Business strategy and operational effectiveness

Michael Porter (1996) states that business strategy means conducting activities that are different from those of the competition or conducting similar activities in different ways. That is the reason why he highlights the fact that company need help in achieving and sustaining above the average profitability (Porter, 2007). Companies need to be flexible to react quickly to competitive and market changes. In addition, companies need to take care of several basic competencies to maintain advantage over competition.

That is why he published an interesting article titled "What Is Strategy?" in which he literally confronted all the authors denying that positioning is at the heart of business strategy and that it is static rather than dynamic in its nature. However, he argues that it is a consequence of the fact that there is no distinction between operational effectiveness and business strategy. More worryingly, most strategic management concepts have been created as a consequence of not recognising the difference between operational effectiveness and business strategy. Operational effectiveness means conducting similar activities better than the competition. Contrary, business strategy means conducting activities that are different from the activities of the competition, or they are conducted in a different manner (Porter, 1998).

Some companies have the capacity of a better utilisation of their production factors than others due to the elimination of needless tasks, the use of modern technology, better employee motivation or a better insight of the management of certain activities. Such differences in operational effectiveness represent an important source of differences in competition profitability because they are a direct influence on the positions of relative expenses and the degree of differentiation. The difference in operational effectiveness was a source of competitive advantage in the 1980s. As competitors mutually imitate their quality enhancement, cycle time or partnership with suppliers, their business strategies become more similar, and competitiveness is turned into a race in the same track where nobody can win. Competition based solely on operational effectiveness is destructive for the competitors themselves since it causes extinction wars which can be stopped only by limiting the competition. Business strategy is creating a trade-off and competition. In addition to trade-off, it is recommended to harmonise activities conducted by the company, because such a practice reduces the expenses on one side and increases differentiation on the other side. Namely, competitive advantage is the result of a system of directed activities of a company, rather than a single activity which can be imitated by competitors. It is difficult, even for a highly capable competitor, to successfully imitate an entire system of activities.

While shaping business strategy, it is vital to research deeper and analyse each of the five competitive forces individually while acquiring knowledge on opportunities and dangers in the process. All the five competitive forces mutually form the intensity of competitiveness and profitability, and the strongest force is the decisive one when shaping the business strategy. The ultimate goal of this analysis is to explain the above the average profitability. Profitability is seen as one of the biggest indicators of company success. However, a company seeks to achieve above the average profitability which creates room for investment enhancement influencing the reduction of operating risk.

Michael Porter (Magretta, 2012) argues that the desired profitability has to be above industry average to ensure the growth and development of the company. The average industry profitability depends on the price flexibility of the product and production technology (exogenous variable) and industry structure and business strategy (endogenous variable) adopted by companies within the industry (Tipurić et al., 1999).

Michael Porter (2008) located the basis of above the average characteristics of a company in sustainable competitive advantage. It is powerful and unique enough to contribute to the above the average profitability and sufficiently adequate for further corporation development. The concept of sustainable competitive advantage is based on the long-term prospect, i.e. above the average competitive advantage sustainable over a long period of time. In other words, sustainable competitive advantage is not easily achieved nor imitated by competitors.

Michael Porter warns about the danger of demands for constant profitability. A created competitive position needs to be reinforced. However, such beliefs present dangerous semi truths which are increasingly leading companies into mutually destructive competitiveness. It is true that, as the regulatory rules are becoming more flexible and the markets are becoming more liberal, some obstacles are disappearing. The root of the problem should be sought after in the failure to make a distinction between operational effectiveness and business strategy. Operational effectiveness and business strategy are important for achieving above the average profitability which is the main goal of every company.

However, operational effectiveness and business strategy operate in very different ways. The company can deliver higher or same value to its customers with lower cost, or both. This entails the following calculation: *Providing higher value enables the company to charge more than the average unit price, whereas higher efficiency enables lower cost compared with the average unit.* The first component is associated with effectiveness (doing the right things) (Drucker, 1974) the second one is proportionally associated with efficiency (doing things right) (Figure 3.1; Drucker, 1974).

According to Aziz Šunje (2002), the following can be concluded when considering effectiveness and efficiency as two ambivalent orientations: *There is one (effectiveness) that is completely turned outwards and one (efficiency) that is completely turned inwards.*

The balancing process between efficiency and effectiveness is seen through *profit as a difference between total revenue (in that case, effectiveness is displayed as*

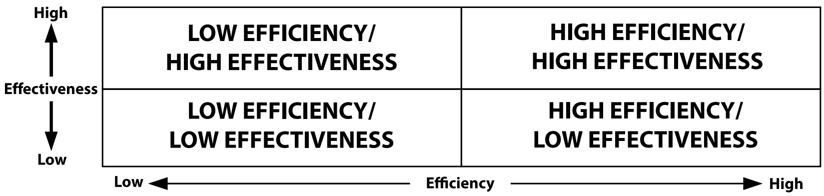

Figure 3.1 Effectiveness and efficiency ratio.

Source: Adapted from Hill and Jones (1998:6).

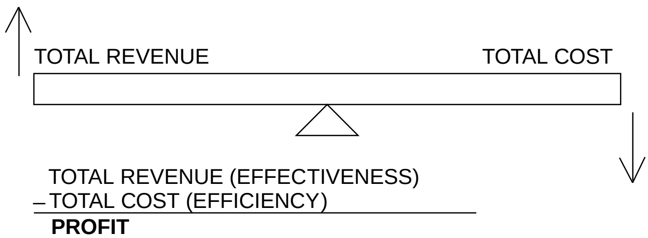

Figure 3.2 Profit as a measure of total income and total cost balancing.

Source: Šunje (2002:29).

operational effectiveness) and total costs (in that case, efficiency is displayed as operational efficiency). The stated existence of profit, in that case, confirms that the effective (total revenue) and efficient (total cost) orientation have been balanced. The goal is to make sure the total revenue (operational effectiveness) is higher than total cost (operational efficiency) (Figure 3.2).

Considering the context of operational effectiveness and operational efficiency, it can be concluded that it is quite an undertaking to keep these two ambivalent orientations balanced, i.e. to demand for both higher operational effectiveness and operational efficiency (to do the right thing in the right way). It is certain that each misbalance between operational effectiveness and operational efficiency reduces the level of success all the way to the level of failure.

Strategic positioning, once at the heart of business strategy, has been discarded as too static for today's dynamic markets and changing technology. Today, competitors can quickly copy each market position, hence competitive advantage is, at best, temporary. Positioning is one of the essences of business strategy. In the era of fast technological changes and changes of surroundings, there is an understanding that positioning has been discarded as being too static, due to the fact that a formed set of activities of a company could be easily and quickly copied by another company. In order to survive in such conditions, companies have to reorient their strategic positioning to some other possibilities. Some of these possibilities include outsourcing, benchmarking, alliances, partnerships, licensing and similar.

Michael Porter (1985) highlights the key structural industry features determining the strength of five competitive forces and industry profitability as well. The purpose is to find a position in the industry where the company can partially defend itself from five competitive forces and partially influence them to its own advantage. If there were such a single good position, there would be no need for business strategy on the market. Strategic positioning can be traced back to the positioning – analytical school of strategic management.

The school is titled as positioning due to the position inherited by the company or the position limiting and shaping its selection without defining it. *The school is additionally labelled as analytical* due to the calculations and data processing often conducted by consulting companies which effects their generic strategy proposal (Mintzberg et al., 2005).

Strategic positioning consists of three parts (Tošović-Stevanović, 2009):

1 Positioning based on the production of substituted products (Michael Porter labels it as positioning based on varieties);
2 Positioning based on needs (Michael Porter labels it as positioning based on diversity);
3 Positioning based on consumer segmentation (Michael Porter labels it as positioning based on approach).

Positioning based on variety, needs or approach or a combination requires a specific set of activities to be established. A smartly created and established set of activities can be a basis for a company for ensuring an appropriate position at the market in relation to its competitors.

There are six approaches to strategic positioning, according to Michael Porter (2001).

The first approach is to start with the right aim of achieving above the average profitability. Real economic added value can be created only if a business strategy based on sustainable profitability is used. Economic added value is created if the buyers are prepared to pay the price of a product which is higher than the costs of its production. If the goals are defined to focus on the scale of sales or market leadership with the key premise of following profit, there is usually a formation of a bad business strategy. The same scenario occurs if business strategies are created as a response to demands previously set by the investor.

In the second approach, the business strategy of the company has a task of creating a value offer or a set of benefits different from the one offered by the competition. Business strategy does not entail the best universal way for being a competitor and working hard to offer all the assets to customers. It defines the manner in which competition delivers superior value for a special set of application and a special set of customers. Value offer is an element of business strategy oriented externally in relation to the market, whereas value chain is an element of business strategy oriented towards the market. It is a somewhat limitation of activity adaptation for value delivery.

In the third approach, business strategy needs to be reflected in the reconfigured distinctive company value chain to establish new competitive advantage of a company. The company needs to configure the way of conducting primary and support activities in such a manner that it differs from competition to offer value at the market. If a company focuses on adopting the best practices, it will conduct most of its activities similarly as competition creating difficulties in forming and sustaining competitive advantage. Competitive advantage is a consequence of activities resulting in low cost or differentiation.

In the fourth approach, strong business strategies include balancing the selection of forces to be abandoned or forgotten by the company with an aim of reaching uniqueness. Such balances achieved in value chain activities are the one thing that make a company really different from others. When value chain enhancement does not require balancing, it quickly becomes the best practice which can be imitated by competitors without sacrificing their competitiveness. Trying to please all customers is an almost certain guarantee that the company will fail in achieving competitive advantage. Balancing is a choice which makes business strategy sustainable because some things are not easily balanced or neutralised.

The fifth approach entails the harmony of all elements at the disposal of a company. Business strategy includes the formation of a selection of mutually harmonised activities present within primary and support activities in a value chain. All company activities must be reinforced. In addition to reinforcing competitive advantage, such harmonisation is hard to imitate. Harmonisation implies that the values or expenses of an activity are influenced by the conduction manner of other activities. Harmonisation can be viewed as a result of the attitude that the unit is more important than individual parts, i.e. that value lies in quantity, not in several isolated parts.

The sixth approach implies that business strategy includes a continuity of directing. A company needs to define a unique value offer which will be sustained even if some variants have been overlooked. Continuous advancement is a requirement, but it always has to be strategically directed. It enhances the advancements in activities and their coordination to ensure the company forms unique competencies. Continuity does not mean inadaptability. When a company has stability at the heart of its value, it should aim at innovations. It is a paradox that the continuity of business strategy actually enhances the ability of a company to adapt to changes or innovations.

As Momčilo Milisavljević (2014) states, competitive advantage is not a static item present or absent in a company. It is more like a changing cycle process (shaped as the letter S). A company should use competitive advantage as a basis for selecting a field where it excels, instead of a field where it would like to be present. This means that it is more important for a company to