

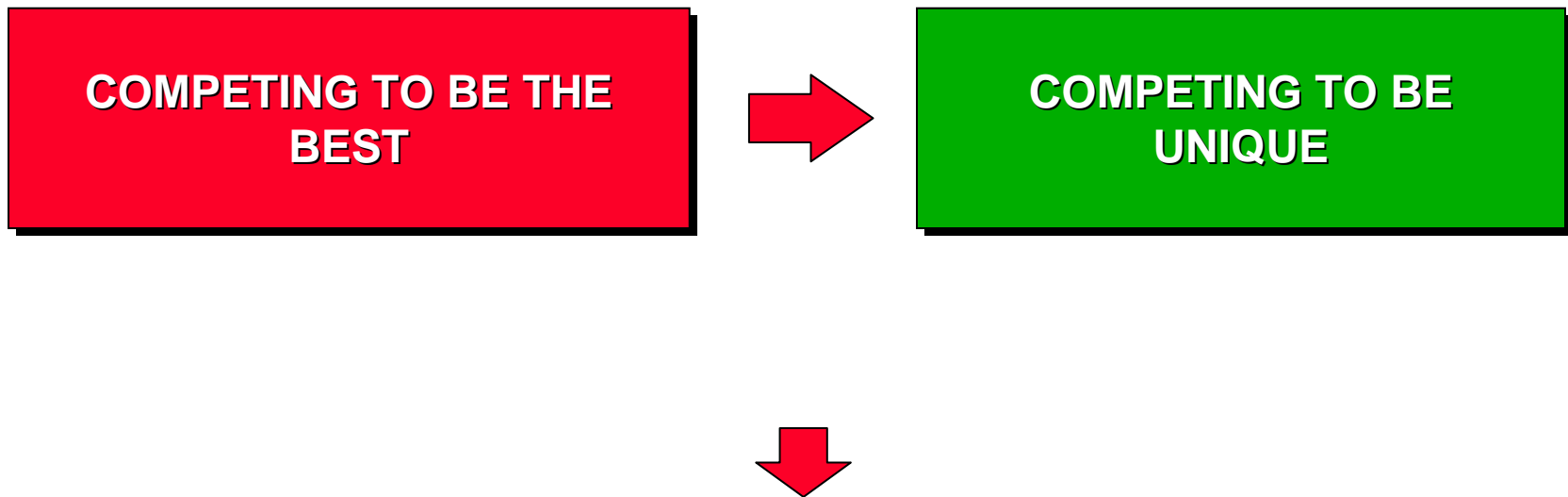
Strategy: Enduring Principles and New Directions in Today's Shifting Global Marketplace

Professor Michael E. Porter
Harvard Business School

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This presentation draws on ideas from Professor Porter's books and articles, in particular, *Competitive Strategy* (The Free Press, 1980); *Competitive Advantage* (The Free Press, 1985); "What is Strategy?" (*Harvard Business Review*, Nov/Dec 1996); "Strategy and the Internet" (*Harvard Business Review*, March 2001); and a forthcoming book. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Michael E. Porter. Additional information may be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu. Version: November 26, 2008, 6pm

How Managers Think About Competition



- The worst error in strategy is to compete with rivals on the **same dimensions**

Setting the Right Goals

- Good strategy starts with setting appropriate financial goals for the company



- The fundamental goal of a company is **superior long-term return on investment**
- Growth is good only if superiority in ROIC is **achieved and sustained**
 - ROIC threshold
- Profitability must be measured realistically, capturing the **actual profits** on the **full investment**

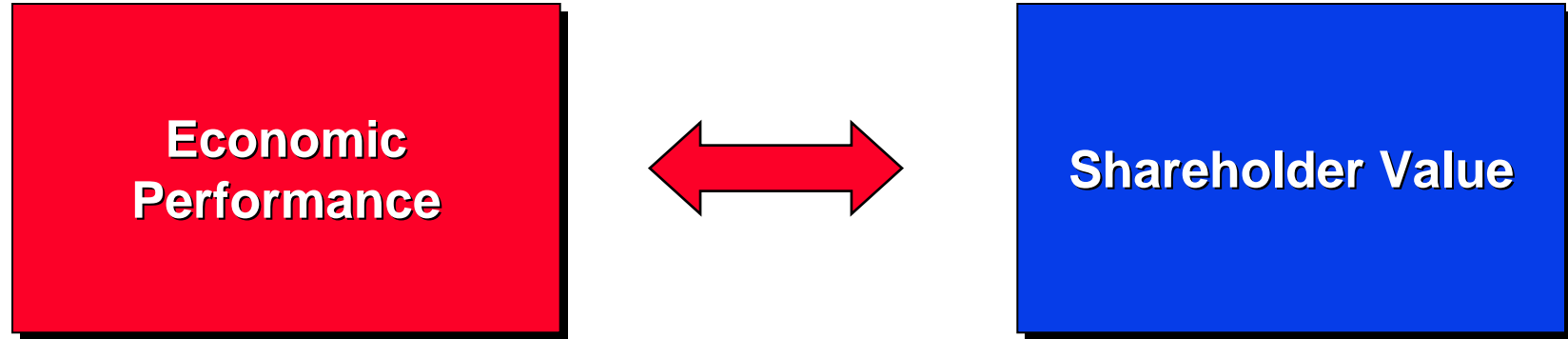
• Profitability metrics besides ROIC (e.g., return on sales; ebitda margin; pro-forma earnings; and cash flow margin) are **risky for strategy**

• Prevalent **accounting adjustments** to reported profitability (e.g., writeoffs, restructuring charges) can obscure true economic performance and lead to bad competitive choices

• Goodwill must be treated as **part of investment**

- Setting **unrealistic profitability** or **growth targets** can undermine strategy

Economic Performance versus Shareholder Value



- Sustained ROIC
- Sustainable Revenue Growth

- Stock Price
- EPS
- EPS Growth

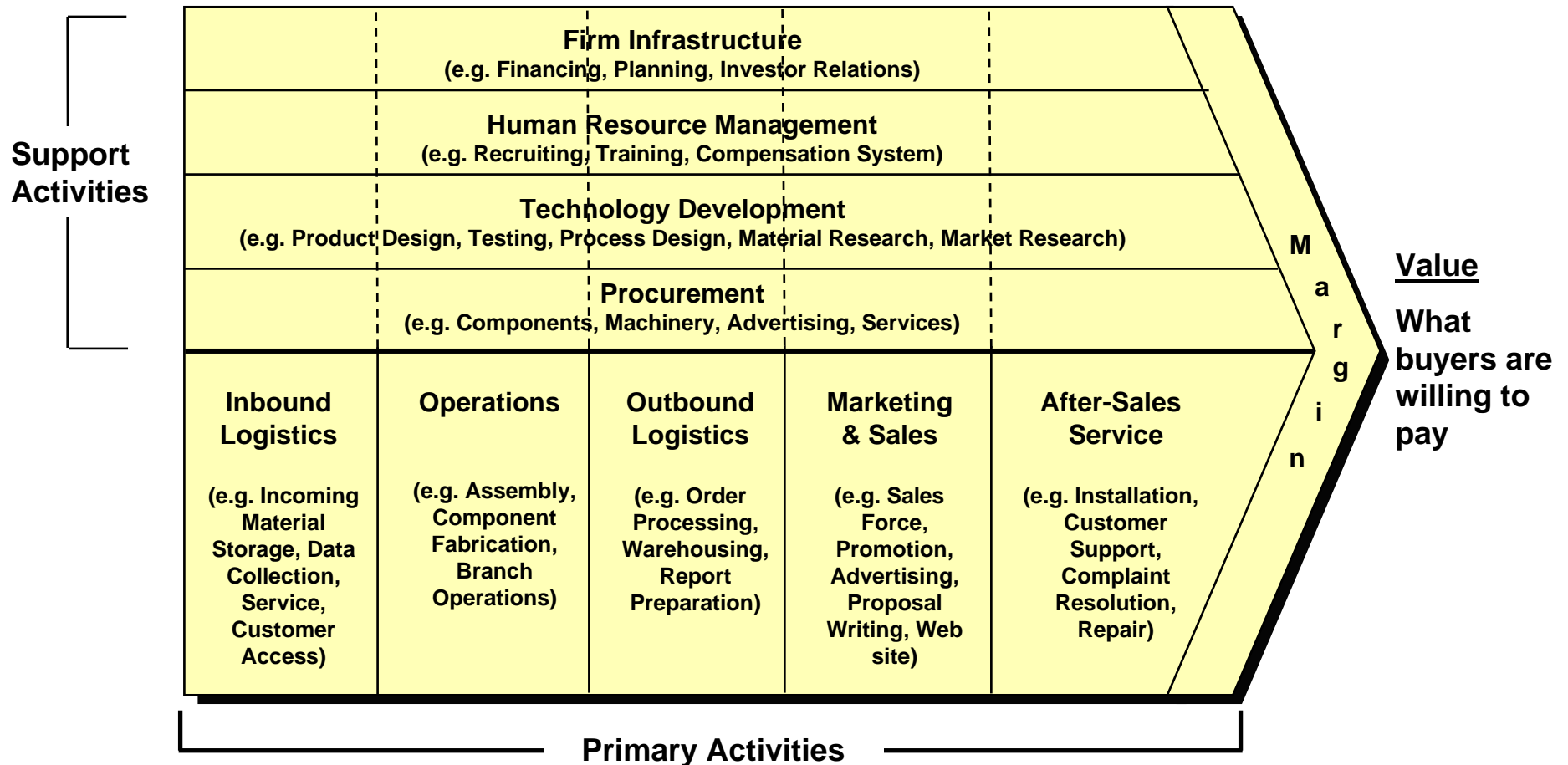
- Shareholder value is the **result** of creating real economic value
- Pleasing today's shareholders is **not** the goal

Determinants of Relative Performance



Foundations of Competitive Advantage

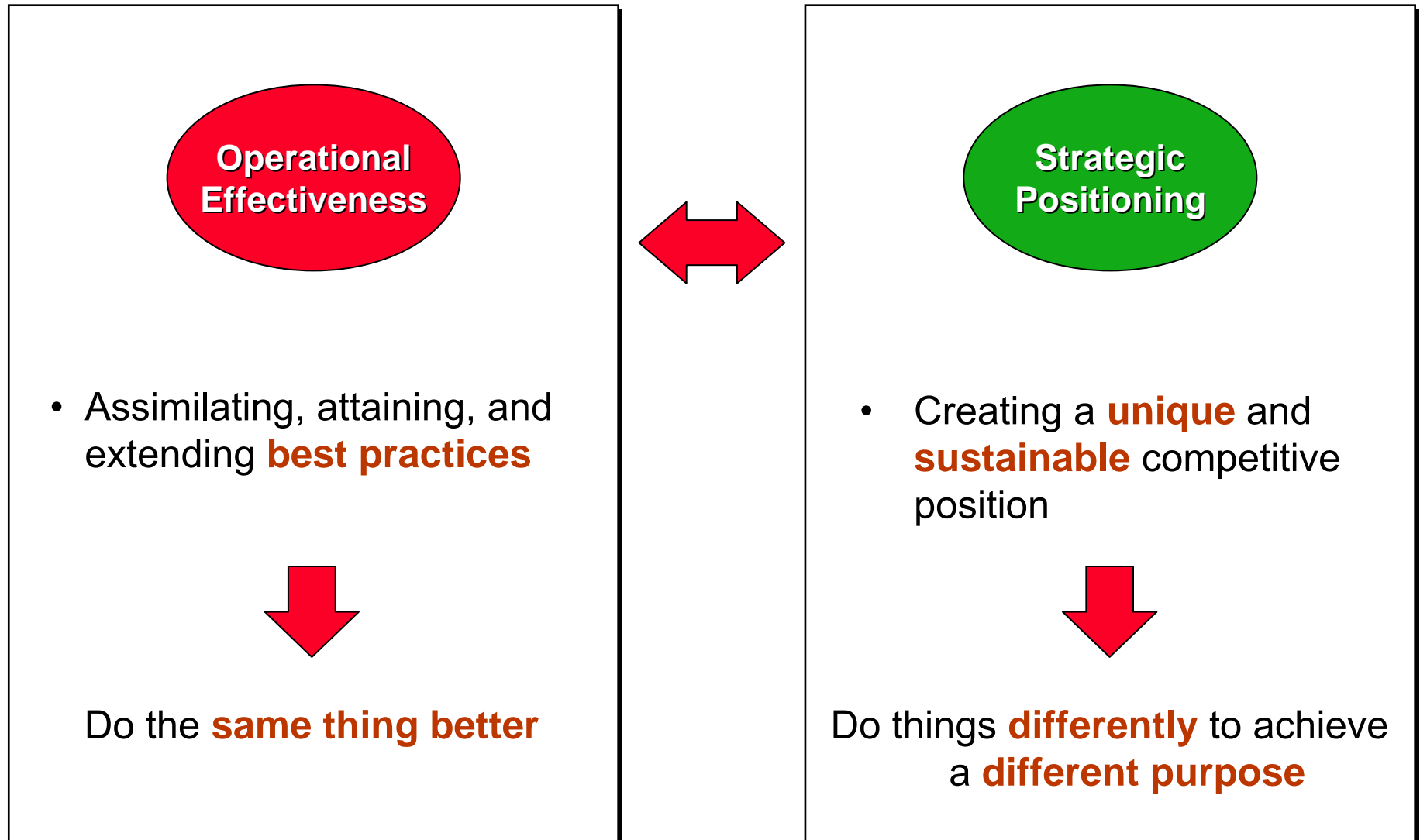
The Value Chain



- Competing in a business involves performing a set of discrete **activities**, in which **competitive advantage resides**

Achieving Superior Performance

Operational Effectiveness is Not Strategy



Five Tests of a Good Strategy

- A **unique value proposition** compared to other organizations
- A **different**, tailored value chain
- Clear tradeoffs, and choosing what **not to do**
- Activities in the value chain that **fit together and reinforce each other**
- **Strategic continuity** with continual improvement in realization

Strategic Positioning

IKEA, Sweden

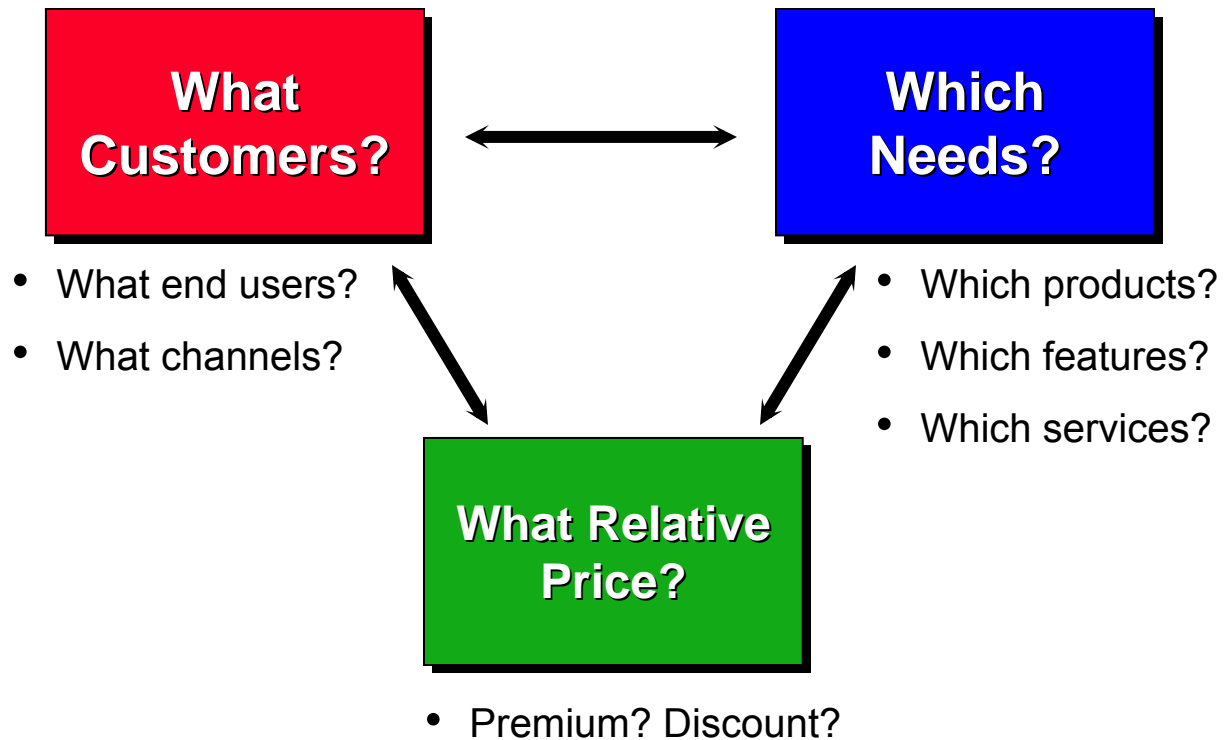
Value Proposition

- Young, first time, or price-sensitive buyers who want stylish, space efficient and scalable furniture and accessories at very low price points.

Distinctive Activities

- Modular, ready-to-assemble, easy to package designs
- In-house design of all products
- Wide range of styles displayed in huge warehouse stores with large on-site inventories
- Self-selection
- Extensive customer information in the form of catalogs, explanatory ticketing, do-it-yourself videos, and assembly instructions
- Ikea designer names attached to related products to inform coordinated purchases
- Long hours of operation
- Suburban locations with large parking lots
- On-site, low-cost, restaurants
- Child care provided in the store
- Self-delivery by most customers

Defining the Value Proposition



- A novel value proposition often **expands the market**

Strategic Tradeoffs

IKEA, Sweden

IKEA

Product

- Low-priced, modular, ready-to-assemble designs
- No custom options
- Furniture design driven by cost, manufacturing simplicity, and style

Value Chain

- Centralized, in-house design of all products
- All styles on display in huge warehouse stores
- Large on-site inventories
- Limited sales help, but extensive customer information
- Long hours of operation

Typical Furniture Retailer

Product

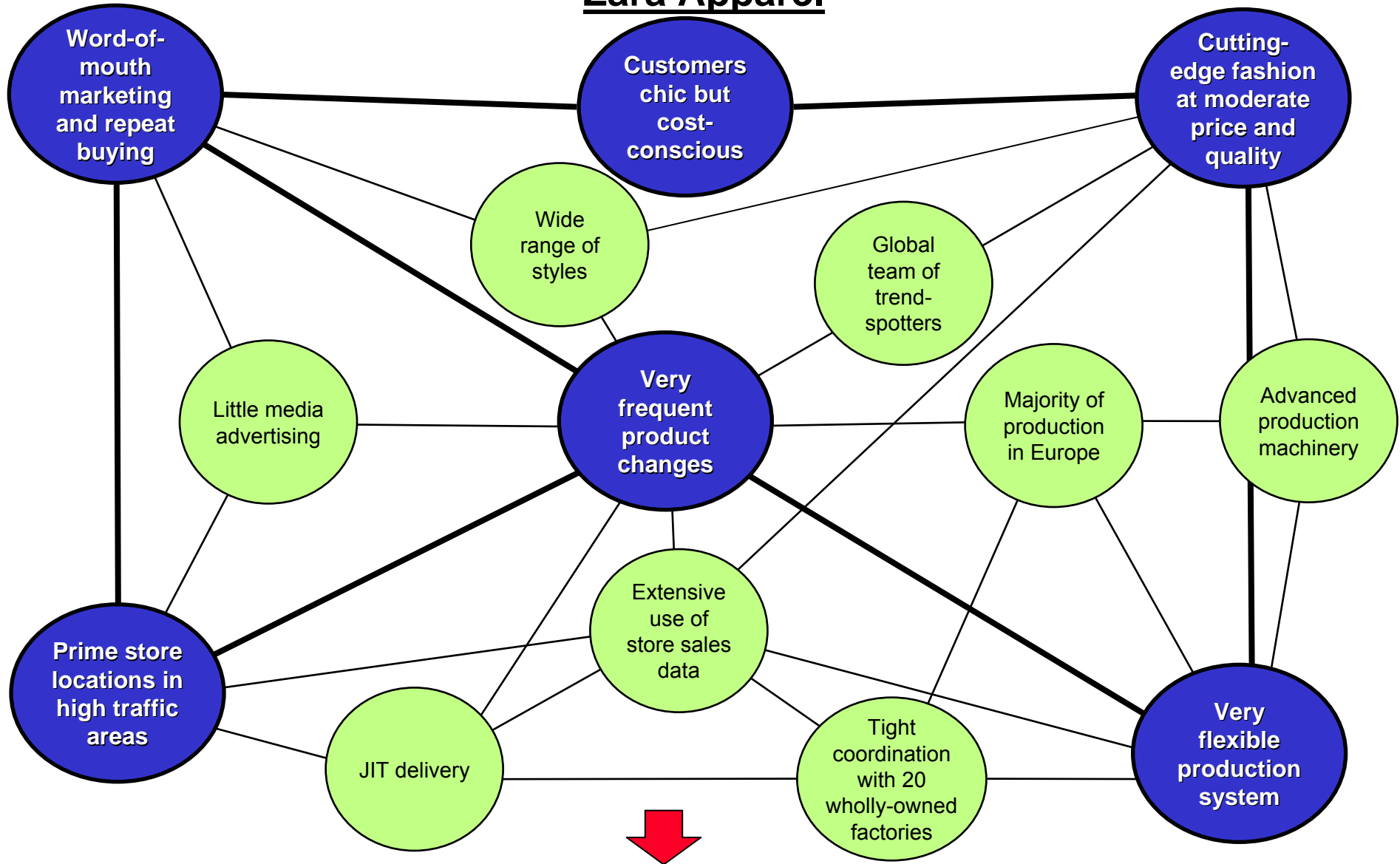
- Higher priced, fully assembled products
- Customization of fabrics, colors, finishes, and sizes
- Design driven by image, materials, varieties

Value Chain

- Source some or all lines from outside suppliers
- Medium sized showrooms with limited portion of available models on display
- Limited inventories / order with lead time
- Extensive sales assistance
- Traditional retail hours

Mutually Reinforcing Activities

Zara Apparel



- Fit is leveraging what is different to be **more** different

Strategic Continuity

- **Continuity of strategy** is fundamental to sustainable competitive advantage
 - e.g., allowing the organization to **understand the strategy**
 - building truly **unique skills** and **assets** related to the strategy
 - establishing a clear **identity** with customers, channels, and other outside entities
 - strengthening **fit** across the value chain
- **Reinvention** and **frequent shifts in direction** are costly and confuse the customer, the industry, and the organization



- Maintain continuity in the **value proposition**
- **Continuously improve** ways to realize the value proposition
 - Strategic continuity and continuous change should occur **simultaneously**. They are not inconsistent
- Continuity of strategy allows learning and change to be **faster** and **more effective**

Corporate Social Responsibility

A Growing Agenda

- External pressures for CSR continue to grow
- Numerous organizations **monitor**, **rank**, and **report** social performance
- The **legal** and **business risks** are great for companies engaging in practices deemed unacceptable



- CSR is **increasingly important** to business leaders, yet the concept and its justifications remain unclear
- Few companies have **integrated society into strategy** in a way that reinforces competitive advantage for the business

Four Prevailing Justifications for CSR

Moral Obligation

“Achieving commercial success in ways that honor ethical values”

- Inadequate guidance to balance complex competing social and economic interests
- Wide variability of personal values among managers and stakeholders

Sustainability

“Meeting the needs of the present without compromising future needs”

- Most effective on environmental issues where improvements can yield immediate economic benefits
- In other areas, intangible long term consequences provide a weak justification for short term costs

License to Operate

“Building goodwill to secure the acquiescence of governments and stakeholders”

- Licenses and approvals are necessary
- But this approach cedes control of CSR agenda to external players that do not fully understand the company’s competitive positioning, capabilities, and operations
- Encourages short term, defensive, and disjointed responses to “the squeakiest wheel” of the moment

Reputation

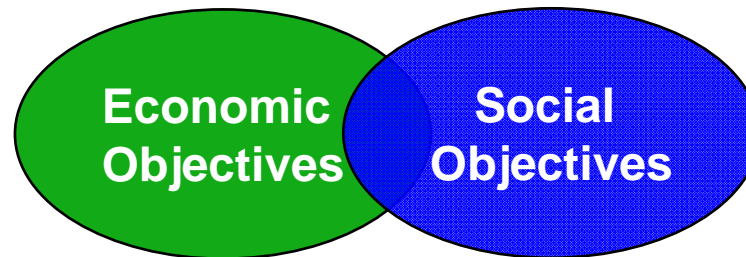
“Enhancing reputation and brand with customers, investors, and employees”

- Little evidence of sustained competitive advantage
- Emphasizes the visible and popular rather than the social and business impact of corporate activities



- The prevailing justifications focus on the **tension** between business and society rather than the **interdependence**
- These generic rationales provide **little specific guidance or priorities** for company actions

Integrating Strategy and Society



- There is an **inevitable link** between a business and society
- The **health of a society** depends on having competitive companies that can create wealth and support high wages
- The **competitiveness of companies** depends on the surrounding community
 - E.g., educated and skilled employees
 - Safe working conditions
 - A transparent, corruption-free business environment
 - A sense of equal opportunity
 - Low levels of environmental degradation (productive use of physical resources)
- Companies can positively affect many **social** issues



- There is a long-term **synergy** between economic and social objectives
- To maximize this synergy, business decisions and social policies must follow the principle of **shared value**
 - Company competitiveness and social conditions must benefit simultaneously

The Role of Business in Social Issues

- Business **cannot solve** all of society's problems, nor bear the cost of doing so
- Business must approach its social agenda **proactively** and **strategically**
- Business must address society and social issues where it can **add the most value**

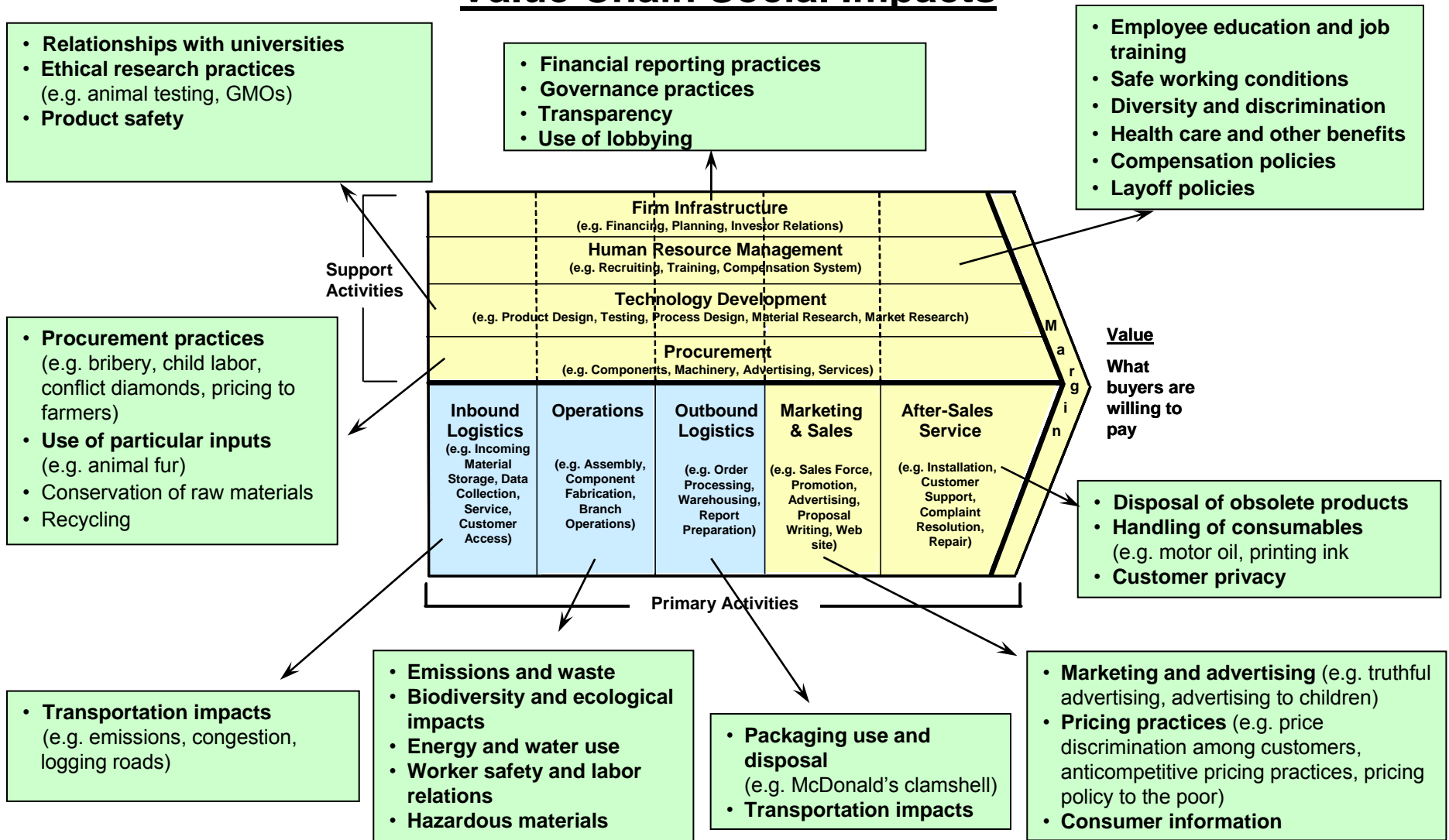


- Where is a company able to have the greatest **impact** on social issues versus other institutions?

$$\text{Social Value} = \frac{\text{Social Benefits}}{\text{Resources Expended}}$$

Inside-Out Links with Society

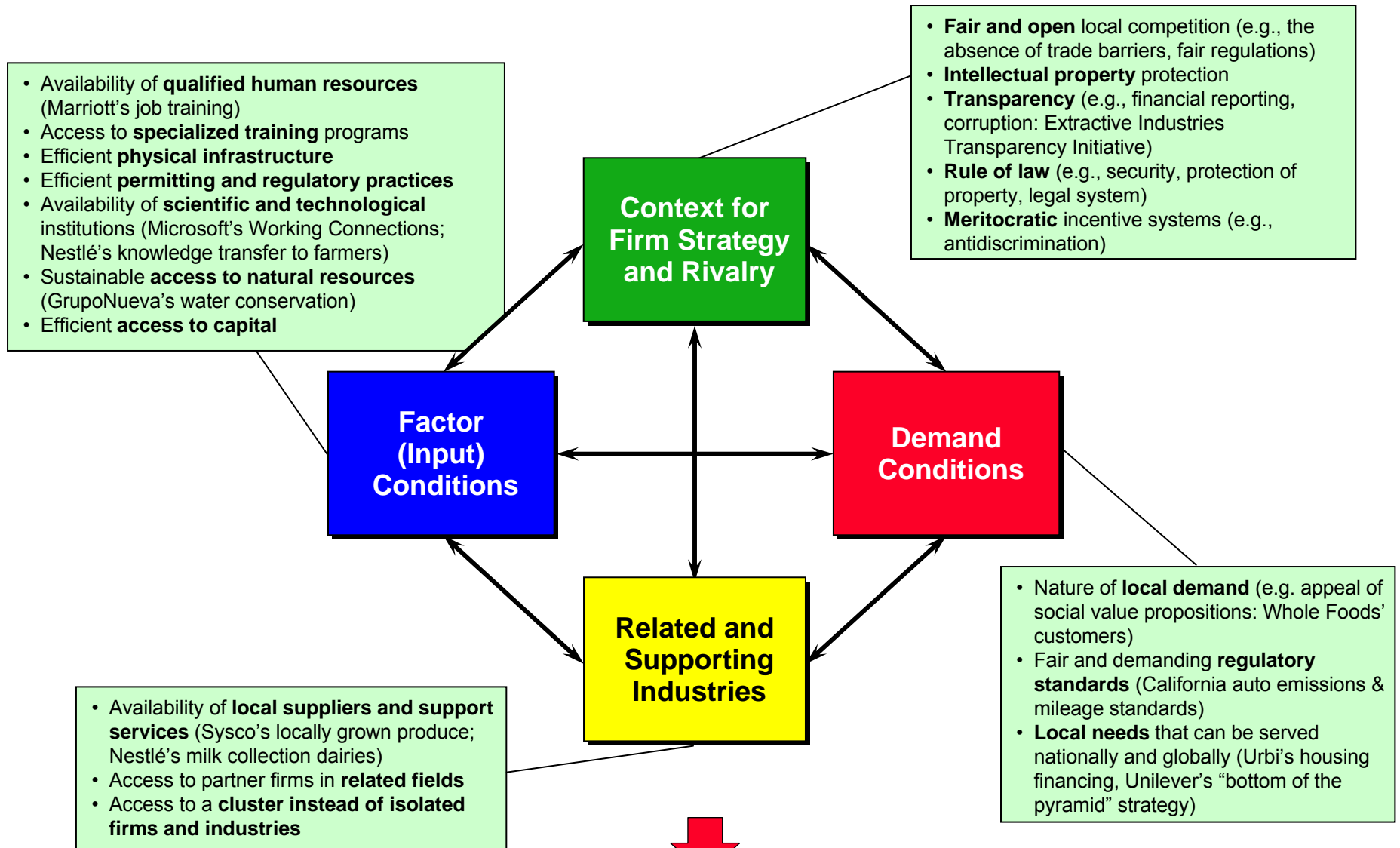
Value Chain Social Impacts



- Every activity in the value chain touches on communities in the locations where a company operates. These impacts can be positive or negative.

Identifying Shared Value

Outside-In Social Impact on the Company



- Competitive context is often influenced by or inextricably linked with **social conditions**

Categorizing Corporate Social Issues

Generic Social Issues

- Social issues that are **not significantly impacted** by the company's operations, nor materially **influence its long term competitiveness**

Value Chain Social Impacts

- Social issues that are **significantly impacted** by the **company's activities** in the ordinary course of business

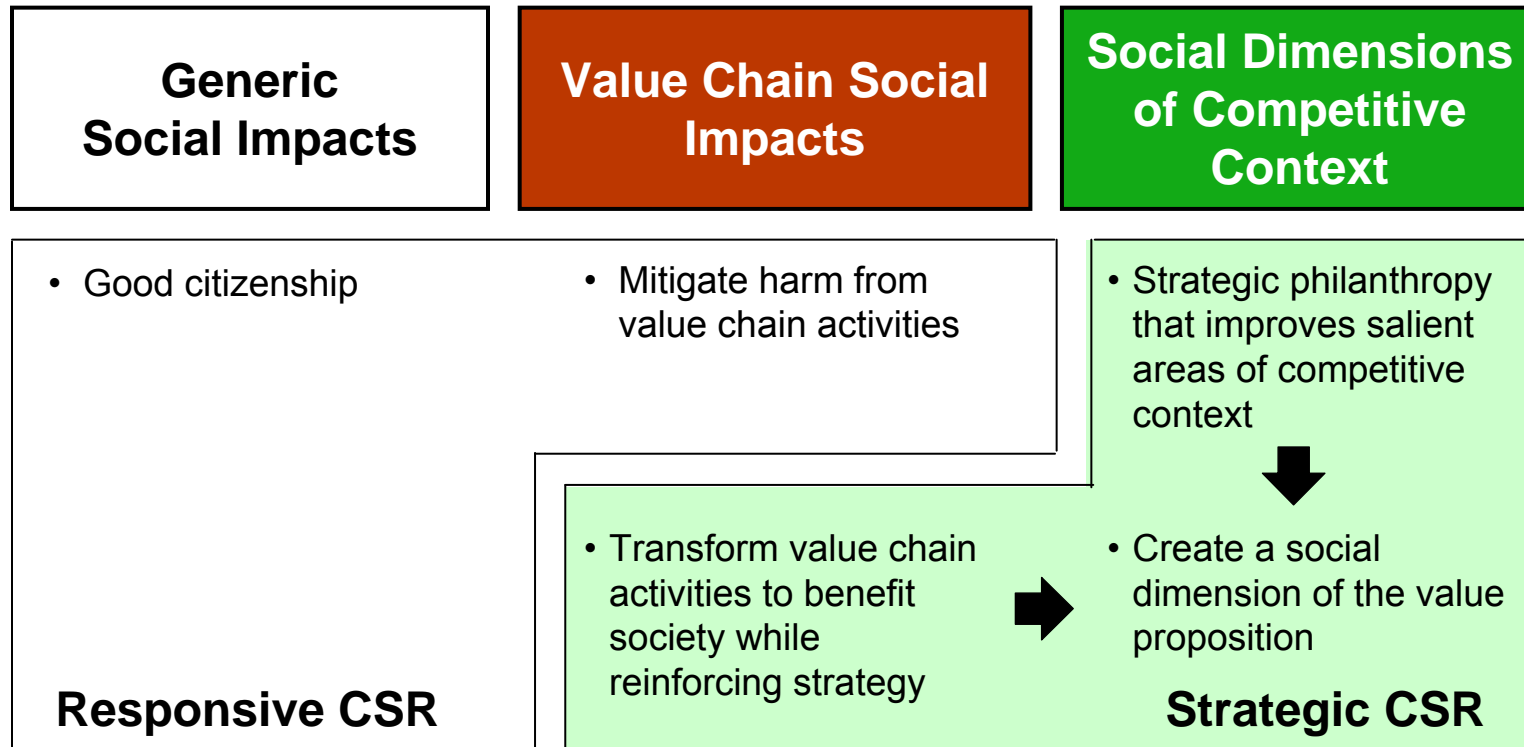
Social Dimensions of Competitive Context

- Social issues in the company's **external environment** that affect the **underlying drivers of competitiveness** in those places where the company operates



- Which issues fall into each category will **differ** by business unit, company, industry, cluster, and location

Creating a Corporate Social Agenda



- The impact of CSR is greatest when responsive CSR, value chain social impacts, and investments in competitive context are **integrated**

Strategic Corporate Social Responsibility: ChoicePoint

- ChoicePoint's core business is providing **personal identification, screening, and credit verification**
 - e.g., employment background screening, credit verification, DNA identification, drug testing
- The company's CSR program focuses on providing identification and verification services and advice to **social organizations**:
 - e.g., background checks of volunteers working with children
 - Identity verification for disaster victims
 - Assisting NGOs to find missing children and prevent identity theft



- ChoicePoint's CSR is **aligned with its founding principle**: creating a safer and more secure society through responsible use of information
- ChoicePoint leverages its **skills, data, technological knowledge, and staff** to maximize social benefit
- CSR activities are not just charity but **improve the company's capabilities** around identity issues

Strategic CSR: Nestlé in India

- Nestlé's entered the poor Moga region of India in 1962
- Local milk supply was hampered by small parcels of land, poor soil, periodic droughts, animal disease, and lack of a commercial market
- Nestlé established local milk purchasing organizations in each town
- Nestlé invested in **improving competitive context**
 - Collection infrastructure such as refrigerated dairies was accompanied by veterinarians, nutritionists, agronomists, and quality assurance experts to assist small farmers
 - Medicines and nutritional supplements were provided to improve animal health
 - Monthly training sessions were held for local farmers
 - Wells to secure water supply for animals were dug with financing and technical assistance from Nestlé
- Nestlé has built a productive **milk cluster** in Moga, buying milk from more than 75,000 farmers through 650 local dairies



- Moga has dramatically improved social conditions
- Nestlé has developed a **long-term competitive advantage** in the milk cluster

Creating a Social Dimension of the Value Proposition

- Economic and social value are **complementary**, especially in the medium and long-run
- Customers value **social performance**, not just economic performance
- Companies can have the greatest social impact in areas **tightly connected to their business**
- Social Improvements can create **shared value** for the business



- Companies should incorporate a **social dimension to their value proposition**
- This social dimension can be **more sustainable** than conventional cost and quality advantages

Strategic Positioning

Whole Foods Markets

Value Proposition

- Natural, fresh, organic, and prepared foods and health items with excellent service at premium prices
- Educated, middle class, and affluent customers passionate about food as a part of a healthy lifestyle

Distinctive Activities

- Well-lit, inviting supermarket store formats with appealing displays and extensive prepared foods sections
- Produce section as “theater”
- Café-style seating areas with wireless internet for meetings and meals
- Each store carries local produce and has the authority to contract with the local farmers
- Information and education provided to shoppers along with products
- High touch in-store customer service via knowledgeable, non-unionized, highly motivated personnel
- Egalitarian compensation structure
- Own seafood procurement and processing facilities to control quality (and price) from the boat to the counter
- Donates 5% of profits to non-profits
- Each store has “green projects,” directed by employees to improve environmental performance



- Excellent strategies often include a **social dimension** of the value proposition

The Moral Purpose of Business

- The most important thing a corporation can do for society is to contribute to a **prosperous economy**
 - Only business can **create wealth**; other institutions in society are principally involved in redistributing wealth or investing it to meet human needs
 - Business has the tools, capabilities, and resources to make a **far greater positive impact on social issues** than most other institutions
 - Corporations depend on a **healthy society** to sustain competitiveness
 - Business is **more transparent** and **more accountable** than most foundations and NGOs
 - Corporations are not responsible for **all the world's problems**, nor do they have the resources to solve them all
 - Business has **no need to be defensive** about its role in society
 - Each company can and should identify the **particular set of societal problems** that it is best equipped to help resolve, and from which it can gain the greatest competitive benefit
 - Addressing social issues through **shared value strategies** will lead to self-sustaining solutions
- 
- Using these principles, businesses can have a **greater impact** on social good than any other institution or philanthropic organization