THE STRATEGIST

BE THE LEADER YOUR BUSINESS NEEDS

CYNTHIA A. MONTGOMERY

HARVARD BUSINESS SCHOOL

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Dedication

To Anneke, Mathea, and Nils
That you may find places where you
can make a difference that matters

And to Bjørn, forevermore

Epigraph

In the end, it is important to remember that we cannot become what we need to be by remaining wh
we are.

—Max De Pree, CEO of Herman Miller, in *Leadership Is an A*

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Introduction
What I Learned in Office Hours

YOU'RE ABOUT TO get a revisionist view of strategy. It's not that what you've learned is incorrect. It that it's incomplete.

Strategy is a fundamental course at nearly every business school in the world. I have been privileg to teach variations of it for more than thirty years—first at the University of Michigan, then at th Kellogg School at Northwestern, and for the last twenty-plus years at the Harvard Business School.

For most of that time I worked with MBA students, until the center of my teaching shifted executive education. It was this experience, particularly a five-year stint in Harvard's Entrepreneu Owner, President program (EOP), that inspired this book.[1] Working intimately with leaders fro nearly every industry and nation as they confronted their own real-world strategic issues changed n only how I teach strategy, but, more fundamentally, how I think about it. The experience led me challenge some of strategy's basic precepts, and ultimately to question both the culture and mind-s that have grown up around it. Even more important, teaching in EOP forced me to confront ho strategy is really made in most businesses, and by whom.

All of this convinced me that it is time for a change. Time to approach strategy in a different wa and time to transform the process from a mechanical, analytical activity to something deeper, mo meaningful, and far more rewarding for a leader.

THE ROAD TO HERE

Fifty years ago strategy was taught as part of the general management curriculum in most busine schools. In the academy as well as in practice, it was identified as the most important duty of th president—the person with overarching responsibility for setting a company's course and seeing th journey through. This vital role encompassed both formulation and implementation: thinking an doing combined.

Although strategy had considerable depth then, it didn't have much rigor. Heuristically, manage used the ubiquitous SWOT model (Strengths, Weaknesses, Opportunities, and Threats) to assess the businesses and identify attractive competitive positions. How best to do that, though, was far fro clear. Other than making lists of various factors to consider, managers had few tools to help the make these judgments.

In the 1980s and '90s, my colleague Michael E. Porter broke important new ground in the field. H watershed came in firming up the Opportunities and Threats side of the analysis by bringing muc needed economic theory and empirical evidence to strategy's underpinnings, providing a far mo sophisticated way to assess a firm's competitive environment. This led to a revolution in both th practice and teaching of strategy. In particular, managers came to understand the profound impa industry forces could have on the success of their businesses and how they could use that informati to position their firms propitiously.

Advances over the next few decades not only refined the tools but spawned a whole new industr Strategy in many ways became the bailiwick of specialists—legions of MBAs and strateg consultants, armed with frameworks, techniques, and data—eager to help managers analyze the industries or position their firms for strategic advantage. In truth, they had a lot to offer. My ow academic training and research in this period reflected this intellectual environment, and what I did the classroom for many years thereafter was a living embodiment of this “new” field of strategy.

In time, though, a host of unintended consequences developed from what in its own right was a ve good thing. Most notably, strategy became more about formulation than implementation, and mo about getting the analysis right at the outset than living with a strategy over time. Equal problematic, the leader’s unique role as arbiter and steward of strategy had been eclipsed. Whi countless books have been written about strategy in the last thirty years, virtually nothing has bee written about the *strategist* and what this vital role requires of the person who shoulders it.

It wasn’t until years into this shift that I fully realized what had happened. It was class Shakespeare: As a field, we had hoisted ourselves on our own petard. We had demoted strategy fro the top of the organization to a specialist function. Chasing a new ideal, we had lost sight of the valu of what we had—the richness of judgment, the continuity of purpose, the will to commit a organization to a particular path. With all good intentions, we had backed strategy into a narro corner and reduced it to a left-brain exercise. In doing so, we lost much of its vitality and much of i connection to the day-to-day life of a company, and we lost sight of what it takes to lead the effort.

Teaching in the EOP program drove these insights home for me.

When I first started working with the group, I used a curriculum that was much like one I would u in any executive program. Through a series of class discussions and presentations, we discussed th enduring principles of strategy, the frameworks that capture them, and a series of case studies th brought the concepts and tensions alive. We still do that—and it’s a valuable part of what we do.

But in between class sessions, the EOP students—all accomplished executives and entrepreneurs- started to ask if they could meet me in my office to talk about various situations they were facing their companies. These conversations often took place at unusual hours, and sometimes lasted far in the evening. Most started out predictably enough: We talked about the conditions in their industrie the strengths and weaknesses of their own companies, and their efforts to build or extend competitive advantage. Some discussions ended there, and a thoughtful application of whatever we been doing in class seemed to meet the need.

Often, though, these conversations took a different turn. Alongside all the conventional questio were ones about what to do when the limits of analysis had been reached and the way forward was st not clear; questions about when to move away from an existing competitive advantage and when to t to stay the course; questions about reinventing a business or identifying a new purpose, a new reaso to matter. Even though many of the companies at issue were remarkably successful (one had grow from a start-up to $2 billion in revenue in just nine years), almost none had the kind of long-ru sustainable competitive advantage that strategy books tout as the Holy Grail.

Working with these managers, typically over three years, and hearing the stories within the stories, came to see that we cannot afford to think of strategy as something fixed, a problem that is solved an settled. Strategy—the system of value creation that underlies a company’s competitive position an uniqueness—has to be embraced as something open, not something closed. It is a system that evolve moves, and changes.

In these late-night one-on-one conversations, I also saw something else: I saw the strategist, th human being, the leader. I saw how responsible these executives feel for getting things right. I sa how invested they are in these choices, and how much is at stake. I saw the energy and commitme they ~~bring to this endeavor. I saw their confidential concerns, too: “Am I doing this job well~~? Am providing the leadership my company needs?”

And, more than anything, I saw in these conversations the tremendous potential these leaders ho in their hands, and the profound opportunity they have to make a difference in the life of a compan In those moments together, we both came to understand that if their businesses were going to pu away from the pack, to create a difference that mattered, it had to start with them.

A NEW UNDERSTANDING

In all our lives there are times of learning that transform us, that distance us from the familiar, ar make us see it in new ways. For me, the EOP experience was one of those times. It not only change some of my most central views about strategy; it gave me a new perspective on the strategist, and o the power and promise of that role.

In these pages I will share with you what I have learned. In doing so, I hope that you will gain a ne understanding about what strategy is, why it matters, and what you must do to lead the effort. I als hope that you will come to see that beyond the analytics and insights of highly skilled advisors and th exhortations of “how-to” guides, there is a need for judgment, for continuity, for responsibility th rests squarely with you—as a leader.

Because this role rests with you, *The Strategist* is a personal call to action. It reinstates an essenti component of the strategy-making process that has been ignored for decades: You. The leader. Th person who must live the questions that matter most.

That’s why my ultimate goal here is not to “teach strategy,” but to equip and inspire you to be strategist, a leader whose time at the helm could have a profound effect on the fortunes of yo organization.

Author’s Note

The examples and stories in this book are based largely on five years’ teaching in one of th comprehensive executive programs at Harvard Business School. In the pages of this book, I refer this program as the Entrepreneurs, Owners, Presidents program (EOP), though the actual name of th program is different. You can find more information about various executive programs the schoo offers at www.exed.hbs.edu.

In some cases, companies’ locations or certain details about them or individuals have been change or composites of student experiences have been created so as not to violate the privacy of form students. Where names of companies or individuals are disclosed, it is done with express permissio and the details in the accompanying discussions have been approved for release by the firms.

In some instances, I have presented cases in class in a different way than they are described here used other cases than the ones in this book to make the same important points.

Chapter 1
Strategy and Leadership

Does your company matter?

That's the most important question every business leader must answer.

If you closed its doors today, would your customers suffer any real loss?[1] *How long would it take, and how difficult would it be, for them to find another firm that could meet those needs as well as you did?*

Most likely, you don't think about your company and what it does in quite this way. Even if you've hired strategy consultants, or spent weeks developing a strategic plan, the question probably still gives you pause.

If it does or if you're not sure how to respond, you're not alone.

I know this because I've spent the better part of my life working with leaders on their business strategies. Again and again, I've seen them struggle to explain why their companies truly matter. It's a difficult question.

Can you answer it?

If you cannot, or if you're uncertain of your answer, join me as I explore this question with a group of executives now gathering.

It is evening on the campus of the Harvard Business School. The kickoff orientation to th Entrepreneur, Owner, President program ("EOP" for short), one of the flagship executive programs the school, is about to begin. Along with five of my fellow faculty, I sit in the "sky deck," the last ar highest row of seats, in Aldrich 112, an amphitheater-style classroom characteristic of the school, ar watch as the newest group of executives stream into the room.

I see that there are considerably more men than women, and that the majority appear to be in the late thirties to mid-forties. Most exude an air of seasoned self-confidence. That's no surprise—they' all owners, CEOs, or COOs of privately held companies with annual revenues of $10 million to $ billion—the kind of small- to medium-size enterprises that drive much of the global economy. Mo arrived on campus within the last few hours and have had just enough time to find their dorm roon and meet the members of their living groups before heading here to Aldrich.

The information they provided in their applications tells part of their stories: Richard, a thir generation U.S. steel fabricator; Drazen, CEO of a media firm in Croatia; Anna, founder and head one of the largest private equity groups in South America; and Praveen, the scion of a fami conglomerate in India. But this is just a taste of their diversity and accomplishments. The rich details and the breadth of the class will emerge in the weeks ahead.

As the clock ticks past the hour, some last-minute arrivals burst through the door. They are typic first-time EOPers in their lack of concern about being late. Most of these people hail from worl where meetings don't start until they arrive. That will change in the coming days, as they make th adjustment from the top-of-the-line leather chairs in their offices back home to the standard-issu seats that line the classrooms. Indeed, for their time here, they will be without many of the suppor they rely on in their daily lives, such as administrative assistants and subordinates to whom they ca delegate work and problems. Families are strongly discouraged from living near campus and a prohibited from dorms once classes begin. BlackBerrys and cell phones are allowed, but never class.

A final hush settles as the program begins with an overview of who's here: 164 participants fro thirty-five countries, with a collective 2,922 years of experience. Two-thirds of their businesses are service industries, the remainder in manufacturing.

They are here to participate in an intensive management boot camp for experienced busine leaders. It spans topics in finance, marketing, organizational behavior, accounting, negotiations, an strategy, and runs for nine weeks in total, divided into three three-week sessions spread over thre years. Between sessions, students return to their businesses and start to apply what they have learne Debriefs the following year are an opportunity for feedback and reflection on what has worked an what hasn't. This structure has given the faculty an exceptional opportunity to develop a hands-o curriculum that brings theory and practice much closer together, even for a school that has alway championed the connection.

Why do these talented, seasoned managers from every major world culture come to this progran As heads of their companies, why do they elect to spend tens of thousands of dollars to se *themselves* to school?

THE VIEW FROM THE BALCONY

If past participants are any indication, these executives have not come to seek specific answers narrow questions. They have come to learn how to be more effective leaders and to find ways to mal their businesses more successful. Successful in what ways, and through what means, for most, is sti an open question. They are here to throw themselves into the program, to be challenged, to discov what they might learn in this environment.

This experience will be an important juncture for many, in their careers and even their lives. Wh they learn here will lead them to think in broader, more far-reaching ways. To explain how th happens, I've always liked the metaphor of a dance taking place in a great hall.Most dancers spend a their time on the dance floor, moved by the music, jostled by dancers around them, complete absorbed in the flow. But it's not until they extricate themselves from the crowd and move to th balcony above that the larger picture becomes clear. It is then that overall patterns become appare and new perspectives emerge. Often these reveal opportunities for better choices about what to d down on the dance floor.

Many EOPers have spent years without ever leaving the dance floor. Absorbed by the day-to-da challenges of running a business, they've never gone to the balcony. On one level, our job is to he them understand the value of going to the balcony in the first place. On another, it is to equip the with the tools to see their dances in new ways, ways that reveal options they may never hav considered before.

THE STRATEGY COURSE

When it's time for the faculty to introduce their courses, I stand and give a quick summary of th work we'll be doing in strategy. Like most businesspeople, these managers are likely to be famili with at least a vague definition of strategy. The word itself comes from the ancient Greek fo "general"—specifically for the general on campaign in the field. In business, strategy is a company ~~campaign in the marketplace: the domain in which it competes, how it competes, and what it wants~~ accomplish.

We will begin our journey with the fundamentals—what strategy is, how to craft it, and how evaluate it. We'll then push the envelope on current practice by challenging strategy's elusive goal– the long-run sustainable competitive advantage—and introduce a dynamic model of strategy that better grounded and better suited for the competitive realities most managers face.

All of this material is prelude to the last and most challenging task they will face here, when eve member of the class will be asked to apply the concepts and frameworks we've been studying to the own companies and present their own strategies for critiquing by their EOP colleagues. The exercis takes many days and, in the end, the class votes on a winner, what they consider the "best strategy" the group.

This step from the general to the highly particular, from the objective to the subjective, is whe things become profoundly real for most executives. This is when the appraisals of cases—now *the* cases—get deadly serious and the discussions especially heartfelt. These are competitive people. spirit of intense rivalry prevails. Most refine their strategies through multiple iterations, oft working through the night for one more iteration. These weeks are arduous for some, exhilarating f others, and, for most, a healthy mix of both.

GETTING TO THE REALITY OF YOUR STRATEGY

Having seen hundreds if not thousands of such strategies in their initial form, what is clear to me this: Many leaders haven't thought about their own strategies in a very deep way. Often, there is curious gap between their intellectual understanding of strategy and their ability to drive tho insights home in their own businesses.

Some EOPers find it extremely difficult to identify why their companies exist. Accustomed describing their businesses by the industries they're in or the products they make, they can't articula the specific needs their businesses fill, or the unique points that distinguish them from competitors anything beyond a superficial level. Nor have they spent much time thinking concretely about whe they want their companies to be in ten years and the forces, internal and external, that will get the there.

If leaders aren't clear about this, imagine the confusion in their businesses three or four leve lower. Yet, people throughout a business—in marketing, production, service, as well as near the top the organization—must make decisions every day that could and should be based on some shar sense of what the company is trying to be and do. If they disagree about that, or simply don understand it, how can they make consistent decisions that move the company forward? Similarl how can leaders expect customers, providers of capital, or other stakeholders to understand what really important about their companies if they themselves can't identify it? This is truly basic—the is no way a business can thrive until these questions are answered.

Even so, the exercises in EOP are designed to do more than set high standards, communica concepts, and improve participants' existing strategies. The overarching goal is something differen something deeper and more personal. It is to make clear to these executives that strategy is the hea of the ongoing leadership their companies need from them. That's why competition for "best strategy is so hard fought and generates so much energy. CEOs, accustomed to asking questions and bei deferred to, are challenged by their peers and encouraged to think and rethink parts of their strategi they'd taken for granted. Most of them describe it as a pivotal experience that fundamentally chang their views of their own businesses.

~~Behind the scenes, though, the real contest is closer in: It's each of these leaders pushing thei~~r ow ideas to the increasingly high standards they themselves have come to demand of excellent strategi and of themselves as leaders. It's that process, more than any short-term answers they might find her that will serve them well in the long run.

LEADERSHIP AND STRATEGY ARE INSEPARABLE

Many leaders today do not understand the ongoing, intimate connection between leadership ar strategy. These two aspects of what leaders do, once tightly linked, have grown apart. Now specialis help managers analyze their industries and position their businesses for competitive advantage, ar strategy has become largely a job for experts, or something confined to an annual planning process. this view, once a strategy has been identified, and the next steps specified, the job of the strategist finished. All that remains to be done is to implement the plan and defend the sustainable competitiv advantage it has wrought. Or at least that's the positive take on the story.

But, if this were so, the process of crafting a strategy would be easy to separate from the day-to-da management of a firm. All a leader would have to do is figure it out once, or hire a consulting firm figure it out, and make sure it's brilliant. If this were so, the strategist wouldn't have to be concerne with how the organization gets from here to there—the great execution challenge—or how it wi capitalize on the learning it accumulates along the way.

But this is not so.

What's been forgotten is that strategy is not a destination or a solution. It's not a problem to b solved and settled. It's a journey. It needs continuous, not intermittent, leadership.

It needs a strategist.

Good strategies are never frozen—signed, sealed, and delivered. No matter how careful conceived, or how well implemented, any strategy put into place in a company today will eventual fail if leaders see it as a finished product. There will always be aspects of the plan that need to b clarified. There will always be countless contingencies, good and bad, that could not have been ful anticipated. There will always be opportunities to capitalize on the learning a business h accumulated along the way.

The strategist is the one who must shepherd this ongoing process, who must stand watch, identi and weigh, decide and move, time and time again. The strategist is the one who must decline certa opportunities and pursue others. Consultants' expertise and considered judgments can help, as ca perspectives and information from people throughout an organization. But, in the end, it is th strategist who bears the responsibility for setting a firm's course and making the choices day after da that continuously refine that course.

That is why strategy and leadership must be reunited at the highest level of an organization. A leaders—not just those who are here tonight—must accept and own strategy as the heart of the responsibilities.

I say little of this tonight in the classroom. But it is on my mind as I return to my seat in the sk deck and reflect on all the would-be strategists I've worked with over the years as well as those of yo who are just starting out. My hope is that you will come not only to understand the vital role of th strategist, but also to embrace it for yourself.

Five years ago, when I first started teaching in EOP, I heard the program described as challengir and transformative. At the time, "challenging" struck me as right, but "transformative" seemed clos to hype. Having seen it happen again and again, I now share the optimism.

As our orientation session draws to a close, I join the executives and fellow faculty as we head e masse to Kresge Hall for cocktails and dinner. Our work is about to begin in earnest.

In all my classes, I pose one fundamental question: "Are you a strategist?" Sometimes it's spoken, often it's only implicit, but it's always there. We talk about the questions strategists ask, about how strategists think, about what strategists do. My intent is not to coach these executives in strategy in the way they might learn finance or marketing. As business heads, they aren't going to be functional specialists. But they do need to be strategists.

Are you a strategist?

It's a question all business leaders must answer because strategy is so bedrock crucial to every company. No matter how hard you and your people work, no matter how wonderful your culture, no matter how good your products, or how noble your motives, if you don't get strategy right, everything else you do is at risk.

My goal in this book is to help you develop the skills and sensibilities this role demands, and to encourage you to answer the question for yourself. It's a difficult role and it may be tempting to try to sidestep it. It requires a level of courage and openness to ask the fundamental questions about your company and to live with those questions day after day. But little you do as a leader is likely to matter more.

Chapter 2
Are You a Strategist?

HERE'S A TEST of your strategic thinking. It's the same one I give my EOPers right at the beginning the course.

Step into the shoes of Richard Manoogian, CEO of Masco Corporation, a highly successful compar on the verge of a momentous decision.[1] You've got a big pile of money and must decide whether t invest it in a far-reaching new business venture. The stakes are high, and it's not an easy or obviou decision. If you don't go ahead, you could be passing up an opportunity for growth in a new directio and hundreds of millions of dollars in future profits. If you take the plunge and turn out to be wron you may have wasted $1–2 billion. Either way, you will have to live with the results for many years.

To make the decision, you'll first need to know something about Masco and its marketplace. Th story begins more than two decades ago, but its lessons are timeless, and the intervening years allo us to take a long view on the company and the industry.

FIRST, CONSIDER THE COMPANY

It's 1986. Masco is a successful $1.15 billion company that has just recorded its twenty-nin consecutive year of earnings growth. Its ability to wring outsized profits out of industries that a neither high tech nor glamorous has won it the monicker of "Master of the Mundane" on Wall Stree Its portfolio includes faucets, kitchen and bathroom cabinets, locks and building hardware, and variety of other household products.[2] Masco expects the businesses to generate $2 billion in free cas flow over the next few years.

What would you do with all that money? Masco's leaders want to tackle other mundane business where their prowess can "change the game." They envision becoming the "Procter & Gamble consumer durables." In their immediate sights is the U.S. household furniture business, where they se another opportunity to seize profitable dominance of a sleepy industry.

Is Manoogian's idea a promising one? If so, is Masco the company to lead the charge?

When I raise these questions the first morning in class, the executives don't immediately jump u Like you, they enjoy being the decision maker; it's the role they play in their real-life jobs, but they' reluctant to put themselves on the line with a group they've just met. With some coaxing, thoug we're soon deep into Masco's situation and the issues Manoogian faces.

The case for Manoogian's strategy looks compelling. Through a long record of triumphs in durab goods industries, Masco distinguished itself through efficient manufacturing, good management, ar innovation. Its biggest success to date was reinventing the faucet business. Prior to Masco's entry, th industry was highly fragmented and had a general lack of brand recognition, minimal advertising, ar a low level of salesperson training. Leveraging the company's deep metalworking expertise, garnere in its early years as a supplier to the automotive industry, Masco's founder, Richard's father Alex solved an engineering problem that made one-handle faucets workable. When he couldn't intere faucet companies in his patented innovation, Masco began making and selling the faucets itself.

~~Homeowners loved them, finding them a big improvement over traditional faucets that forced~~ use to fiddle with hot and cold water separately. This extra functionality was particularly valued kitchens where utility and maintenance-free operation were important. Not neglecting two-hand faucets, the company introduced a model with a new type of valve. This design, also patente eliminated rubber washers, the major cause of faucet failure.

Masco went on to innovate in many other aspects of these new products, from basic manufacturi to distribution and marketing. It was the first to create brand recognition for a faucet with its Del and Peerless brands. It was the first to introduce see-through packaging, to market faucets direct to th consumer through the do-it-yourself channel, and to advertise faucets on TV during the Olympics. refashioning an industry of “me-too” products and boldly setting itself apart from others, Masc demonstrated that it was creative, able to apply traditional capabilities in new ways, and willing take risks and make them pay off—abilities Richard Manoogian hoped would enable him to transfor the furniture business.

NOW CONSIDER THE INDUSTRY

At the time Manoogian was weighing this decision, household furniture was a $14 billion busine in the United States that didn’t make much money. With high transportation costs, low productivit and eroding prices, it had about 2 percent annual growth, and return on sales, on average, was about percent. There were more than 2,500 manufacturers, but 80 percent of sales came from only fo hundred. Not all players were small, but most were, and many were family firms that had stuck it o through thick and thin, reluctant to leave the only livelihood their families had known for generation Making matters worse, both sales and profits were cyclical and tied to broad economic factors such new home starts and sales of existing homes.

Management in the industry was generally regarded as unsophisticated, and hadn’t made mar significant changes in the previous fifty years. Wesley Collins, a furniture executive and trenchar observer of industry conditions, summed it up dramatically:

> *When everything else in our lives was changing, furniture stood its ground. While we put a man on the moon . . . furniture put another steak on the backyard grill and muttered, “My god, the price of oak went up again.”*
>
> *When videotape put the home movie camera in the trash can forever, and tape cassettes put the plastic record-maker six feet under, and word processors put typewriters in the closet, and microwave popcorn killed the makers of popcorn makers . . . the furniture industry said, “Thanks, but we’ll stand pat.”*
>
> *While we sat on our tuffets, the consumer forgot all about us. Our share of consumer expenditures slipped year after year. We lost over 40 percent of the retail furniture space in America, 25 percent of the retailers shut their doors, and department stores discontinued furniture right and left for products that gave them a better ratio of margin and turns per square foot.*[3]

Collins went on to say that “the average tobacco chewer spends more for Levi Garrett Chewin Tobacco every year than he does for furniture.”

Most furniture purchases were discretionary and highly postponable, and, as Collins noted, the were many substitutes and lots of competition for the customer's dollar. New innovations and desig ~~were quickly knocked off by competitors, eliminating any advantage the innovators might~~ hav momentarily enjoyed.

Equally distressing, in the United States, there was little brand recognition in the industr Customers didn't know much about furniture and weren't motivated enough to find out. There w little advertising and consumer research had shown that many American adults could not name single furniture brand. Think for a minute: "What brand of sofa do you have in your living room When I pick an executive in the class at random and ask this question, the response is usually startled look, a long moment of silence, and then, something like "Brown leather?" Everyone laugh but when I open the question to the entire class, only a few hands go up and they're inevitab executives from Europe. Yet when I ask how many of them know the brand of car their neighbo drive, virtually all hands go up. Yours probably would, too.

On top of its marketing challenges, the industry was riddled with inefficiencies, extreme produ variety, and long lead times that frustrated customers. Buyers often received partial shipments; f example, a dining table might arrive weeks or months before the chairs that went with it.

The real issue, though, is not whether there are problems in the industry but what they mean. Are a these problems an opportunity for a courageous company with the right skills? Or are they red fla warning outsiders to stay away?

When I ask my executives whether they would take the plunge, most respond with a resoundi "Yes!" They're energized, not intimidated, by the challenges. Most say, in effect, "Where there challenge, there's opportunity." If it were an easy business, they say, some company would alrea have seized the opportunity: It would be much tougher to dislodge a strong leader than to gain grou in an industry like this where there are no big players, no Microsofts already established. "It's a hors race," someone once said, "and all the other horses are slow."

Further, they note, the furniture industry is much like the faucet industry before Masco entered. T opportunity is a great fit with Masco's manufacturing skills, its marketing savvy, and its stron management capabilities. It's another chance for Masco to bring money, sophistication, and disciplin to a fragmented, unsophisticated, and chaotic industry.

Opponents can't get past how awful the furniture business is. They can't imagine any compa overcoming such huge hurdles. So the arguments go back and forth. Enthusiasm and a gung-ho spi on one side struggle against caution and concern on the other. In one discussion, an exasperat proponent blurted out, "Look, this isn't about being passive investors in some yet-to-be-invent furniture industry index fund. We're going to be players in this game. We can make things happen. Starbucks or Under Armour had listened to you naysayers, they wouldn't have done anything!"

What's your inclination at this point?

Usually when the time comes for a decision in my classes, "Do it" wins definitively, by at least a to-1 margin.

So what, in fact, happened?

Masco did enter and in a bold way. Over two years, it bought Henredon (high-end furniture) f $300 million, Drexel Heritage (mid-price) for $275 million, and Lexington Furniture (low–middle) f $250 million. Combined, the revenues from the three made Masco the second-largest player in t U.S. furniture industry. It followed up by spending $500 million for Universal Furniture Limited (lo end), which had manufacturing operations in ten countries on three continents and followed a read to-assemble concept—component parts were manufactured in low-cost countries and shipped containers to five U.S. locations for assembly. Now Masco was both the largest furniture company the world and one of the only firms with products spanning nearly every price point, a strategy th had worked well for the firm in faucets.

In total, Masco spent $1.5 billion acquiring ten companies and another $250 million upgrading the manufacturing facilities and investing in new marketing programs.

Presenting Manoogian with its Gold Award in the Building Materials Industry, the *Wall Stre Transcript* cited his

> *imagination, foresight and strategic sense. . . . Manoogian has acquired low growth, mature products and become the dominant player in those product categories. . . . [H]is most recent set of acquisitions has been in the furniture industry. His strategy is to do to the furniture industry what he did to the faucet and kitchen cabinet industry. . . .*[4]

With this historical update, the classroom crackles with energy. Executives who had advocated fo bold action nod their heads to one another or give each other high-fives and thumbs-up, pleased th they've nailed their first Harvard case. I hear little "told-you-so" comments directed at the naysayer who sit in grim silence. Someone once even called across the room: "Don't worry, Bob. One ba decision won't ruin your reputation. We won't hold it against you the rest of the program."

But it doesn't take long for those who opposed entry to speak up.

"But how did Masco do?"

"They bought great brand names," says someone.

"But how did they do?"

"They're number one in market share. What more do you want?"

"But did they make money?"

There, as it's said, is the rub.

When I post Masco's financial results, silence falls as people absorb the numbers. In a few second there are whispered expletives around the room.

After thirty-two years of consecutive earnings growth, Masco's net income fell 30 percent. Tw years later, operating earnings from furniture came to $80 million on sales of $1.4 billion, a operating margin of 6 percent, versus 14 percent for the rest of the company. After many years o struggle, Masco announced its intentions to sell its furniture businesses, leading one analyst comment:

> *In the spring, management will go on the road with restated financials illustrating their "core" earnings growth as if they never entered the furniture business. They hope to rebuild investor confidence in the old [pre-furniture] Masco . . . as a growth company by showing their track record and prospects in the building materials arena. Given the $2 billion furniture "mistake," this won't be easy.*

In a sad postscript, Masco discovered that exiting the furniture business was much harder tha entering it. After a number of deals fell through, it eventually succeeded in selling its furniture firm at a loss of some $650 million.[5] When it was all over, CEO Manoogian admitted, "The decision to g into the home furnishings business was probably one of the worst decisions I've made in 35 years."[6]

It's a sobering moment in the classroom. The executives there didn't intend to open their careers the Harvard Business School by losing hundreds of millions of dollars their first morning.

So, let me ask you again, as I do the managers in my class: “Are you the strategist your busine needs?”

Chapter 3
The Myth of the Super-Manager

AS A STRATEGIST, what can you learn from Masco's foray into furniture and the support mo executives give that ill-fated decision?

Even if you were undecided or skeptical about the furniture industry, I'm willing to bet that som part of you supported Masco's move. No one respects timid, passive managers. Bold, visionar leaders who have the confidence to take their firms in exciting new directions are widely admire Isn't that a key part of strategy and leadership?

In truth, it is. But the confidence every good strategist needs can readily balloon in overconfidence. A belief that is unspoken but implied in much management thinking and writin today is that a highly competent manager can produce success in virtually any situation. One writ calls this "the sense of omnipotence that plagues American management, the belief that no event situation is too complex or too unpredictable to be brought under management control."[1]

I call this belief, when taken to its extreme, the myth of the super-manager. It seems to com naturally to many successful entrepreneurs and senior managers who see themselves as actio oriented problem solvers, confident doers for whom difficulties are daunting but solvable challenges see it behind Masco's leap into furniture manufacturing and behind executives' choice of the sam path every time I teach the case. Confidence matters. But there's much more to strategy an leadership than a steadfast belief that a daring vision backed by good management can overcom virtually all obstacles. Without the rest of it, "bold" too often becomes "reckless."

Look at what such thinking did to Masco. Operating profitability dropped to half its historic average, and the firm's stock price was lower when it left the furniture industry than when it entere ten years earlier. And money was only part of the cost. Where Wall Street had spoken of Masco as "Master of the Mundane," it began to speak of the company's "past glory" and "bitter shareholders." The company lost momentum as its leaders spent years distracted by a massive venture that ultimate failed.

For Masco, its move into furniture was a defining moment, but not a positive one. A legacy bui over decades was shattered, an affirmation of a well-known Warren Buffett maxim: "It takes twen years to build a reputation and five minutes to ruin it." All because the strategist got this one choi wrong.

What happened?

Your instinct, like most managers', is probably to seek the answer by looking at Masco itself and i leaders. Surely, the ultimate fault lies there. But to get the full picture, you must look as much outsi as inside the firm.

Here is a first clue.

As our faculty team was preparing to teach the case for the first time, a colleague, the most senior the room, said, "Wait a minute. This story sounds very familiar." He left the meeting and went back his office files. There he found “Mengel Company (A),” a case so old it was typed on onionskin pape

Set in 1946, the Mengel case describes the firm’s plans to revolutionize the highly fragmente furniture industry. Mengel’s bold idea? Build scale, gain efficiencies by leveraging its manufacturin skills, and establish brand identity. To do this, it would buck industry practice and spend $500,000 c national advertising to “make the average consumer style-conscious” and build its “Permanize brand name.[3] I had never heard of Mengel, but with an eerie sense of déjà vu, I wondered if Masco leaders had known about them.

My own research in the industry led to the following list. What do you think these seeming disparate companies have in common?

Consolidated Foods
Champion International
Mead
General Housewares
Ludlow
Intermark
Georgia Pacific
Beatrice Foods
Scott Paper
Burlington Industries
Gulf + Western

Like Mengel and Masco, these are all companies that tried and failed to find fortune in furnitu manufacturing.

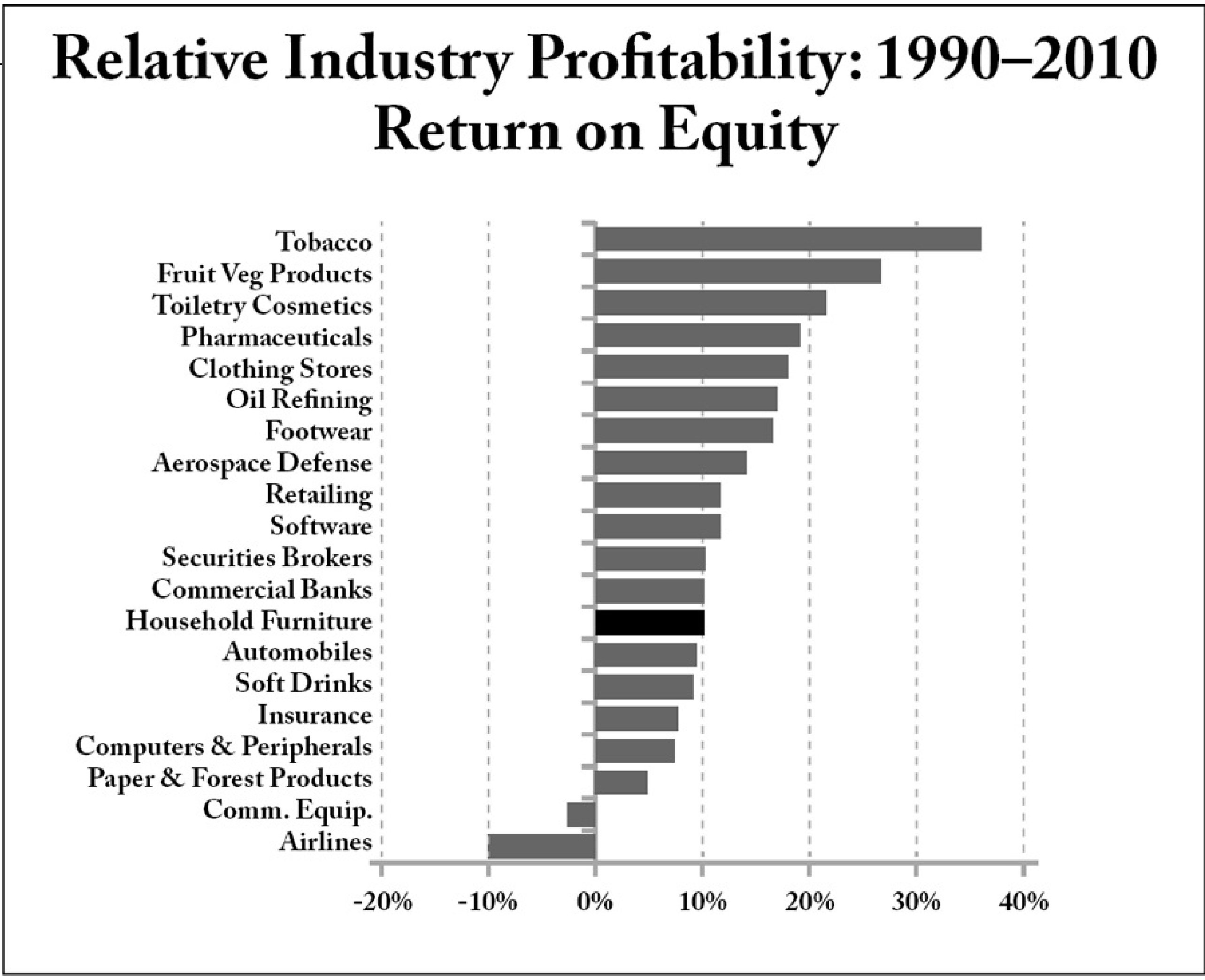
Most were regarded as well-run companies. Like Masco, they considered a fragmented, chaot industry to be an opportunity for good managers to apply their skills. With great expectations and hig hopes of success, they all jumped in with the intention of reshaping the industry through the infusio of “professional management.” Years later, they all left.

UNDERSTANDING THE FORCES

Most executives find this list both revealing and disconcerting. These were companies wi considerable track records, yet they all failed in the same endeavor. Was there something problemat about the endeavor itself? Was something at work in the furniture industry that was outside the contr of these companies and their leaders?

Here’s another clue.

Look at the chart on Relative Industry Profitability. It shows the average return on equity for twen industries over the twenty-year period from 1990 to 2010. The chart was compiled from Standard Poor’s and Compustat databases that include data on all companies that traded on U.S. stoc exchanges.



Relative Industry Profitability: 1990–2010
Return on Equity

Are you surprised by how much profitability varies by industry? Compare Tobacco companies 36.1 percent *average annual* return on equity—which means leading firms in the industry do eve better—with Airlines at -10 percent or Commercial Equipment at -2 percent.

In my experience, most executives understand that average profitability will differ from industry industry, but the scale of variation often comes as a surprise. Annual average returns in the mo profitable industries are well more than double those in median industries, and more than four or fi times those at the bottom of the distribution. Researchers have found similar differences in oth countries, in both advanced and emerging economies.[4]

Are these vast differences from industry to industry caused by random variation? It's not likely- they're too large and too consistent. Do some types of businesses attract great managers while othe attract only poor ones? Sometimes, but not enough to account for the differences.

In fact, these variations are caused by economic forces that shape each industry's competiti landscape differently.[5] As Michael Porter has shown, some of these relate to the nature of rival within the industry itself; others have to do with the balance of power between the industry and i suppliers and customers, substitute products, and potential new entrants. Sometimes the forces a fierce and lead to low levels of industry profitability; other times they're relatively benign and set t scene for much more profitable outcomes.

The collective impact of these forces on the profitability of individual firms, and, in turn, o industries in which they operate, is called the industry effect. You may be surprised to learn that som and perhaps much of your company's performance is determined by such forces.[6]

These competitive forces are beyond the control of most individual companies and their manage

They're what you inherit, a reality that you have to deal with. It's not that a firm can never chang them, ~~but in most cases it's very difficult to do. The strategist's first job is to understand them~~ ar how they affect the playing field where competition takes place.

MAKING THE DISTINCTIONS

As suggested by the above chart, industries can be arrayed along a continuum extending fro "Unattractive" to "Attractive," where attractiveness refers to the degree to which industry competiti forces restrict, allow, or even foster firm profitability. The table below identifies the most importa of these economic forces and characterizes what they probably would be like in industries at t bounds of such a continuum.[7]

Unattractive..........		**............to Attractive**
High. Many homogeneous competitors and homogeneous products. Innovations quickly copied. Slow growth. Excess capacity. Price competition.	**Rivalry among firms**	**Low.** One or a few dominant, differentiated players. Unique products. Strong brand identitie Rapid industry growth. Shortag of capacity.
High. Industry is dependent on a few, concentrated suppliers producing unique products, and Industry is not important source of profitability to suppliers.	**Power of suppliers**	**Low.** Many suppliers producing homogeneous products. Price competition and plentiful suppl make it easy to procure supplie at reasonable cost.
High. Customers have lots of choice among similar products. Low levels of brand awareness. Low switching costs. Low levels of emotional involvement with purchase.	**Power of customers**	**Low.** Products are scarce, highl differentiated, and important to customers' well-being. Customers have limited choice. Brands are strong.
Low. Industry is easy to enter and sometimes difficult to exit, creating excess capacity. Strategies of existing competitors can be easily replicated or surpassed. Entry requires low levels of capital, modest scale, and no scarce or specialized resources.	**Barriers to entry and exit**	**High.** It is difficult or not economical for new firms to enter your industry. Entry requires economies of scale, product differentiation, high capital investment, regulatory approval, or accumulation of special expertise or experience.
High. Wide variety of compelling substitute products are available that meet customers' needs at attractive relative prices.	**Availability of substitute products**	**Low.** Customers have few or no choices of alternative products that could meet their needs at comparable prices.

Note how closely many of the competitive conditions in furniture manufacturing mirror those in t left-hand "Unattractive" column.

- Rivalry among furniture firms is intense, as shown by the high number of firms making simil furniture and by the ability of firms to copy innovations made by competitors.

- Suppliers to the furniture industry, such as textile makers, dominate the vendor relationship becau no furniture company buys enough textiles to be an important customer.

- Customers in the industry are powerful because furniture purchases are highly postponable, produc are long-lived and commodity-like, and customers are not brand sensitive.

- Entry barriers are low, meaning that new firms can flood in and pull down prices if industr conditions ever become more attractive. On the other hand, the industry can be difficult to ex especially for the many family firms that have few alternative options, making excess capacity slo to leave the industry.

- Substitute products abound. New furniture must compete for the customer's dollar with countle alternatives—including used furniture or hand-me-down furniture passed from user to user. Sin many customers consider furniture a discretionary purchase, it must also compete with a plethora products such as televisions and sound systems that customers are more excited about and consider be a better value for their discretionary dollars. Even when furniture prices lagged increases in t consumer price index, sales did not respond.

How do you react to the existence of these forces?

It isn't a happy lesson for many executives I teach. It seems to say, "Your prospects a predetermined—the game is up—or, if not up, a big chunk of it is out of your control." Actio oriented executives, I find, prefer not to think of themselves as in the grip of outside forces. Th prefer to believe in free will, not determinism. The possibility that their industries might drive heavily influence their own performance isn't near the top of their minds. As proactive leaders a believers in the power of management, they tend to focus on what they can control, while ignoring underestimating what they cannot.

REJECTING THE MYTH

Ironically, the most successful and admired leaders, the titans of business, understand the profou significance of competitive forces outside their control. They know the crucial importance of pickin the right playing field. They don't buy the management myth that a truly good manager can preva regardless of the circumstances.

Look at Jack Welch, *Fortune* magazine's "Manager of the Century." You probably don't rememb that when he took over General Electric, Welch sold off more than 200 businesses worth more th $11 billion and used that money to make more than 370 acquisitions. Why? He wanted out industries where conditions were too negative, where he thought it would be too hard for GE flourish. "I didn't like the semiconductor business," he said. "I thought it was too cyclical and required too much capital. There were some very big players in it and only one or two were makin any money on a sustained basis. . . . [Exiting that business] allowed us to put our money into thin like medical equipment, power generation, all kinds of industries where we changed the game. . . ."[8]

A comment from the Sage of Omaha himself, Warren Buffett, caps the point:

> *When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.*[9]

Buffett and Welch, two of the strongest managers on record, recognize that industry matters a lo They understand that a significant measure of a firm's success depends on competitive forces beyo sample content of The Strategist: Be the Leader Your Business Needs

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