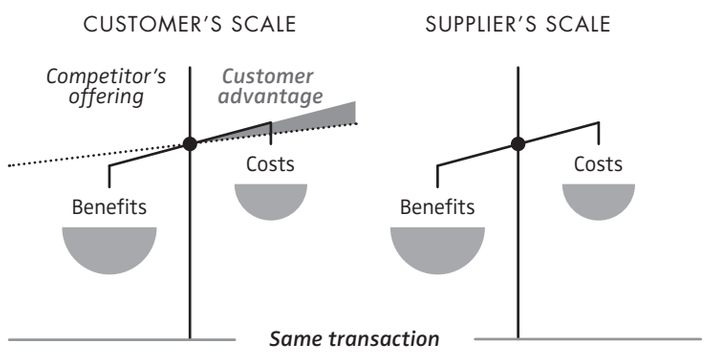


Figure 1.2: The cost-benefit scale for the supplier and customer

The markets that we are interested in here are characterized by intense competition. It is therefore not enough for the supplier to offer the customer something that provides greater benefit than it had cost them. In addition, the customer must see it as being better than anything put forward by relevant competitors. If this is the case, then the supplier enjoys a customer advantage.

Suppliers can secure this advantage by keeping their prices lower than those of their competitors, thus reducing the weight in the pan containing the customer's costs. However, they must then consider how much this weighs down their own side of the scale. If suppliers agree to transactions that do not cover their own costs over the long term, they will disappear from the market down the line. This means that suppliers not only have to keep offering customers as many benefits as possible, but they must also ensure that they remain profitable. Only then can it be said that the supplier in question enjoys a competitive advantage. In summary, a competitive advantage must fulfill the following three criteria:

- It must be important for the customer.
- It must be difficult for the competition to replicate.
- It must be profitable for the supplier.

Achieving this competitive advantage is the key focus when considering business strategy and has already been scrutinized in countless research projects. Michael Porter is well known in this field, particularly for his extensive empirical study into "PIMS": profit impact of marketing strategies. The study was commissioned by General Electric (GE) in the 1960s to examine how companies or individual business units can secure competitive advantages. One of the results that Porter achieved was to plot a U-shaped curve that portrays the relationship between a business unit's return on investment and its share of the market. As it turned out, successful companies' market shares were either particularly large or small. Business units with medium-sized market shares, on the other hand, were less successful.

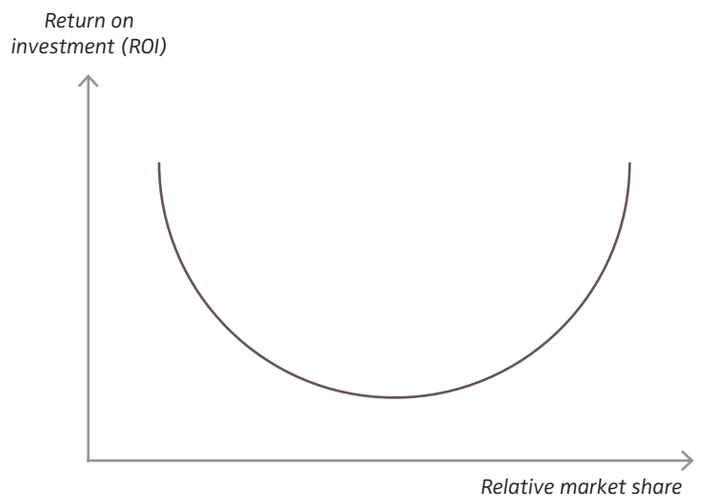


Figure 1.3: Porter's U-shaped curve

With regard to business units with large market shares, this phenomenon surely stems from the lower production costs per item that result from economies of scale. In the 1920s, the aircraft industry discovered that doubling production volume reduced the costs per item by around 20 to 30 percent. This potential for reducing costs became prominent under the name "learning curve effect," coined by the Boston Consulting Group.

By definition, business units with small market shares cannot leverage economies of scale. Their success stems from the flexibility that their small size affords them, particularly when it comes to meeting customer requirements. Customers are prepared to pay higher prices for this reward, which has a positive effect on the supplier's profitability. By contrast, medium-sized business units risk being too small to benefit from economies of scale, yet they are already too large to be flexible. One example of this is Nordex, a European supplier of wind turbines and equipment with a workforce of approximately 5,000. Although the market for these products has grown worldwide, the company has lost some of its market share. On the one hand, it competes against larger suppliers such as Vestas, Siemens/Gamesa, and Goldwind. On the other hand, it competes against smaller specialist manufacturers such as TetraSpar, which focuses on floating offshore systems.

The results of this research led Porter to draw up three generic strategy options:

- A business unit can secure a competitive advantage with the quality of its products, which Porter terms a differentiation strategy.
- A business unit can achieve lower unit costs through large sales volumes, so as to offer customers lower prices than the competition – a cost leadership strategy.
- A business unit can focus on a specific segment of customers by pursuing a niche strategy.[5]

Xavier Gilbert and Paul Strebel then expanded these three strategies by adding a dynamic component.[6] They believe that competitive pressure forces companies to improve themselves over the long term with regard to both costs and customer benefits. This helps firms to always stay one step ahead of the competition. To start with, companies should focus for a certain period on just one dimension, which Gilbert and Strebel call "outpacing." Porter then ascertained that improvements in costs and quality cannot be continued indefinitely. A few decades ago, video recorders were big, heavy, and expensive when they first came on the market. Over the course of time, they became more compact and affordable, but the price never dropped below €10. Manufacturers reached the limit for optimizing the quality and costs of video recorders at some point. In this regard, Porter talks of the productivity frontier. In the best-case scenario, suppliers will occupy a point on the outside curve (see Figure 1.4).[7]

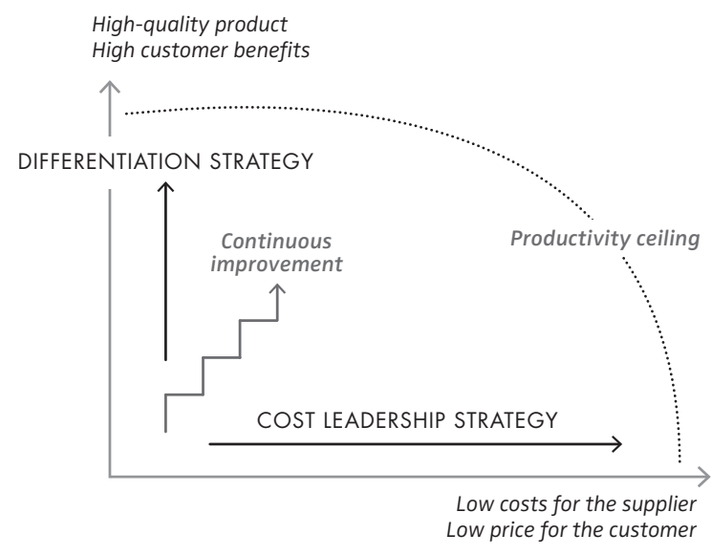


Figure 1.4: Outpacing and the productivity frontier

These trains of thought were further developed by W. Chan Kim and Renée Mauborgne under the heading "Blue Ocean Strategy."[8] They argued that companies must strive for product and process innovations if they are to overcome the productivity limits and thus attain unique competitive positions. The idea is to use innovative offerings to generate new demand, thus rendering the previous interaction between costs and quality redundant. An example of this is how we can now use streaming technology to watch a film on a notebook more conveniently and cheaply than with a top-of-the-range video recorder 10 years ago.

The approaches adopted by Porter, Strebel/Gilbert, and Kim/Mauborgne set up the first rough decision-making framework for developing a competitive advantage. But before considering any other factors in the company, the market that the strategy is to address must first be defined. Consider Porsche as an example. Some see the success of this brand as evidence of the successful application of Porter's implementation strategy. Others view Porsche as implementing a successful cost leadership strategy. It depends on how you define the company's market. The first group views Porsche as the quality leader in the automotive market, whereas the second defines the relevant market more narrowly, comparing Porsche only with other suppliers of luxury sports cars, thus focusing on Porsche's much higher production volumes than Ferrari and Lotus.

This example shows that defining a division's competitive advantage raises further key questions, which need answering. The three most important of these are discussed below.

WHAT CUSTOMER NEED ARE WE ADDRESSING?

The supplier must determine which customer need it wants to address. In the B2B sphere, where products are often described as a solution to a problem, there is an additional question: What fundamental problem has generated the demand for a solution? For example, potential customers might be seeking to bond two materials, to transport goods from point A to point B, or to obtain certain chassis parts to manufacture a car. The question can thus focus more squarely on the solution: What function must an offering serve to meet the customer's need?[9]

A customer's problem – such as transporting goods – can be broken down into its specific components, in this case by asking: What distance needs to be covered? How quickly must the goods arrive? What safety regulations must be followed?

Customers have different expectations of the products that they buy. Nonetheless, some share certain similarities when it comes to the criteria they base their purchase decisions on and how they evaluate offers. These customers can be grouped into segments. In many markets, customers' willingness to pay is used to define a segment. For example, some passengers will pay 10 times more than others for the same flight to enjoy the perks of first class. Others are willing, or forced, to pare things down to the basics to secure a cheap ticket.

The more accurately a supplier defines and addresses the needs of a segment, the greater the benefits for the customers in question. Pharmaceutical companies such as Pfizer are currently adopting this approach. As sales of mass-market, blockbuster drugs are on the wane, Pfizer is successfully focusing on developing drugs that target the precise needs of small target groups. It is important for suppliers who concentrate on a specific market segment to not lose sight of their own needs. Kim and Mauborgne cite the example of the airline Song to illustrate this. In the United States, this company focused on female business customers, offering organic meals and a targeted entertainment program, including in-flight workouts. However, Song was unable to survive on the market for long.[10] The authors thus recommend "desegmenting" customer groups, which means considering whether a strategy might be too tightly focused on a specific target group.

Suppliers decide whether to address single, several, or all customer segments in the market. McLaren Automotive, for example, only addresses the premium segment of purchasers in its market – that of extremely expensive sports cars. Volkswagen targets the same segment with its Bugatti and Lamborghini brands while simultaneously addressing lower customer price-bracket segments with 10 other brands. The only segment that Volkswagen has ignored so far is the large one of emerging economies, where the customers' price bracket for cars lies between €5,000 and €8,000, though the company is planning to close this gap.

Closely linked to customer segment considerations is a supplier's regional alignment: Customers' purchasing behaviors differ from country to country and according to traditional tastes and national legal frameworks. This proved a fatal pitfall for Starbucks in Israel and for Walmart in Germany. It is why no company in the alcoholic beverages sector would plan to set up an affiliate in an Islamic state, for example. In most markets, other customer segmentation criteria are more important than nationality, meaning that cross-border customer segments can be formed. Nonetheless, it is important for suppliers to consider which in regions of the world customers belonging to a target segment are to be addressed, since serving foreign markets consumes a lot of resources. Fundamental decisions on regional focus should therefore be made during the strategic planning.

WHAT IS IT THAT WE ARE MARKETING?

We have seen that a product portfolio is determined by customers' needs. Next, the operating principles and technology that the supplier will require to solve a customer's problem must be decided during the strategic planning. This might be to bond two materials using screws or an adhesive; to transport goods by rail, truck, plane, or ship; or to manufacture car chassis parts from steel, plastic, or aluminum.

A supplier's predominant technology is frequently used to specify its sector, such as in the automotive industry. Having said that, a supplier can apply several technologies to solve a customer's problem and thus fall into a broader category of sectors. For instance, current developments in requirements and technology are turning companies such as Daimler, General Motors, and Volkswagen into ''mobility'' rather than ''automotive'' operators. This means that they want to offer their customers a broader range of transportation technologies in the future.

Besides determining the technology that will be used to solve a customer's problem, the breadth of the portfolio should be defined during the strategic planning. For example, a truck manufacturer must decide whether to offer just standard versions of a vehicle or a wider range of models. It must also decide whether to include truck bodies in the portfolio and whether financing options should be offered or not. Closely related to this is customer individuality, which increases, for example, in cases where traditional industrial enterprises make the strategic decision to extend their product portfolios.[11]

In their quest to fulfill customers' every wish and leave no sales potential untapped, some companies are tempted to make their sales portfolios as broad as possible. Although one should bear in mind that a wider range of products does not automatically generate more demand. Konrad Wetzker and Peter Strüven cite an experiment in which supermarket customers were given coupons for jelly. As many as 10 times more customers used the coupons when only six jelly choices were offered instead of 30.[12] Suppliers sometimes overlook the fact that a wider range of products can incur high complexity costs, even if digitization promises savings in this respect. Furthermore, any supplier offering a wide range of products should be aware that they are competing against product specialists in certain fields who can offer customers greater benefits. To avoid losing the focus on competitive advantage, it should be decided during the strategic planning as to what is not part of the supplier's offering.

WHAT BUSINESS MODEL ARE WE APPLYING?

Finally, defining a business strategy should set the cornerstones of the commercial framework in which the supplier wishes to conduct business. In this context, we are referring to the business model. This defines which inputs and outputs are attributed to the supplier and the customer in a transaction. It also addresses how pain and gain are divided between the two parties along the value-creation chain.[13]

Deciding on a business model can be a matter of determining who has which usage and property rights. Is a product going to be offered for sale, rent, or lease? Recently, the question has arisen as to who owns the data produced during the value-creation process. The Italian rail company Trenitalia, for example, shares the data for its climate control units with SAP. By contrast, Deutsche Bahn keeps its product data under wraps for its own further value-creation activities.

The business model must stipulate how any created value will be distributed between the supplier and the customer. For example, the aircraft turbine manufacture Rolls-Royce links its earnings to airlines' use of its products and charges customers based on ''power by the hour.'' This means spreading the risk. By systematically applying this rule in this case, Rolls-Royce shares the sales-loss risk with its customers, for example, if an airline's workers go on strike.

When it comes to service-oriented pricing schemes, there are even business models in which the supplier's risk goes beyond the customer's use of the product. For example, the business consultancy Bain & Company entered the market by offering to link its consultancy fees to its customers' stock exchange value. The actual course that the stock price takes, of course, depends on factors over which Bain has no influence.

The design of a business model's core elements can determine which work processes in the value-creation chain are to be performed by the supplier and which by the customer. Consider the furniture retailer IKEA. To save costs, the company made a name for itself by leaving the final product assembly to its customers.

Of course, these decisions are closely linked to the kinds of products on offer and the breadth of the portfolio. Yet, the elements of business strategy decisions always overlap. They are interdependent. Ultimately, everything is interlinked. It is nonetheless advisable to structure strategic decisions in the same way. This makes it easier to cope with the complexities that crop up in practice. With this in mind, the 3 + 1 key questions depicted in Figure 1.5 provide a useful guideline for devising a business strategy.

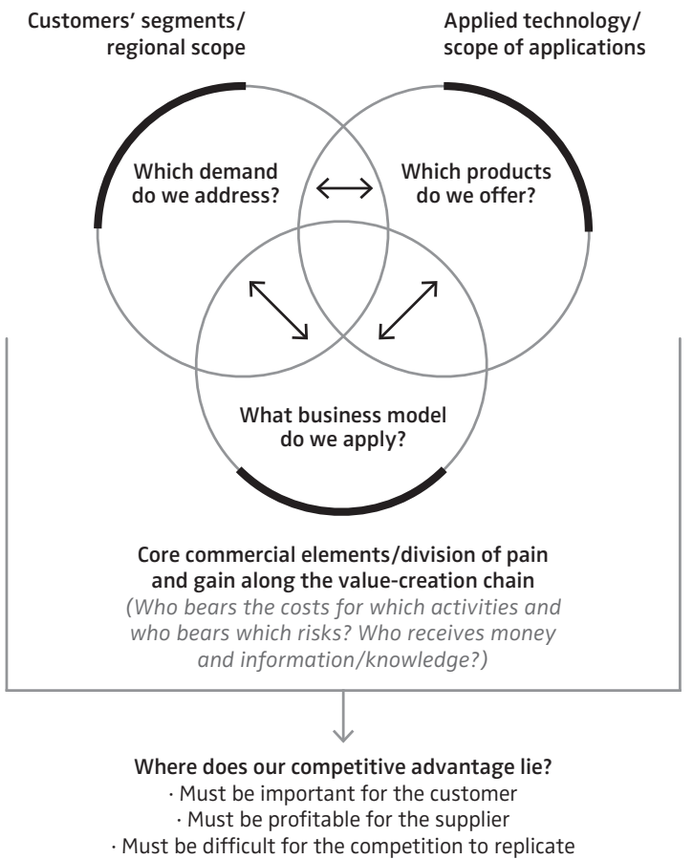


Figure 1.5: 3 + 1 key questions for devising a business strategy

As stated above, strategic planning should focus solely on the key elements of business development. This restriction helps when it comes to explaining the strategy to others. Too many details can blur the overall picture. The key questions cited above can, of course, be subdivided. Consider, for example, a supplier as it determines a business model. If the supplier intends not to sell but rather to lease the product in question, it needs to decide how to set the leasing rate, the frequency of payments, and who is to be responsible for which kinds of product damage. The answers to these questions already encroach upon the operational planning, which exceeds the scope of strategic planning and goes into more detail.

THE STARTING POINT

Companies are rarely on the green field when answering the 3 + 1 questions for devising business strategy. Instead, their answers need to take into account both their unique starting points and the concept of "core competences," which was developed by C. K. Prahalad and Gary Hamel and has become an established approach for doing so.[14] (Although designed in relation to companies, the concept can be applied to individual business units.) In contrast to market-centric approaches, in which strategic decisions are based primarily on market conditions, Prahalad and Hamel recommend focusing on the skills that exist in the company or business unit. However, only those skills that help the company maintain a lasting competitive advantage are considered relevant in terms of core competences. Prahalad and Hamel illustrate their concept in the form of a tree, with the roots representing the core competences, the branches the types of product, and the leaves and blossoms the products.

Besides core competences, a company's financial resources are a variable that must be considered to determine a business unit's starting point. The first factors to be ascertained are sales and costs. These can be broken down further, for example, by product type or region. A comparison between income and expenditures then produces values that can be used to ascertain the economic starting point. These values can be broken down even further according to the specific goal of the analysis. This could include, for example, a focus on financial data (i.e., cash flow). In recent years, profit levels have increasingly been set in relation to a company's capital factors, such as the return on capital employed, which compares pre-tax operating returns with operating assets. These and similar indicators are not compiled just to ascertain a business unit's current situation. They also help estimate the potential for raising the financial resources necessary to implement a specific business strategy. This potential is a key factor in the strategic decision-making framework.

Besides the available skills and resources, how the company applies them is of interest. A wide range of approaches exist for structuring these processes, of which Porter's value-creation chain model is the best known.[15] This calls for recording the stages involved in the process used to transform the basic material into a ready-to-use product. This process is then divided into the primary activities directly related to providing the service (e.g., customer service) and the support activities used to perform the primary processes (e.g., human resources). The costs and effects of these activities in the company are then analyzed to evaluate their contribution toward creating competitive advantages. The goal is to identify the strengths and weaknesses of a company or business unit as accurately as possible.

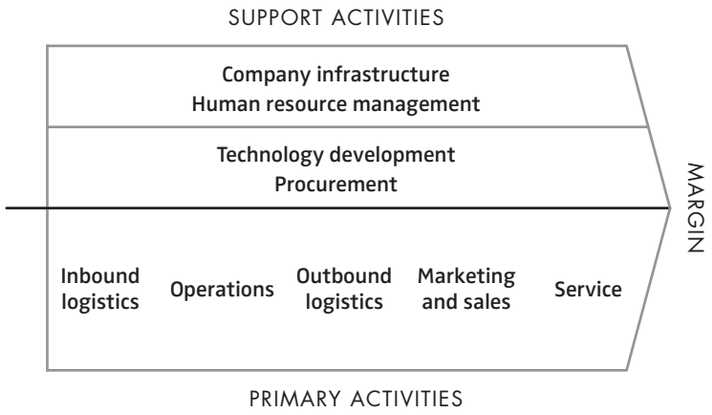


Figure 1.6: Porter's value-creation chain

The level of detail required in such an analysis varies from case to case. In general, benchmarks will be required to evaluate the results. It is common practice to perform annual comparisons within each business unit. Comparisons with other companies' business processes are even more useful, although the information is more difficult to obtain. The most helpful comparison would be with a company that achieves the best cross-sector results for a specific activity. This is what is meant by the practice of benchmarking.

MARKET-SPECIFIC DEVELOPMENTS

We now return to the sailing analogy. Besides knowing your own position, you have to have an idea of how environmental conditions, such as the weather, will develop during the course of your journey. With regard to planning a business strategy, this means anticipating how the market environment will develop in the future as well as knowing your point of departure. In the following section, we compare and contrast the developments that relate to a business unit's particular market and the overarching developments relevant to strategic planning.

Numerous institutions and associations conduct studies to ascertain the current situation and predict developments in a sector. These efforts are supplemented by the market research that many companies conduct themselves. Porter's Five Forces model has become the established approach for sorting and understanding bundles of information better. This model was developed originally as a means of explaining how

profitability differs between sectors.[16] Porter discovered, for example, that profits in the aviation industry had been much lower than those of soft-drink products for years. He identified five sector-specific factors that were responsible for these differences: suppliers' and customers' bargaining power, the threat of new entrants and substitute products entering the market, and intense competition from rivals (see Figure 1.7).

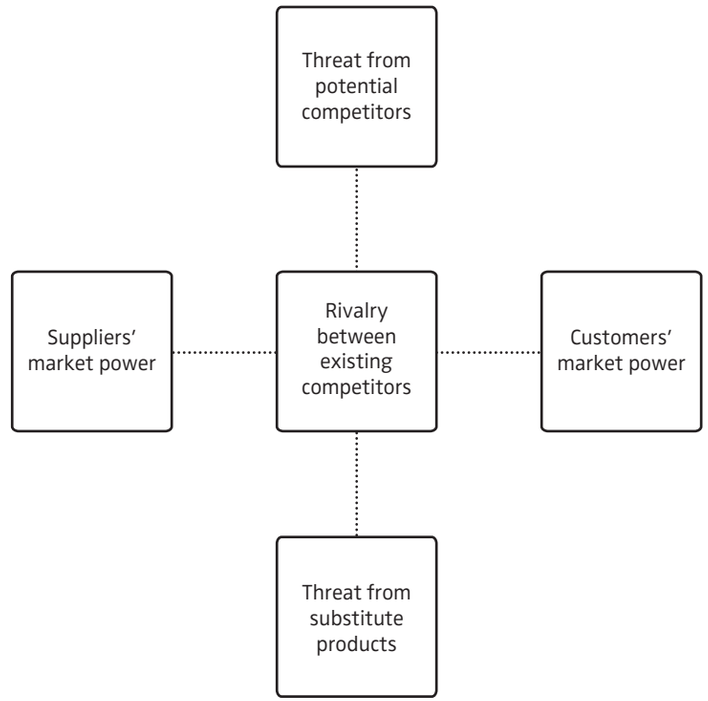


Figure 1.7: Porter's Five Forces model

The more intense competition there is in a sector, the lower the suppliers' profitability will be, particularly if many rivals pursue the same strategy. If strategies differ – for example, because one company seeks its competitive advantage through low prices whereas another focuses on providing quality – these suppliers can still be competitors despite targeting different customer segments. The reason for this is customers' inconsistent behavior, as they base their decisions on changing criteria. This is the context in which substitutes represent competition.

The power wielded by customers and suppliers depends primarily on the extent to which these market participants rely on each other. The supplier must therefore consider several important questions. Could a customer still manage without my products? Could they produce them themselves? Has the customer committed long-term to purchasing from a certain supplier? If not, do other suppliers offer similar products to mine in their portfolio? In the latter case, the customer's costs for switching to a different supplier must be considered. The amount that a company would stand to lose if a customer or supplier were to end the business relationship, or the cost of finding a new partner, also plays a role. According to the logic of the Five Forces model, the more power that lies with a customer or a supplier, the lower the profitability for the company.

The threat presented by new competitors and substitute products is determined mainly by the costs associated with their entry into the market. These costs depend, among other things, on the capital that the new market entrant requires and the extent of the economies of scale available to competitors. Apart from this, the achievable profits, of course, play a role, as low profits in a sector can be a barrier to market entry.

Finally, government regulation can influence the number and profitability of the suppliers in a sector. This can take the form of incentives for startup companies or, equally, protection for well-established businesses, whose survival on the market would otherwise be under threat. One example of this is the steel industry, in which none of the major suppliers dropped out of the market in 2015, despite global production of approximately 1.5 billion metric tons versus global demand of just 800 million. The spectrum of state intervention measures is diverse and can range from subsidizing loss-making companies to introducing punitive tariffs for competitors. This aspect leads us to our next topic, which deals with the broader set of factors that extend beyond the sector.

CROSS-MARKET DEVELOPMENTS

The number of people living in urban environments worldwide surpassed rural regions for the first time in 2008. This trend toward urbanization is international and affects companies from a wide range of sectors. An approach called the PEST analysis, which stands for ''political, economic, socio-demographic and technical,'' is frequently used to record cross-market developments. Of the numerous aspects covered in a PEST analysis, five points that are particularly important for global industrial companies are focused on.

1. The world's population keeps on growing, despite the reverse trend in industrialized countries. From an economic perspective, this growth is good news, as it means purchasing demand will grow as well. As most of the population growth is occurring in emerging economies and developing countries, the increase in demand is focused mainly in customer segments with a low willingness to pay. Prosperity is increasing in pockets throughout emerging economies and developing countries, and this boosts demand for products in higher price ranges. Yet, over the medium term, higher sales potential is located in the lower price ranges.

2. Instead of international corporations, the financially weak customer segments in these emerging markets are more often addressed by regional suppliers, whose lower-quality but more affordable products meet the requirements in these countries. Although most of the suppliers in question cannot maintain their success over the long term and disappear from the market over time, a number of them keep on growing and reach levels that prompt them to seek new business opportunities. These suppliers have the chance to improve the quality of their offerings and address customer segments with a higher willingness to pay. At this point, they start to compete with the established premium companies and change the competitive landscape in their markets. This is how the Chinese companies Huawei and ZTE were so successful in ousting the US company Lucent Technologies and Germany's Siemens Public Networks from their commanding positions in the telecommunications network infrastructure market.

3. Rapid developments in state-of-the-art information and communication technologies are changing many customers' requirements, while the exchange of information between objects such as machines and products is becoming increasingly important. These new communication options are coupled with analysis and evaluation systems that are able to capture, analyze, and evaluate big data for the purposes of boosting the efficiency of processes and offerings. These developments are discussed under different slogans, depending on the region: ''Internet of Things'' in the United States, ''Made in China 2025'' in China, and ''Industry 4.0'' in Germany. A pertinent example of this big data is state-of-the-art aircraft turbines, which today are already equipped with more than 3,000 sensors. The information they provide can be continuously evaluated, for example, to alert the need for a replacement part before the fault causes an operational outage.

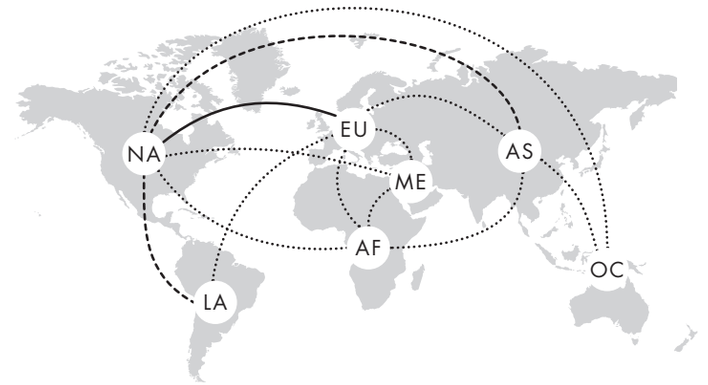
4. Because data management and the associated software play an increasing role in fulfilling customers' wishes, some companies in the IT sector are moving into markets that were previously dominated by industrial companies. For example, electricity grid operators are no longer restricted to well-established suppliers such

as GE, Siemens, and ABB. Today, they can seek grid optimization from companies such as IBM. In general, it can be said that software companies are increasingly investing in hardware companies, whereas the abovementioned industrial companies have been investing very heavily in developing software expertise in recent years. For example, the stalwart industrial company Siemens is now one of the ten largest employers of software programmers in the world, and Google bought the room thermostat manufacturer Nest for more than $3 billion in 2014. Developments like these shake up the conventional competitive landscape.

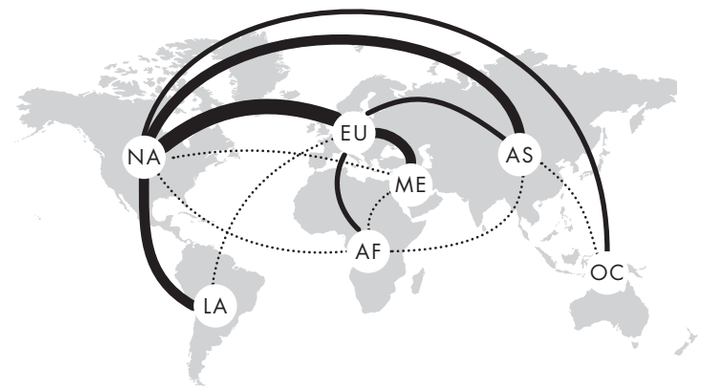
5. Globalization is on the rise. By this, we mean the cross-border movement and exchange of people, goods, services, data, and money. Though it is true that international trade in goods is no longer showing the same rates of growth as in recent decades, and it has experienced a significant decline in 2020 due to the Corona pandemic. But during this pandemic, it has become apparent that globalization was continuing to grow in other areas, particularly in the exchange of data. Between 2005 and 2014, cross-border data traffic increased to 45 times its prior volume (see Figure 1.8). It is set to increase again to nine times its current volume by 2021.

Figure 1.8:
Increase in cross-border data exchange 2005–2014
(source: TeleGeography, Global Internet Geography, McKinsey Global Institute Analysis, 2015)

CROSS-BORDER DATA-FLOWS ARE SURGING AND CONNECTING MORE COUNTRIES



(2005: 100% = 4.7 Terabits per second)



(2014: 100% = 211.3 Terabits per second)

Regions:
NA = United States and Canada
EU = Europe
AS = Asia
LA = Latin America
ME = MiddleEast
AF = Africa
OC = Oceania

Bandwith, Gigabits per second**:**
< 50
50 – 100
100 – 500
500 – 1,000
1,000 – 5,000
5,000 – 20,000
> 20,000

Note: Lines represent interregional bandwidth (e.g., between Europe and North America) but exclude intraregional cross-border bandwith (e.g., connecting European nations with one another).

All of this affects economic globalization in many ways. Knowledge is now accessible around the clock, international teams of developers can work simultaneously on the same project, and machines coordinate production processes autonomously across borders. An aircraft turbine manufacturer no longer has to send entire spare parts to a customer. Instead, it can transmit information to a 3-D printer in the customer's country for local manufacture. This opens up new potential for globalization, particularly for small companies, as they no longer require a large administrative apparatus or contacts overseas to purchase or sell products worldwide. This makes it easier than ever before for small companies to become "micro-multinationals."

INTERNATIONALIZATION

A business unit engages with foreign markets either to increase sales or to harness cost benefits. Smaller companies, such as the abovementioned micro-multinationals, initially have their sights set on boosting sales. They frequently use large international trade platforms such as Amazon and Alibaba to sell their products abroad. These platforms offer a number of advantages. They dispatch products to customers on the seller's behalf, assist with customs procedures and payment methods, and, above all, attract large numbers of potential customers to peruse the offers. This provides suppliers with access to customers in other countries without needing to be there on the ground. In this particular respect, the same goal can be achieved by appointing agents and distributors to perform marketing activities. If an industrial company wishes to outsource production to third parties abroad, it can award licenses. The German engine manufacturer MAN has been doing this for years with its ship engines. These diesel engines, which provide more than 100,000 hp, were too large to transport from German factories to its customers in Asia. Awarding licenses saved MAN the costs of constructing its own production facilities there.

If an industrial company does not wish to entrust its foreign activities to external partners, it must establish its own resources there instead. This is advisable, for example, with complex products that require explanation. External partners would be unable to easily acquire the requisite knowledge. That is why it is smarter for the supplier to dispatch a member of the company's own workforce to oversee sales. Alternatively, a representative office might be founded abroad for purchasing materials or other value-creating activities. Depending on the supplier's business model, multiple value-creation activities can be performed abroad, right through to establishing an independent company that covers a similar spectrum of value creation as that in the home country. Some suppliers achieve this by acquiring a foreign company, such as the Chinese automaker Geely did when it purchased Volvo's private car division, or when the Indian automaker Tata Motors acquired Jaguar. The resulting advantages of the

increasingly international division of value creation can be harnessed even better by leveraging synergies between networked foreign branches. The technologies developed under the heading "Industry 4.0" have greatly expanded these possibilities in recent years. Figure 1.9 depicts the different options for foreign business activity.

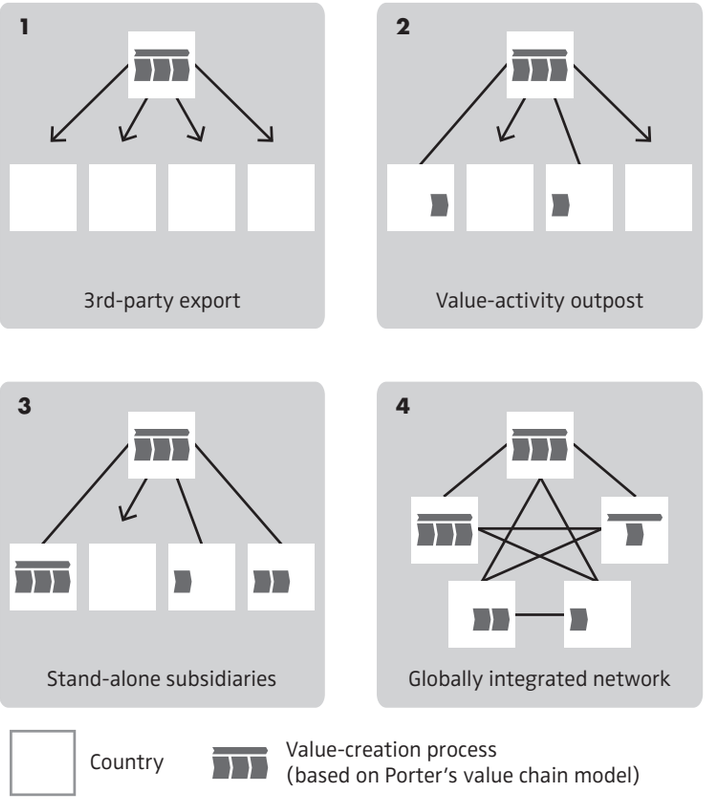


Figure 1.9: Organizational options for foreign business activity

The numbering of the options in Figure 1.9 indicates a process of globalization that industrial companies frequently use. After all, companies are rarely "born global." An exception to this in the consumer goods sector is Airbnb, an international internet platform set up to provide travelers with private accommodations. Another example, this time from the B2B environment, is Upwork, an employment platform that lists

workers in 180 countries (so it claims), and taps into the low-wage levels of emerging economies and developing countries. The business models for such born-global companies are based on the use of internet platforms to match business partners worldwide. Industrial companies should examine how to use this kind of sales potential, although their portfolios generally require much more extensive value-creation activities in development, production, and sales.

If a company wishes to perform some of these value-creation activities abroad using its own resources, this calls for investment. Economists often refer to foreign direct investment (FDI) in this regard. Whether FDI eventually pays off depends on the opportunities and risks that the host country has to offer, such as those that stem from political instability. The competition situation also plays a role. For example, some suppliers with small market shares worldwide make any new entry into a foreign market conditional upon the market leader's behavior, according to the principle "never attack a gorilla at his home." The risks attached to foreign investments not only relate to the market but can also arise from local management errors. The higher the ratio between suppliers' investment and their financial capacity, the greater the risk. To keep these risks better in check, small and medium-sized enterprises (SMEs) in particular prefer to carefully increase their foreign investments incrementally.

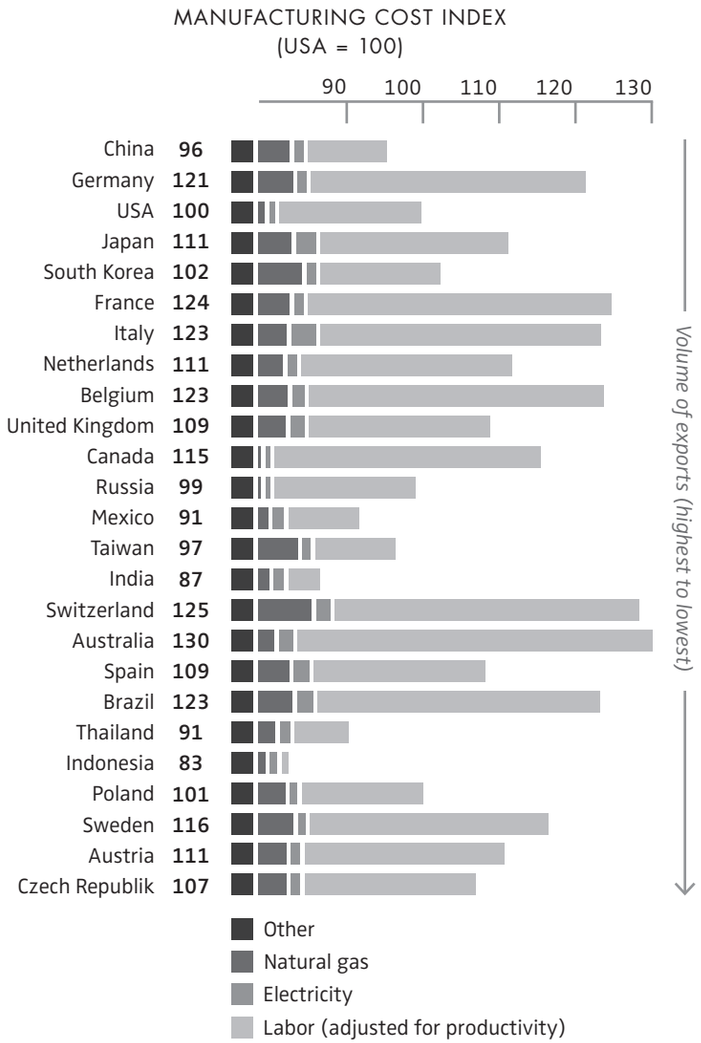
A good example is the German SME Wilo, which manufactures pumps for use in water supplies and climate technology. The company generates annual sales of €1.3 billion in more than 60 countries. When it wants to break into the market in a new country, Wilo starts off by looking for a "pioneer." This is usually a local who is familiar with German culture. After that, the company checks this potential pioneer's entrepreneurial spirit and sense of responsibility. If the person turns out to be suitable and is appointed, he or she starts off by focusing on selling Wilo's products. As soon as sales exceed €1 million, Wilo establishes a representative company in the related country. Once revenues reach €2 million, Wilo creates a subsidiary, which is preferably managed by the pioneer. After that, Wilo starts to consider whether third parties should take on certain assembly stages of the product in the host country, and if so, which. At the same time, warehouses are constructed to hold products and spare parts. As a rule of thumb, sales of €50 million warrant stocking around 70 percent of the Wilo product portfolio. If sales continue to increase, the company considers establishing country-specific product platforms and local production.

Following this approach, Wilo invests abroad primarily to increase sales of its products, thereby attracting new customers and encouraging repeat purchases by existing foreign customers. These sales increases are generated in no small part by the inventory held in the host country. This shortens delivery times, thus making the products more attractive.

The Global Revenue Index (GRI) can be used to acquire an overview of how far a company leverages the global sales potential in a given market. This index identifies the global distribution of sales according to sector and compares it with the supplier's own regional sales distribution. A low GRI indicates that a supplier focuses heavily on one region. A high GRI represents an even distribution of sales across regions worldwide.

Acquiring a foreign company increases a supplier's sales thanks to the new brand rights and the expertise that this secures. These factors play a key role. This is particularly true for suppliers from emerging economies who buy companies in industrialized countries, including the abovementioned automakers Geely and Tata Motors. Another possible motive for companies to invest abroad is to gain access to subsidies. Foreign acquisitions, however, are more commonly made to save on import duties, taxes, and other government levies. This then relates to the supplier's costs rather than sales factors. FDI can achieve further cost savings thanks to the economies of scale generated by higher sales volumes and lower transportation costs. Furthermore, access to cheap resources abroad can have a positive effect on a company's cost structures. As with the business idea behind Upwork, international differences in wage levels are often the key factor.

In Western countries, the FDI is often limited to the cases of European and North American companies relocating jobs to Asia or South America, though other trends are now becoming evident. One example is Huajian Group, one of the world's largest manufacturers of shoes for women. In 2011, the company relocated some elements of its production to Ethiopia, where wages were only one-fifth of those in China.[17] In fact, China had lost much of its production cost advantage by 2014. This can be seen in Figure 1.10, which shows the results of a study on manufacturing costs in various countries. Besides personnel costs, this comparison factors in further components such as expenditures on energy. To illustrate the differences, production costs in the United States were given an index value of 100.



Note: The index covers four direct costs only. No difference is assumed for other costs, such as raw-material inputs and machine and tool depreciation. Cost structure is calculated as a weighted average across all industries.

Figure 1.10: International comparison of production costs (sources: US Economic Census; US Bureau of Labor Statistics; US Bureau of Economic Analysis; International Labour Organization; Euromonitor International; Economist Intelligence Unit; The Boston Consulting Group et al., 2015)

When it comes to marketing abroad, companies must decide on the degree to which their portfolios and business models need to be localized. Adaptations are necessary where differences exist between customers' requirements. For example, trucks with the driver's seat on the left can hardly be sold to customers in countries where people drive on the left side of the road, and vice versa. Differences in safety and emissions standards also need to be considered with regard to production setup. Country-specific adaptations might be necessary with regard to sales channels. Western companies operating in Arab countries, for example, are frequently unable to sell directly to the customer company. Instead, they must conduct transactions through local brokers. A lot of country-specific idiosyncrasies need to be considered in communications measures, such as when a brand name is difficult to pronounce or has negative connotations in the target country.

In terms of pricing policy, many suppliers tend to make initial concessions in new countries to help them achieve market entry. This can cause problems if the market is very transparent on the demand side, and customers in other countries spot the special terms and conditions. It can cause customer dissatisfaction and – in the worst-case scenario – encourage the practice of arbitrage, which is when customers buy products in the cheapest country and transport them to higher-priced countries.

Suppliers have to bear in mind that increasing the number of adaptations to suit different countries complicates managerial tasks. If the brand names, distribution channels, and pricing and condition policies are different in each country, it is easy to lose the overview of the business. Any increase in product variations makes it more difficult to achieve cost synergies in purchasing and production. For this reason, suppliers should follow the formula ''as much standardization as possible, as much localization as necessary.''

In summary, the reasons for globalization can be divided into the potential for increasing sales on the one hand, and for cost savings on the other. This depends on the opportunities and risks in the target country. To harness the potential, it is thus better for industrial companies to increase their value creation abroad step by step. While doing so, the specific characteristics of the local markets need to be taken into account, along with any synergies with other areas of the business.

FROM PLANNING TO IMPLEMENTATION

The answers to the 3 + 1 key questions mentioned above for devising a business strategy (see Figure 1.5) are very abstract in nature. Turning concepts like these into tangible success for the company calls for implementation. The first step in this process is to translate the strategic decisions into an implementation plan. This means:

- defining the key implementation measures,
- identifying the major implementation risks,
- estimating the resources required, and
- drawing up a schedule.

Planning can be broken down step-by-step into increasingly specific statements. This is how implementation planning is translated into operational planning. The level of specification keeps on increasing until all employees know what they have to do. This ideal scenario can be illustrated by the diagram in Figure 1.11. Strategic planning (large arrow on the left in the diagram) sets the general direction for a business unit. It is then suitably translated into operations for all subdivisions (small arrows). Finally, strategic and operational planning are implemented appropriately (large and small arrows on the right).

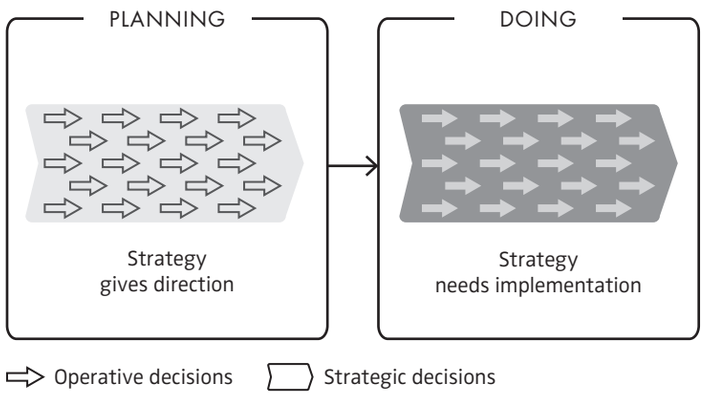


Figure 1.11: From strategy to implementation

So much for the concept. In reality, linking strategic planning, operational planning, and practical implementation does not always work in companies. This has four main reasons:

- Individual actions prove to be unsuitable.
- The actions have not been coordinated carefully enough between those involved.
- Some employees lack the skills required for implementation.
- Some employees lack the motivation required for implementation.

Unsuitable actions include anything that will not help a company achieve its goals. This would be the case, for example, if the target audience in a country was supposed to be wealthy, but the marketing or sales department focused on customers outside of this segment. Even more problematic is when it comes to a department implementing operational actions without their being sufficient interdepartmental coordination. This could happen if a purchasing department were to force price reductions from a supplier, but then production could no longer operate due to a lack of essential materials. Insufficient coordination between departments is often accompanied by a lack of mutual trust. In a survey conducted by Donald Sull et al., 84 percent of managers said they felt that they could rely on their superiors or charges in their own department – compared to 9 percent in relation to coworkers in other departments.[18]

Even rigorous operationalization and cross-departmental coordination do not guarantee success if employees do not implement the plans. Among other things, this can be due to a lack of skills, which can be remedied with supplementary training programs as long as deficits are properly identified. This is simple if it is a matter of employees needing to learn a new language or software program. It is more difficult if an employee's social abilities need to be evaluated, such as leadership, teamwork, or stakeholder management skills.

If asked about the reasons for the unsatisfactory implementation of strategy, managers cite a lack of motivation on the part of employees more frequently than skills deficits. Above all, this applies to strategic decisions that require transformation in the company and behavioral changes from employees. The managers in question sometimes try to overcome resistance by asserting their authority and issuing orders – a principle known as top-down management, or "command and control." This approach ascribes different functions to the head and the hands of the company. Management does the thinking, makes the decisions, and issues orders. Employees simply do what they are

told. Roger L. Martin is one of the many researchers to have shown that this approach has scant hope of success in current-day companies.[19] Although when it comes to implementing strategy, managers like to run things from the top and, where possible, employ this approach even more rigorously in response to problems. This can lead them to ramp up the pressure on their employees and issue increasingly operational directions. As a consequence, they end up getting bogged down in detailed project plans and long to-do lists.

Martin argues the case for including employees in the planning processes for implementing strategy. His research indicates that this boosts employees' motivation to become more involved. In addition, Stephen Bungay advises going beyond co-developing the individual stages of the process and working out the reasoning behind them, as in "each *what* needs a *why*." This inclusive form of managerial behavior has been subject to extensive academic debate under the heading "adaptive leadership." Research conducted by Ronald Heifetz and Marty Linsky indicates that the inclusion of employees even improves the resulting plans and is particularly advisable in cases where there are no established solutions to the problems at hand.[20] Furthermore, it can ensure that employees are able to thoroughly understand the key statements in the strategy. This is not always the case with a top-down approach. Sull et al. cite a case in which 55 percent of mid-level managers were unable to repeat even one of the key statements of their business strategy correctly, despite senior managers reiterating them.

Having said that, even these inclusive "commitment through involvement"-style approaches to implementation planning have their limits. This might be due to legal restrictions, for example if a growth strategy involves the takeover of another company, or if other confidentiality clauses prevent employee involvement. Other examples include plans to cut working hours, wage freezes, and redundancies. In situations like these, it can be assumed that employees' individual interests would compromise implementation planning. Finally, the differences between countries need to be taken into account. After all, openly discussing planning decisions can seem very foreign to employees in strictly hierarchical cultures. It could even be perceived as weakness on the part of the managers.

The individual characteristics of companies and their specific situations thus need to be taken into consideration when implementing strategy. The Congruence Model, created by David Nadler and Michael Tushman, presents a comprehensive picture of the relevant elements of strategy implementation.[21] In summary, it says that when implementing strategies, the four elements of employees, organizational culture, organizational structure, and work content must be harmonized with the company's

environment (see Figure 1.12). This recommendation makes sense. If you wanted to construct the perfect automobile, it would be unwise to combine the design of a Porsche, the interior of a Rolls-Royce, the engine of a Ferrari, and the chassis of a Mercedes. Although these individual components might be excellent in their own right, they do not fit together. The four factors in question always need recalibrating if the company's strategic decisions require modification. Furthermore, the time and contents of any such changes need to be synchronized. In general, it can be said that structures are easier to change than employees' behavior and corporate culture. However, if the corporate culture is not adapted to fall in line with changes in strategy, the much-cited phenomenon outlined by Peter Drucker will occur: "Culture eats strategy for breakfast."

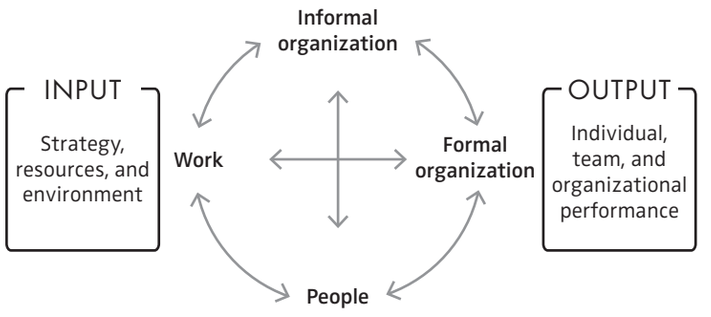
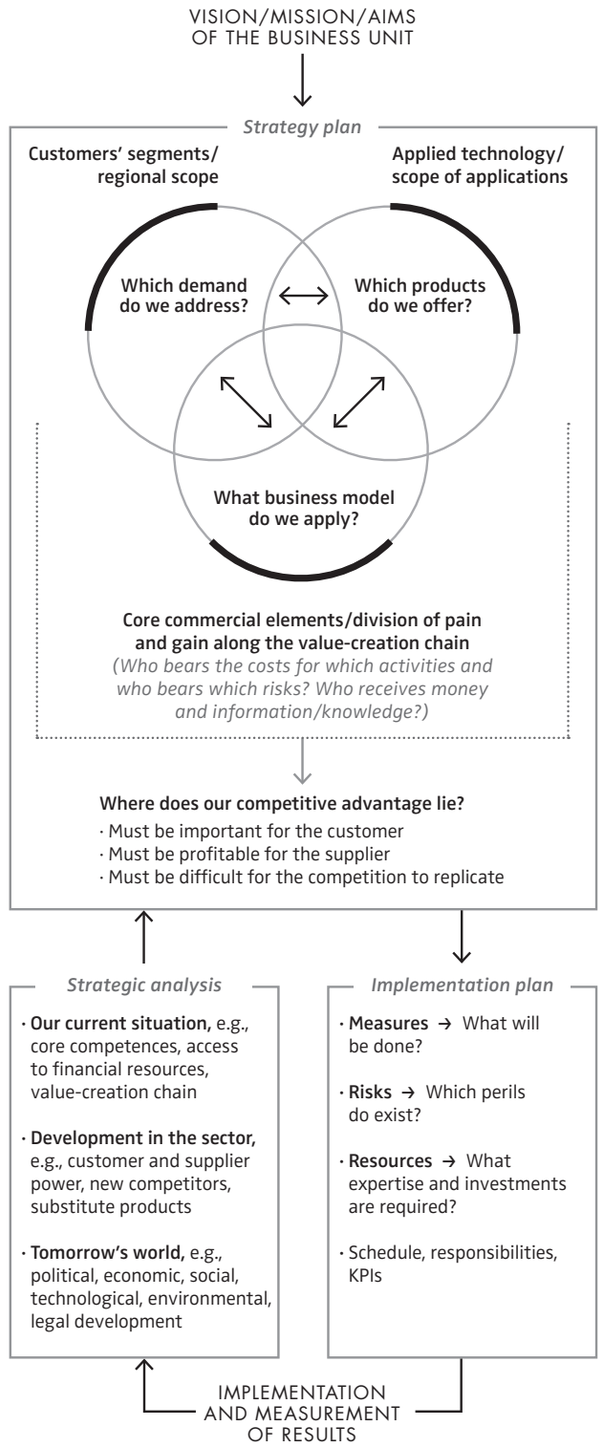


Figure 1.12: The Congruence Model devised by Nadler and Tushman

To ensure that strategic decisions are steering the company in the desired direction and are being implemented on an ongoing basis, goal compliance must be continuously monitored. To achieve this, operational goals must be fixed on a timeline. If a pump manufacturer decides to address premium customers in Thailand in the future, the operational goals might be to hold acquisition discussions with 120 potential customers in the coming 12 months and generate incoming orders worth $6 million. Monitoring these goals can reveal any developments that might be running off track and help analyze the causes. Goals should therefore be defined in a way that makes progress measurable. The Balanced Scorecard, developed by Robert S. Kaplan and David P. Norton, is widely used for this purpose. It even includes operationalizing and quantifying factors such as customer focus and employee motivation.[22]

Goals can be missed if environmental factors change, so these must be checked continuously. Are new competitors copying a product? Do technical innovations place the need for a product in doubt? Have any new regulations been introduced that hinder access to foreign markets? Changes such as these might even mean that it no longer makes sense to continue pursuing the previous goals. Thus, we keep on returning to the starting point of strategic planning and the observation that the process of planning and implementing strategy is a never-ending cycle (see Figure 1.13).

Figure 1.13:
The business strategy cycle



COUNTER STRATEGIES

Advanced globalization is increasing the competitive pressure in many sectors. New competitors are breaking into industrial markets, which until now have been stable and sometimes even limited to one region. Cutting-edge communication and information technologies are accelerating this process. In addition, these technologies enable companies in the IT sector to advance into hardware markets, thus changing the previous processes that distributed value creation between suppliers and customers. Many established industrial companies see these developments as a threat and are searching for ways to defend their market positions. The concept of counter strategies, on the other hand, views market developments as opportunities for growth. Strategic options emerge for industrial companies to not only defend but also expand their market positions.[23]

Counter strategy options touch on all the categories in the aforementioned 3 + 1 key questions used for devising a business strategy. The following questions should be asked from the very beginning:

- What spectrum of services is to be offered, particularly in terms of innovative, data-based services?
- How is the business model to be developed, with particular regard to property rights and pricing?
- To what extent are high price segments to be addressed? (This question is particularly relevant for suppliers in emerging economies.)
- To what extent should low price segments be addressed? (This question is particularly relevant for suppliers in industrialized countries.)
- In which parts of the world are certain services to be provided? How is value creation to be distributed around the world?
- To what extent must the organizational structure, processes, and leadership culture be changed if cutting-edge technologies are to be introduced in the company?

COUNTER STRATEGY 1: ADVANCED PREMIUM PRODUCTS

"Premium" means that this strategy is aimed at customers who are willing to pay high prices. "Advanced" indicates the use of state-of-the-art technologies to create these products. Even though the marketing for this strategy option in industrial markets focuses on physical objects such as machinery, trucks, and turbines, it includes services related to the products, such as maintenance and repairs.

Although traditional markets for advanced premium products are found in industrialized nations, emerging economies and developing countries are gaining ground in this sphere. Some players in these regions are acquiring companies that deal in advanced premium products, such as the aforementioned automotive companies Geely and Tata Motors. In other cases, they break into markets for advanced premium products on their own, such as Huawei, the Chinese telecommunications company that registered the most patents worldwide in 2019.

Besides globally renowned technology groups such as Huawei, Philips, and Boeing, there are many less well-known, medium-sized, advanced premium product manufacturers. Hermann Simon coined the term "hidden champions" for the most successful ones.[24] The companies in question can provide the answers to the following questions:

- How can technical development expertise be expanded over the long term?
- How can products achieve high-quality standards?
- How can an appropriate brand image be established?

We return to these questions in Booklet 2.

COUNTER STRATEGY 2: NO-FRILLS PRODUCTS

As we have noted, the global developments mentioned above generate the greatest growth potential in those customer groups with a low willingness to pay. It therefore makes sense to develop low-price, cost-effective offerings for these segments – known as "no-frills" products. Industrial companies used to serve these markets simply by providing older product types. This was the case in the truck market, where manufacturers supplied earlier vehicle models produced under license by companies in the emerging economies and developing countries. In many sectors, this no longer meets the needs of the no-frills target customers. Just like everyone else, these customers now expect innovative products that have been tailored to meet their price-sensitive needs.

Obvious evidence that the demand for no-frills offerings is on the rise in industrialized countries can be found in the aviation sector. The business model innovations introduced by Southwest Airlines in the United States and Ryanair in Europe (e.g., using only online reservations for cheap tickets and charging extra for luggage) completely shook up the sector's competitive structures. This approach not only won them new customer groups but also individuals who were prepared to exchange standard comforts for a lower price. Budget airlines were formed in the no-frills markets of the emerging economies and developing countries, for example Gol Linhas Aéreas (Brazil), Lion Air (Indonesia), and China United Airlines (China). Many established airlines reacted to these rivals by targeting no-frills customers. British Airways' response was to set up an airline called Go! But these new companies enjoyed limited success. Despites its low prices, Ryanair generates above-average profits, whereas the results for Go! were so unsatisfactory that British Airways closed it down.

It is apparent in other sectors that companies serving affluent target groups struggle to address no-frills customer segments successfully. The kinds of questions that arise are:

- Which employees are most suited to developing no-frills products?
- Should we enter these markets by company acquisition, with strategic partners, or on our own?
- How can a cost level be reached that generates profitability from low prices?
- Which sales channels are suitable?

Besides numerous suppliers in emerging economies and developing countries, companies in industrialized countries found answers to these questions after acquiring first-hand experience – some of it painful. We present these in Booklet 3.

COUNTER STRATEGY 3: COMPLEX SERVICE SOLUTIONS

The first two strategy options involve suppliers who manufacture physical products that are standardized or contain numerous standard components. The sales process begins after production. By contrast, complex service solutions are produced to meet specific customer requirements. Large segments of their value creation are not physical, but are based on a pool of services. The supplier sells these services before they are performed in collaboration with the customer. Success depends upon many variables, leading to the term "complex" solutions.

Trumpf, for example, is a German global leader in laser machinery for processing metal. The company now offers to assist its customers in digitizing all their production processes. The portfolio covers both design and assistance with implementing new smart factories or individual modules, such as setting up customer-specific business platforms and introducing automated material flow controls.

Many complex service solutions like Trumpf's are now based on data management. Industrial companies combine their existing product and market expertise. Their combined potential – unleashed by cutting-edge information and communication systems – provides customer solutions with advantages that never even existed before. For companies like Trumpf, this means performing activities that were previously done by the customers themselves. In this specific example, customers previously coordinated their own material flows and calibrated their own machines. This is now done by Trumpf. Most industrial companies are navigating unknown waters with such offerings and should ask themselves the following questions:

- Which business model for these new complex service solutions is accepted on the market, and what revenue generation can be expected?
- What risks are associated with data-based service offerings?
- What skills are required for marketing them successfully?

We examine these issues more closely in Booklet 4.

These three counter strategies differ in two main respects: the scope of the offering and the customer's willingness to pay. Their relationship can be visualized in this way (see Figure 1.14).

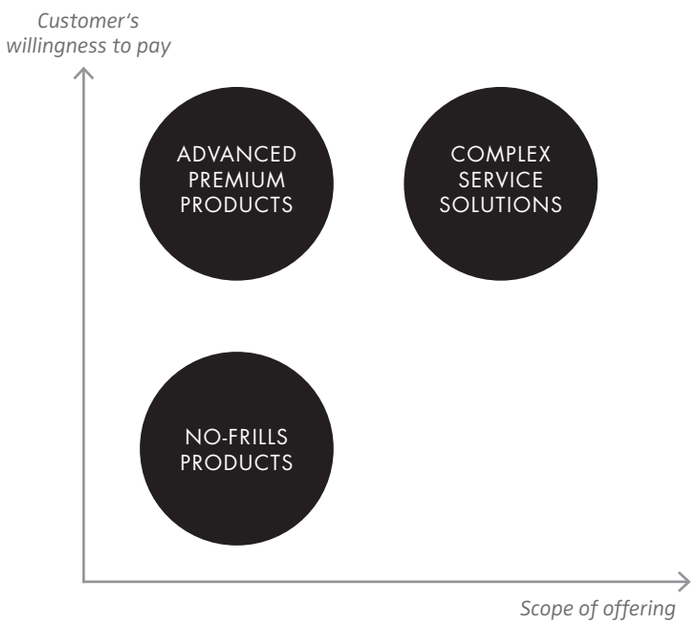


Figure 1.14: The three counter strategy approaches

The three strategy options are explored in more detail in the following booklets. The main focus is on industrial companies that established themselves on the basis of one of these strategy options and are now seeking growth. Some of them, such as GE and Siemens, adopted all three approaches. These companies then operate in different markets and think beyond the strategies for specific fields. This overarching perspective addresses the following questions:

- How can synergies be harnessed between different business units?
- To what extent should the head office be involved in the business units' decisions?
- How can cultural differences between the groups be bridged?

We address these questions in Booklet 5.

1. A.D. Chandler, *Strategy and Structure – Chapters in the History of American Industrial Enterprise* (Cambridge, MA: MIT Press, 1969).
2. H. Mintzberg, *The Rise and Fall of Strategic Planning* (New York, NY: The Free Press, 1994).
3. C. von Clausewitz, *Vom Kriege* (Hamburg: Anaconda, 2010).
4. W. Plinke, "Grundlagen des Marktprozesses," in *Technischer Vertrieb*, 2nd ed. (Berlin: Springer, 2000), 3–99.
5. M.E. Porter, *Competitive Strategy* (New York, NY: The Free Press, 1980).
6. X. Gilbert and P. Strebel, "Strategies to Outpace the Competition," *Journal of Business Strategy* 8, no. 1 (1987): 28–36.
7. M.E. Porter, "What Is a Strategy?" *Harvard Business Review*, November/December (1996): 61–78.
8. W.C. Kim and R. Mauborgne, *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* (Boston, MA: Harvard Business Review Press, 2005).
9. Derek Abell, the founding president of ESMT Berlin and previously professor at Harvard Business School and IMD, talks of the "function served" in this context. D. Abell, *Defining the Business: The Starting Point of Strategic Planning* (Englewood Cliffs, NJ: Prentice Hall, 1980).

   Close to our approach of understanding the customer's demand is the concept of "job to be done" developed by Harvard professor Clayton Christensen and colleagues; see C. Christensen, T. Hall, K. Dillon, and D.S. Duncan, "Know Your Customer's Job to Be Done," *Harvard Business Review* 94, no. 9 (2016): 45–49.
10. W.C. Kim and R. Mauborgne, "Red Ocean Traps," *Harvard Business Review* 93, no. 3 (2015): 68–73.
11. We use the term "product" to cover both material and immaterial components, in other words both goods and services.
12. K. Wetzker and P. Strüven, *Der enttarnte Stratege: Rationalisierte Irrationalität im Management* (Heidelberg: Springer, 2016).
13. The term "business model" can be interpreted in very different ways. A good overview is provided in T. Bieger and S. Reinhold, "Das wertbasierte Geschäftsmodell – ein aktualisierter Strukturierungsansatz," in *Innovative Geschäftsmodelle*, ed. T. Bieger, D. zu Knyphausen-Aufsess, und C. Krys (Berlin/Heidelberg, Springer, 2011). It should be noted that here we interpret the term more narrowly than the now relatively popular definitions forwarded by Osterwalder, who understand a "business model" as basically covering all elements of what we think of as business strategy. See A. Osterwalder, Y. Pigneur, and C.L Tucci, "Clarifying Business Models: Origins, Present, and Future of the Concept," *Communications of the Association for Information Systems* 16 (2005): 1–40.
14. C.K. Prahalad and G. Hamel, *Competing for the Future* (Boston, MA: Harvard Business School Press, 1996).
15. M.E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York, NY: Free Press, 1985).

16. M.E. Porter, ''How Competitive Forces Shape Strategy,'' *Harvard Business Review* 57, no. 2 (1979): 137–45.

17. In 2019 the difference in salary between the two countries has even grown to a factor of 10. See P.M. Barett and D. Baumann-Pauly, *Made in Ethiopia* (New York, NY: NYU Stern Center for Business and Human Rights, 2019).

18. D. Sull, R. Homkes, and C. Sull, ''Why Strategy Execution Unravels – and What to Do About It,'' *Harvard Business Review* 94, no. 3 (2015): 58–67.

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21. D. Nadler and M. Tushman, *Strategic Organization Design: Concepts, Tools & Processes* (London: Longman Higher Education, 1988).

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23. O. Plötner, *Counter Strategies in Global Markets* (New York, NY: Palgrave Macmillan, 2012).

24. H. Simon, *Hidden Champions of the 21st Century: Success Strategies of Unknown World Market Leaders* (New York, NY: Springer, 2009).

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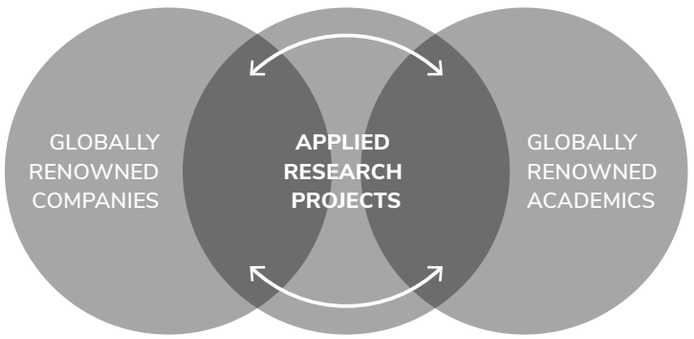

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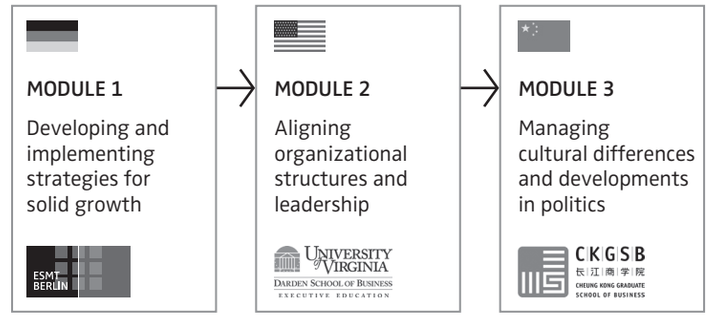

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