COMPETITION

Strategic Intent

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Sixteen years ago, when Gary Hamel, then a lecturer at London Business School, and C.K. Prahalad, a University of Michigan professor, wrote "Strategic Intent," the article signaled that a major new force had arrived in management.

Hamel and Prahalad argue that Western companies focus on trimming their ambitions to match resources and, as a result, search only for advantages they can sustain. By contrast, Japanese corporations leverage resources by accelerating the pace of organizational learning and try to attain seemingly impossible goals. These firms foster the desire to succeed among their employees and maintain it by spreading the vision of global leadership. This is how Canon sought to "beat Xerox" and Komatsu set out to "encircle Caterpillar."

This strategic intent usually incorporates stretch targets, which force companies to compete in innovative ways. In this McKinsey Award-winning article, Hamel and Prahalad describe four techniques that Japanese companies use: building layers of advantage, searching for "loose bricks," changing the terms of engagement, and competing through collaboration.

Today managers in many industries are working hard to match the competitive advantages of their new global rivals. They are moving manufacturing offshore in search of lower labor costs, rationalizing product lines to capture global scale economies, instituting quality circles and just-in-time production, and adopting Japanese human resource practices. When competitiveness still seems out of reach, they form strategic alliances—often with the very companies that upset the competitive balance in the first place.

Important as these initiatives are, few of them go beyond mere imitation. Too many companies are expending enormous energy simply to reproduce the cost and quality advantages their global competitors already enjoy. Imitation may be the sincerest form of flattery, but it will not lead to competitive revitalization. Strategies based on imitation are transparent to competitors who have already mastered them. Moreover, successful competitors rarely stand still. So it is not surprising that many executives feel trapped in a seemingly endless game of catch-up, regularly surprised by the new accomplishments of their rivals.

For these executives and their companies, regaining competitiveness will mean rethinking many of the basic concepts of strategy.[1] As "strategy" has blossomed, the competitiveness of Western companies has withered. This may be coincidence, but we think not. We believe that the application of concepts such as "strategic fit" (between resources and opportunities), "generic strategies" (low cost versus differentiation versus focus), and the "strategy hierarchy" (goals, strategies, and tactics) has often abetted the process of competitive decline. The new global competitors approach strategy from a perspective that is fundamentally different from that which underpins Western management thought. Against such competitors, marginal adjustments to current orthodoxies are no more likely to produce competitive revitalization than are marginal improvements in operating efficiency. (The sidebar "Remaking Strategy" describes our research and summarizes the two contrasting approaches to strategy we see in large multinational companies.)

Remaking Strategy

Over the last ten years, our research on global competition, international alliances, and multinational management has brought us into close contact with senior managers in the United States, Europe, and Japan. As we tried to unravel the reasons for success and surrender in global markets, we became more and more suspicious that executives in Western and Far Eastern companies often operated with very different conceptions of competitive strategy. Understanding these differences, we thought, might help explain the conduct and outcome of competitive battles as well as supplement traditional explanations for Japan's ascendance and the West's decline.

Few Western companies have an enviable track record anticipating the moves of new global competitors. Why? The explanation begins with the way most companies have approached competitor analysis. Typically, competitor analysis focuses on the existing resources (human, technical, and financial) of present competitors. The only companies seen as a threat are those with the resources to erode margins and market share in the next planning period. Resourcefulness, the pace at which new competitive advantages are being built, rarely enters in.

In this respect, traditional competitor analysis is like a snapshot of a moving car. By itself, the photograph yields little information about the car's speed or direction—whether the driver is out for a quiet Sunday drive

We began by mapping the implicit strategy models of managers who had participated in our research. Then we built detailed histories of selected competitive battles. We searched for evidence of divergent views of strategy, competitive advantage, and the role of top management.

Two contrasting models of strategy emerged. One, which most Western managers will recognize, centers on the problem of maintaining strategic fit. The other centers on the problem of leveraging resources. The two are not mutually exclusive, but they represent a significant difference in emphasis—an emphasis that deeply affects how competitive battles get played out over time.

Both models recognize the problem of competing in a hostile environment with limited resources. But while the emphasis in the first is on trimming ambitions to match available resources, the emphasis in the second is on leveraging resources to reach seemingly unattainable goals.

Both models recognize that relative competitive advantage determines relative profitability. The first emphasizes the search for advantages that are inherently sustainable, the second emphasizes the need to accelerate organizational learning to outpace competitors in building new advantages.

Both models recognize the difficulty of competing against larger competitors. But while the first leads to a search for niches (or simply dissuades the company from challenging an entrenched competitor), the second produces a quest for new rules that can devalue the incumbent's advantages.

Both models recognize that balance in the scope of an organization's activities reduces risk. The first seeks to reduce financial risk by building a balanced portfolio of cash-generating and cash-consuming businesses. The second seeks to reduce competitive risk by ensuring a well-balanced and sufficiently broad portfolio of advantages.

Both models recognize the need to disaggregate the organization in a way that allows top management to differentiate among the investment needs of various planning units. In the first model, resources are allocated to product-market units in which relatedness is defined by common products, channels, and customers. Each business is assumed to own all the critical skills it needs to execute its strategy successfully. In the second, investments are made in core competences (microprocessor controls or electronic imaging, for example) as well as in product-market units. By tracking these investments across businesses, top management works to assure that the plans of individual strategic units don't undermine future developments by default.

Both models recognize the need for consistency in action across organizational levels. In the first, consistency between corporate and business levels is largely a matter of conforming to financial objectives. Consistency between business and functional levels comes by tightly restricting the means the business uses to achieve its strategy—establishing standard operating procedures, defining the served market, adhering to accepted industry practices. In the second model, business-corporate consistency comes from allegiance to a particular strategic intent. Business-functional consistency comes from allegiance to intermediate-term goals or challenges with lower-level employees encouraged to invent how those goals will be achieved.

or warming up for the Grand Prix. Yet many managers have learned through painful experience that a business's initial resource endowment (whether bountiful or meager) is an unreliable predictor of future global success.

Think back: In 1970, few Japanese companies possessed the resource base, manufacturing volume, or technical prowess of U.S. and European industry leaders. Komatsu was less than 35% as large as Caterpillar (measured by sales), was scarcely represented outside Japan, and relied on just one product line—small bulldozers—for most of its revenue. Honda was smaller than American Motors and had not yet begun to export cars to the United States. Canon's first halting steps in the reprographics business looked pitifully small compared with the $4 billion Xerox powerhouse.

If Western managers had extended their competitor analysis to include these companies, it would merely have underlined how dramatic the resource discrepancies between them were. Yet by 1985, Komatsu was a $2.8 billion company with a product scope encompassing a broad range of earth-moving equipment, industrial robots, and semiconductors. Honda manufactured almost as many cars worldwide in 1987 as Chrysler. Canon had matched Xerox's global unit market share.

The lesson is clear: Assessing the current tactical advantages of known competitors will not help you understand the resolution, stamina, or inventiveness of potential competitors. Sun-tzu, a Chinese military strategist, made the point 3,000 years ago: "All men can see the tactics whereby I conquer," he wrote, "but what none can see is the strategy out of which great victory is evolved."

Companies that have risen to global leadership over the past 20 years invariably began with ambitions that were out of all proportion to their resources and capabilities. But they created an obsession with winning at all levels of the organization and then sustained that obsession over the 10- to 20-year quest for global leadership. We term this obsession "strategic intent."

On the one hand, strategic intent envisions a desired leadership position and establishes the criterion the organization will use to chart its progress. Komatsu set out to "encircle Caterpillar." Canon sought to "beat Xerox." Honda strove to become a second Ford—an automotive pioneer. All are expressions of strategic intent.

At the same time, strategic intent is more than simply unfettered ambition. (Many companies possess an ambitious strategic intent yet fall short of their goals.) The concept also encompasses an active management process that includes focusing the organization's attention on the essence of winning, motivating people by communicating the value of the target, leaving room for individual and team contributions, sustaining enthusiasm by providing new operational definitions as circumstances change, and using intent consistently to guide resource allocations.

Strategic intent captures the essence of winning.

The Apollo program—landing a man on the moon ahead of the Soviets—was as competitively focused as Komatsu's drive against Caterpillar. The space program became the scorecard for America's technology race with the USSR. In the turbulent information technology industry, it was hard to pick a single competitor as a target, so NEC's strategic intent, set in the early 1970s, was to acquire the technologies that would put it in the best position to exploit the convergence of computing and telecommunications. Other industry observers foresaw this convergence, but only NEC made convergence the guiding theme for subsequent strategic decisions by adopting “computing and communications” as its intent. For Coca-Cola, strategic intent has been to put a Coke within “arm’s reach” of every consumer in the world.

Strategic intent is stable over time.

In battles for global leadership, one of the most critical tasks is to lengthen the organization’s attention span. Strategic intent provides consistency to short-term action, while leaving room for reinterpretation as new opportunities emerge. At Komatsu, encircling Caterpillar encompassed a succession of medium-term programs aimed at exploiting specific weaknesses in Caterpillar or building particular competitive advantages. When Caterpillar threatened Komatsu in Japan, for example, Komatsu responded by first improving quality, then driving down costs, then cultivating export markets, and then underwriting new product development.

Strategic intent sets a target that deserves personal effort and commitment.

Ask the CEOs of many American corporations how they measure their contributions to their companies’ success, and you’re likely to get an answer expressed in terms of shareholder wealth. In a company that possesses a strategic intent, top management is more likely to talk in terms of global market leadership. Market share leadership typically yields shareholder wealth, to be sure. But the two goals do not have the same motivational impact. It is hard to imagine middle managers, let alone blue-collar employees, waking up each day with the sole thought of creating more shareholder wealth. But mightn’t they feel different given the challenge to “beat Benz”—the rallying cry at one Japanese auto producer? Strategic intent gives employees the only goal that is worthy of commitment: to unseat the best or remain the best, worldwide.

Many companies are more familiar with strategic planning than they are with strategic intent. The planning process typically acts as a “feasibility sieve.” Strategies are accepted or rejected on the basis of whether managers can be precise about the “how” as well as the “what” of their plans. Are the milestones clear? Do we have the necessary skills and resources? How will competitors react? Has the market been thoroughly researched? In one form or another, the admonition “Be realistic!” is given to line managers at almost every turn.

But can you *plan* for global leadership? Did Komatsu, Canon, and Honda have detailed, 20-year strategies for attacking Western markets? Are Japanese and Korean managers better planners than their Western counterparts? No. As valuable as strategic planning is, global leadership is an objective that lies outside the range of planning. We know of few companies with highly developed planning systems that have managed to set a strategic intent. As tests of strategic fit become more stringent, goals that cannot be planned for fall by the wayside. Yet companies that are afraid to commit to goals that lie outside the range of planning are unlikely to become global leaders.

Although strategic planning is billed as a way of becoming more future oriented, most managers, when pressed, will admit that their strategic plans reveal more about today’s problems than tomorrow’s opportunities. With a fresh set of problems confronting managers at the beginning of every planning cycle, focus often shifts dramatically from year to year. And with the pace of change accelerating in most industries, the predictive horizon is becoming shorter and shorter. So plans do little more than project the present forward incrementally. The goal of strategic intent is to fold the future back into the present. The important question is not “How will next year be different from this year?” but “What must we do differently next year to get closer to our strategic intent?” Only with a carefully articulated and adhered to strategic intent will a succession of year-on-year plans sum up to global leadership.

Just as you cannot plan a ten- to 20-year quest for global leadership, the chance of falling into a leadership position by accident is also remote. We don’t believe that global leadership comes from an undirected process of intrapreneurship. Nor is it the product of a Skunk Works or other technique for internal venturing. Behind such programs lies a nihilistic assumption: that the organization is so hidebound, so orthodox ridden, the only way to innovate is to put a few bright people in a dark room, pour in some money, and hope that something wonderful will happen. In this Silicon Valley approach to innovation, the only role for top managers is to retrofit their corporate strategy to the entrepreneurial successes that emerge from below. Here the value added of top management is low indeed.

Sadly, this view of innovation may be consistent with reality in many large companies.[2] On the one hand, top management lacks any particular point of view about desirable ends beyond satisfying shareholders and keeping raiders at bay. On the other, the planning format, reward criteria, definition of served market, and belief in accepted industry practice all work together to tightly constrain the range of available means. As a result, innovation is necessarily an isolated activity. Growth depends more on the inventive capacity of individuals and small teams than on the ability of top management to aggregate the efforts of multiple teams toward an ambitious strategic intent.

In companies that have overcome resource constraints to build leadership positions, we see a different relationship between means and ends. While strategic intent is clear about ends, it is flexible as to means—it leaves room for improvisation. Achieving strategic intent requires enormous creativity with respect to means: Witness Fujitsu’s use of strategic alliances in Europe to attack IBM. But this creativity comes in the service of a clearly prescribed end. Creativity is unbridled but not uncorralled, because top management establishes the criterion against which employees can pretest the logic of their initiatives. Middle managers must do more than deliver on promised financial targets; they must also deliver on the broad direction implicit in their organization's strategic intent.

Strategic intent implies a sizable stretch for an organization. Current capabilities and resources will not suffice. This forces the organization to be more inventive, to make the most of limited resources. Whereas the traditional view of strategy focuses on the degree of fit between existing resources and current opportunities, strategic intent creates an extreme misfit between resources and ambitions. Top management then challenges the organization to close the gap by systematically building new advantages. For Canon, this meant first understanding Xerox's patents, then licensing technology to create a product that would yield early market experience, then gearing up internal R&D efforts, then licensing its own technology to other manufacturers to fund further R&D, then entering market segments in Japan and Europe where Xerox was weak, and so on.

In this respect, strategic intent is like a marathon run in 400-meter sprints. No one knows what the terrain will look like at mile 26, so the role of top management is to focus the organization's attention on the ground to be covered in the next 400 meters. In several companies, management did this by presenting the organization with a series of corporate challenges, each specifying the next hill in the race to achieve strategic intent. One year the challenge might be quality, the next it might be total customer care, the next, entry into new markets, and the next, a rejuvenated product line. As this example indicates, corporate challenges are a way to stage the acquisition of new competitive advantages, a way to identify the focal point for employees' efforts in the near to medium term. As with strategic intent, top management is specific about the ends (reducing product development times by 75%, for example) but less prescriptive about the means.

Like strategic intent, challenges stretch the organization. To preempt Xerox in the personal copier business, Canon set its engineers a target price of $1,000 for a home copier. At the time, Canon's least expensive copier sold for several thousand dollars. Trying to reduce the cost of existing models would not have given Canon the radical price-performance improvement it needed to delay or deter Xerox's entry into personal copiers. Instead, Canon engineers were challenged to reinvent the copier—a challenge they met by substituting a disposable cartridge for the complex image-transfer mechanism used in other copiers.

Corporate challenges come from analyzing competitors as well as from the foreseeable pattern of industry evolution. Together these reveal potential competitive openings and identify the new skills the organization will need to take the initiative away from better-positioned players. (The exhibit "Building Competitive Advantage at Komatsu" illustrates the way challenges helped Komatsu achieve its intent.)

Building Competitive Advantage at Komatsu

Corporate Challenge	Protect Komatsu's Home Market Against Caterpillar	Reduce Costs While Maintaining Quality
Programs	**early 1960s** Licensing deals with Cummins Engine, International Harvester, and Bucyrus-Erie to acquire technology and establish benchmarks **1961** Project A (for Ace) to advance the product quality of Komatsu's small and midsize bulldozers above Caterpillar's **1962** Quality circles companywide to provide training for all employees	**1965** Cost Down (CD) program **1966** Total CD program

	Make Komatsu an International Enterprise and Build Export Markets	Respond to External Shocks That Threaten Markets	Create New Products and Markets
	early 1960s Develop Eastern bloc countries **1967** Komatsu Europe marketing subsidiary established **1970** Komatsu America established **1972** Project B to improve the durability and reliability and to reduce costs of large bulldozers **1972** Project C to improve payloaders **1972** Project D to improve hydraulic excavators **1974** Establish presales and service departments to assist newly industrializing countries in construction projects	**1975** V-10 program to reduce costs by 10% while maintaining quality; reduce parts by 20%; rationalize manufacturing system **1977** ¥180 program to budget companywide for 180 yen to the dollar when exchange rate was 240 **1979** Project E to establish teams to redouble cost and quality efforts in response to oil crisis	**late 1970s** Accelerate product development to expand line **1979** Future and Frontiers program to identify new businesses based on society's needs and company's know-how **1981** EPOCHS program to reconcile greater product variety with improved production efficiencies

Building Competitive Advantage at Komatsu

For a challenge to be effective, individuals and teams throughout the organization must understand it and see its implications for their own jobs. Companies that set corporate challenges to create new competitive advantages (as Ford and IBM did with quality improvement) quickly discover that engaging the entire organization requires top management to do the following:

- *Create a sense of urgency,* or quasi crisis, by amplifying weak signals in the environment that point up the need to improve, instead of allowing inaction to precipitate a real crisis. Komatsu, for example, budgeted on the basis of worst-case exchange rates that overvalued the yen.

- *Develop a competitor focus at every level through widespread use of competitive intelligence.* Every employee should be able to benchmark his or her efforts against best-in-class competitors so that the challenge becomes personal. For instance, Ford showed production-line workers videotapes of operations at Mazda's most efficient plant.

- *Provide employees with the skills they need to work effectively*—training in statistical tools, problem solving, value engineering, and team building, for example.

- *Give the organization time to digest one challenge before launching another.* When competing initiatives overload the organization, middle managers often try to protect their people from the whipsaw of shifting priorities. But this "wait and see if they're serious this time" attitude ultimately destroys the credibility of corporate challenges.

- *Establish clear milestones and review mechanisms* to track progress, and ensure that internal recognition and rewards reinforce desired behaviors. The goal is to make the challenge inescapable for everyone in the company.

It is important to distinguish between the process of managing corporate challenges and the advantages that the process creates. Whatever the actual challenge may be—quality, cost, value engineering, or something else—there is the same need to engage employees intellectually and emotionally in the development of new skills. In each case, the challenge will take root only if senior executives and lower-level employees feel a reciprocal responsibility for competitiveness.

We believe workers in many companies have been asked to take a disproportionate share of the blame for competitive failure. In one U.S. company, for example, management had sought a 40% wage-package concession from hourly employees to bring labor costs into line with Far Eastern competitors. The result was a long strike and, ultimately, a 10% wage concession from employees on the line. However, direct labor costs in manufacturing accounted for less than 15% of total value added. The company thus succeeded in demoralizing its entire blue-collar workforce for the sake of a 1.5% reduction in total costs. Ironically, further analysis showed that their competitors' most significant costs savings came not from lower hourly wages but from better work methods invented by employees. You can imagine how eager the U.S. workers were to make similar contributions after the strike and concessions. Contrast this situation with what happened at Nissan when the yen strengthened: Top management took a big pay cut and then asked middle managers and line employees to sacrifice relatively less.

Reciprocal responsibility means shared gain and shared pain. In too many companies, the pain of revitalization falls almost exclusively on the employees least responsible for the enterprise's decline. Too often, workers are asked to commit to corporate goals without any matching commitment from top management—be it employment security, gain sharing, or an ability to influence the direction of the business. This one-sided approach to regaining competitiveness keeps many companies from harnessing the intellectual horsepower of their employees.

Creating a sense of reciprocal responsibility is crucial because competitiveness ultimately depends on the pace at which a company embeds new advantages deep within its organization, not on its stock of advantages at any given time. Thus, the concept of competitive advantage must be expanded beyond the scorecard many managers now use: Are my costs lower? Will my product command a price premium?

Few competitive advantages are long lasting. Uncovering a new competitive advantage is a bit like getting a hot tip on a stock: The first person to act on the insight makes more money than the last. When the experience curve was young, a company that built capacity ahead of competitors, dropped prices to fill plants, and reduced costs as volume rose went to the bank. The first mover traded on the fact that competitors undervalued market share—they didn't price to capture additional share because they didn't understand how market share leadership could be translated into lower costs and better margins. But there is no more undervalued market share when each of 20 semiconductor companies builds enough capacity to serve 10% of the world market.

Keeping score of existing advantages is not the same as building new advantages. The essence of strategy lies in creating tomorrow's competitive advantages faster than competitors mimic the ones you possess today. In the 1960s, Japanese producers relied on labor and capital cost advantages. As Western manufacturers began to move production offshore, Japanese companies accelerated their investment in process technology and created scale and quality advantages. Then, as their U.S. and European competitors rationalized manufacturing, they added another string to their bow by accelerating the rate of product development. Then they built global brands. Then they de-skilled competitors through alliances and outsourcing deals. The moral? An organization's capacity to improve existing skills and learn new ones is the most defensible competitive advantage of all.

To achieve a strategic intent, a company must usually take on larger, better-financed competitors. That means carefully managing competitive engagements so that scarce resources are conserved. Managers cannot do that simply by playing the same game better—making marginal improvements to competitors' technology and business practices. Instead, they must fundamentally change the game in ways that disadvantage incumbents: devising novel approaches to market entry, advantage building, and competitive warfare. For smart competitors, the goal is not competitive imitation but competitive innovation, the art of containing competitive risks within manageable proportions.

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Four approaches to competitive innovation are evident in the global expansion of Japanese companies. These are: building layers of advantage, searching for loose bricks, changing the terms of engagement, and competing through collaboration.

The wider a company's portfolio of advantages, the less risk it faces in competitive battles. New global competitors have built such portfolios by steadily expanding their arsenals of competitive weapons. They have moved inexorably from less defensible advantages such as low wage costs to more defensible advantages such as global brands. The Japanese color television industry illustrates this layering process.

By 1967, Japan had become the largest producer of black-and-white television sets. By 1970, it was closing the gap in color televisions. Japanese manufacturers used their competitive advantage—at that time, primarily, low labor costs—to build a base in the private-label business, then moved quickly to establish world-scale plants. This investment gave them additional layers of advantage—quality and reliability—as well as further cost reductions from process improvements. At the same time, they recognized that these cost-based advantages were vulnerable to changes in labor costs, process and product technology, exchange rates, and trade policy. So throughout the 1970s, they also invested heavily in building channels and brands, thus creating another layer of advantage: a global franchise. In the late 1970s, they enlarged the scope of their products and businesses to amortize these grand investments, and by 1980 all the major players—Matsushita, Sharp, Toshiba, Hitachi, Sanyo—had established related sets of businesses that could support global marketing investments. More recently, they have been investing in regional manufacturing and design centers to tailor their products more closely to national markets.

These manufacturers thought of the various sources of competitive advantage as mutually desirable layers, not mutually exclusive choices. What some call competitive suicide—pursuing both cost and differentiation—is exactly what many competitors strive for.[3] Using flexible manufacturing technologies and better marketing intelligence, they are moving away from standardized "world products" to products like Mazda's minivan, developed in California expressly for the U.S. market.

Another approach to competitive innovation, searching for loose bricks, exploits the benefits of surprise, which is just as useful in business battles as it is in war. Particularly in the early stages of a war for global markets, successful new competitors work to stay below the response threshold of their larger, more powerful rivals. Staking out underdefended territory is one way to do this.

To find loose bricks, managers must have few orthodoxies about how to break into a market or challenge a competitor. For example, in one large U.S. multinational, we asked several country managers to describe what a Japanese competitor was doing in the local market. The first executive said, "They're coming at us in the low end. Japanese companies always come in at the bottom." The second speaker found the comment interesting but disagreed: "They don't offer any low-end products in my market, but they have some exciting stuff at the top end. We really should reverse engineer that thing." Another colleague told still another story. "They haven't taken any business away from me," he said, "but they've just made me a great offer to supply components." In each country, the Japanese competitor had found a different loose brick.

The search for loose bricks begins with a careful analysis of the competitor's conventional wisdom: How does the company define its "served market"? What activities are most profitable? Which geographic markets are too troublesome to enter? The objective is not to find a corner of the industry (or niche) where larger competitors seldom tread but to build a base of attack just outside the market territory that industry leaders currently occupy. The goal is an uncontested profit sanctuary, which could be a particular product segment (the "low end" in motorcycles), a slice of the value chain (components in the computer industry), or a particular geographic market (Eastern Europe).

When Honda took on leaders in the motorcycle industry, for example, it began with products that were just outside the conventional definition of the leaders' product-market domains. As a result, it could build a base of operations in underdefended territory and then use that base to launch an expanded attack. What many competitors failed to see was Honda's strategic intent and its growing competence in engines and power trains. Yet even as Honda was selling 50cc motorcycles in the United States, it was already racing larger bikes in Europe—assembling the design skills and technology it would need for a systematic expansion across the entire spectrum of motor-related businesses.

Honda's progress in creating a core competence in engines should have warned competitors that it might enter a series of seemingly unrelated industries—automobiles, lawn mowers, marine engines, generators. But with each company fixated on its own market, the threat of Honda's horizontal diversification went unnoticed. Today, companies like Matsushita and Toshiba are similarly poised to move in unexpected ways across industry boundaries. In protecting loose bricks, companies must extend their peripheral vision by tracking and anticipating the migration of global competitors across product segments, businesses, national markets, value-added stages, and distribution channels.

Changing the terms of engagement—refusing to accept the front-runner's definition of industry and segment boundaries—represents still another form of competitive innovation. Canon's entry into the copier business illustrates this approach.

During the 1970s, both Kodak and IBM tried to match Xerox's business system in terms of segmentation, products, distribution, service, and pricing. As a result, Xerox had no trouble decoding the new entrants' intentions and developing countermoves. IBM eventually withdrew from the copier business, while Kodak remains a distant second in the large copier market that Xerox still dominates.

Canon, on the other hand, changed the terms of competitive engagement. While Xerox built a wide range of copiers, Canon standardized machines and components to reduce costs. It chose to distribute through office product dealers rather than try to match Xerox's huge direct sales force. It also avoided the need to create a national service network by designing reliability and serviceability into its product and then delegating service responsibility to the dealers. Canon copiers were sold rather than leased, freeing Canon from the burden of financing the lease base. Finally, instead of selling to the heads of corporate duplicating departments, Canon appealed to secretaries and department managers who wanted distributed copying. At each stage, Canon neatly sidestepped a potential barrier to entry.

Canon's experience suggests that there is an important distinction between barriers to entry and barriers to imitation. Competitors that tried to match Xerox's business system had to pay the same entry costs—the barriers to imitation were high. But Canon dramatically reduced the barriers to entry by changing the rules of the game.

Changing the rules also short-circuited Xerox's ability to retaliate quickly against its new rival. Confronted with the need to rethink its business strategy and organization, Xerox was paralyzed for a time. Its managers realized that the faster they downsized the product line, developed new channels, and improved reliability, the faster they would erode the company's traditional profit base. What might have been seen as critical success factors—Xerox's national sales force and service network, its large installed base of leased machines, and its reliance on service revenues—instead became barriers to retaliation. In this sense, competitive innovation is like judo: The goal is to use a larger competitor's weight against it. And that happens not by matching the leader's capabilities but by developing contrasting capabilities of one's own.

Competitive innovation works on the premise that a successful competitor is likely to be wedded to a recipe for success. That's why the most effective weapon new competitors possess is probably a clean sheet of paper. And why an incumbent's greatest vulnerability is its belief in accepted practice.

Through licensing, outsourcing agreements, and joint ventures, it is sometimes possible to win without fighting. For example, Fujitsu's alliances in Europe with Siemens and STC (Britain's largest computer maker) and in the United States with Amdahl yield manufacturing volume and access to Western markets. In the early 1980s, Matsushita established a joint venture with Thorn (in the United Kingdom), Telefunken (in Germany), and Thomson (in France), which allowed it to quickly multiply the forces arrayed against Philips in the battle for leadership in the European VCR business. In fighting larger global rivals by proxy, Japanese companies have adopted a maxim as old as human conflict itself: My enemy's enemy is my friend.

Hijacking the development efforts of potential rivals is another goal of competitive collaboration. In the consumer electronics war, Japanese competitors attacked traditional businesses like TVs and hi-fis while volunteering to manufacture next generation products like VCRs, camcorders, and CD players for Western rivals. They hoped their rivals would ratchet down development spending, and, in most cases, that is precisely what happened. But companies that abandoned their own development efforts seldom reemerged as serious competitors in subsequent new product battles.

Collaboration can also be used to calibrate competitors' strengths and weaknesses. Toyota's joint venture with GM, and Mazda's with Ford, give these automakers an invaluable vantage point for assessing the progress their U.S. rivals have made in cost reduction, quality, and technology. They can also learn how GM and Ford compete—when they will fight and when they won't. Of course, the reverse is also true: Ford and GM have an equal opportunity to learn from their partner-competitors.

The route to competitive revitalization we have been mapping implies a new view of strategy. Strategic intent assures consistency in resource allocation over the long term. Clearly articulated corporate challenges focus the efforts of individuals in the medium term. Finally, competitive innovation helps reduce competitive risk in the short term. This consistency in the long term, focus in the medium term, and inventiveness and involvement in the short term provide the key to leveraging limited resources in pursuit of ambitious goals. But just as there is a process of winning, so there is a process of surrender. Revitalization requires understanding that process, too.

Given their technological leadership and access to large regional markets, how did U.S. and European countries lose their apparent birthright to dominate global industries? There is no simple answer. Few companies recognize the value of documenting failure. Fewer still search their own managerial orthodoxies for the seeds of competitive surrender. But we believe there is a pathology of surrender that gives some important clues. (See the sidebar "The Process of Surrender.")

The Process of Surrender

On the battles for global leadership that have taken place during the past two decades, we have seen a pattern of competitive attack and retrenchment that was remarkably similar across industries. We call this the process of surrender.

The process started with unseen intent. Not possessing long-term, competitor-focused goals themselves, Western companies did not ascribe such intentions to their rivals. They also calculated the threat posed by potential competitors in terms of their existing resources rather than their resourcefulness. This led to systematic underestimation of smaller rivals who were fast gaining technology through licensing arrangements, acquiring market understanding from downstream OEM partners, and improving product quality and manufacturing productivity through company-wide employee involvement programs. Oblivious of the strategic intent and intangible advantages of their rivals, American and European businesses were caught off guard.

Adding to the competitive surprise was the fact that the new entrants typically attacked the periphery of a market (Honda in small motorcycles, Yamaha in grand pianos, Toshiba in small black-and-white televisions) before going head-to-head with incumbents. Incumbents often misread these attacks, seeing them as part of a niche strategy and not as a search for "loose bricks." Unconventional market entry strategies (minority holdings in less-developed countries, use of nontraditional channels, extensive corporate advertising) were ignored or dismissed as quirky. For example, managers we spoke with said Japanese companies' position in the European computer industry was nonexistent. In terms of brand share that's nearly true, but the Japanese control as much as one-third of the manufacturing value added in the hardware sales of European-based computer businesses. Similarly, German auto producers claimed to feel unconcerned over the proclivity of Japanese producers to move upmarket. But with its low-end models under tremendous pressure from Japanese producers, Porsche has now announced that it will no longer make "entry level" cars.

Western managers often misinterpreted their rivals' tactics. They believed that Japanese and Korean companies were competing solely on the basis of cost and quality. This typically produced a partial response to those competitors' initiatives: moving manufacturing offshore, outsourcing, or instituting a quality program. Seldom was the full extent of the competitive threat appreciated—the multiple layers of advantage, the expansion across related product segments, the development of global brand positions. Imitating the currently visible tactics of rivals put Western businesses into a perpetual catch-up trap. One by one, companies lost battles and came to see surrender as inevitable. Surrender was not inevitable, of course, but the attack was staged in a way that disguised ultimate intentions and sidestepped direct confrontation.

It is not very comforting to think that the essence of Western strategic thought can be reduced to eight rules for excellence, seven S's, five competitive forces, four product life-cycle stages, three generic strategies, and innumerable two-by-two matrices.[4] Yet for the past 20 years, "advances" in strategy have taken the form of ever more typologies, heuristics, and laundry lists, often with dubious empirical bases. Moreover, even reasonable concepts like the product life cycle, experience curve, product portfolios, and generic strategies often have toxic side effects: They reduce the number of strategic options management is willing to consider. They create a preference for selling businesses rather than defending them. They yield predictable strategies that rivals easily decode.

Strategy recipes limit opportunities for competitive innovation. A company may have 40 businesses and only four strategies—invest, hold, harvest, or divest. Too often, strategy is seen as a positioning exercise in which options are tested by how they fit the existing industry structure. But current industry structure reflects the strengths of the industry leader, and playing by the leader's rules is usually competitive suicide.

Armed with concepts like segmentation, the value chain, competitor benchmarking, strategic groups, and mobility barriers, many managers have become better and better at drawing industry maps. But while they have been busy mapmaking, their competitors have been moving entire continents. The strategist's goal is not to find a niche within the existing industry space but to create new space that is uniquely suited to the company's own strengths—space that is off the map.

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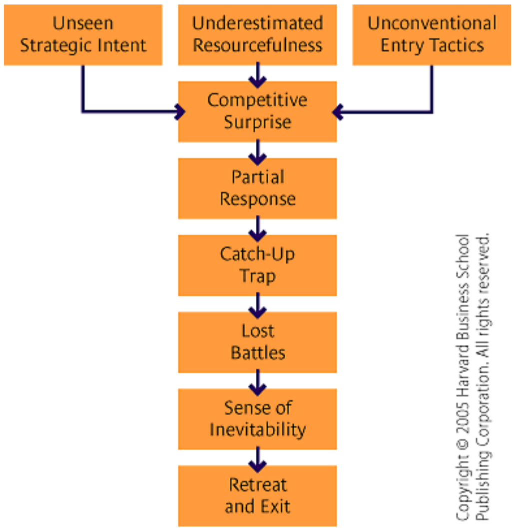
This is particularly true now that industry boundaries are becoming more and more unstable. In industries such as financial services and communications, rapidly changing technology, deregulation, and globalization have undermined the value of traditional industry analysis. Mapmaking skills are worth little in the epicenter of an earthquake. But an industry in upheaval presents opportunities for ambitious companies to redraw the map in their favor, so long as they can think outside traditional industry boundaries.



Concepts like "mature" and "declining" are largely definitional. What most executives mean when they label a business "mature" is that sales growth has stagnated in their current geographic markets for existing products sold through existing channels. In such cases, it's not the industry that is mature, but the executives' conception of the industry. Asked if the piano business was mature, a senior executive at Yamaha replied, "Only if we can't take any market share from anybody anywhere in the world and still make money. And anyway, we're not in the 'piano' business, we're in the 'keyboard' business." Year after year, Sony has revitalized its radio and tape recorder businesses, despite the fact that other manufacturers long ago abandoned these businesses as mature.

A narrow concept of maturity can foreclose a company from a broad stream of future opportunities. In the 1970s, several U.S. companies thought that consumer electronics had become a mature industry. What could possibly top the color TV? they asked themselves. RCA and GE, distracted by opportunities in more "attractive" industries like mainframe computers, left Japanese producers with a virtual monopoly in VCRs, camcorders, and CD players. Ironically, the TV business, once thought mature, is on the verge of a dramatic renaissance. A $20 billion-a-year business will be created when high-definition television is launched in the United States. But the pioneers of television may capture only a small part of this bonanza.

Most of the tools of strategic analysis are focused domestically. Few force managers to consider global opportunities and threats. For example, portfolio planning portrays top management's investment options as an array of businesses rather than as an array of geographic markets. The result is predictable: As businesses come under attack from foreign competitors, the company attempts to abandon them and enter other areas in which the forces of global competition are not yet so strong. In the short term, this may be an appropriate response to waning competitiveness, but there are fewer and fewer businesses in which a domestic-oriented company can find refuge. We seldom hear such companies asking, Can we move into emerging markets overseas ahead of our global rivals and prolong the profitability of this business? Can we counterattack in our global competitors' home market and slow the pace of their expansion? A senior executive in one successful global company made a telling comment: "We're glad to find a competitor managing by the portfolio concept—we can almost predict how much share we'll have to take away to put the business on the CEO's 'sell list.' "

Companies can also be overcommitted to organizational recipes, such as strategic business units (SBUs) and the decentralization an SBU structure implies. Decentralization is seductive because it places the responsibility for success or failure squarely on the shoulders of line managers. Each business is assumed to have all the resources it needs to execute its strategies successfully, and in this no-excuses environment, it is hard for top management to fail. But desirable as clear lines of responsibility and accountability are, competitive revitalization requires positive value added from top management.

Few companies with a strong SBU orientation have built successful global distribution and brand positions. Investments in a global brand franchise typically transcend the resources and risk propensity of a single business. While some Western companies have had global brand positions for 30 or 40 years or more (Heinz, Siemens, IBM, Ford, and Kodak, for example), it is hard to identify any American or European company that has created a new global brand franchise in the past ten to 15 years. Yet Japanese companies have created a score or more—NEC, Fujitsu, Panasonic (Matsushita), Toshiba, Sony, Seiko, Epson, Canon, Minolta, and Honda among them.

General Electric's situation is typical. In many of its businesses, this American giant has been almost unknown in Europe and Asia. GE made no coordinated effort to build a global corporate franchise. Any GE business with international ambitions had to bear the burden of establishing its credibility and credentials in the new market alone. Not surprisingly, some once-strong GE businesses opted out of the difficult task of building a global brand position. By contrast, smaller Korean companies like Samsung, Daewoo, and Lucky-Goldstar are busy building global-brand umbrellas that will ease market entry for a whole range of businesses. The underlying principle is simple: Economies of scope may be as important as economies of scale in entering global markets. But capturing economies of scope demands interbusiness coordination that only top management can provide.

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We believe that inflexible SBU-type organizations have also contributed to the de-skilling of some companies. For a single SBU, incapable of sustaining an investment in a core competence such as semiconductors, optical media, or combustion engines, the only way to remain competitive is to purchase key components from potential (often Japanese or Korean) competitors. For an SBU defined in product market terms, competitiveness means offering an end product that is competitive in price and performance. But that gives an SBU manager little incentive to distinguish between external sourcing that achieves "product embodied" competitiveness and internal development that yields deeply embedded organizational competencies that can be exploited across multiple businesses. Where upstream component-manufacturing activities are seen as cost centers with cost-plus transfer pricing, additional investment in the core activity may seem a less profitable use of capital than investment in downstream activities. To make matters worse, internal accounting data may not reflect the competitive value of retaining control over a core competence.

Together, a shared global corporate brand franchise and a shared core competence act as mortar in many Japanese companies. Lacking this mortar, a company's businesses are truly loose bricks—easily knocked out by global competitors that steadily invest in core competences. Such competitors can co-opt domestically oriented companies into long-term sourcing dependence and capture the economies of scope of global brand investment through interbusiness coordination.

Last in decentralization's list of dangers is the standard of managerial performance typically used in SBU organizations. In many companies, business unit managers are rewarded solely on the basis of their performance against return on investment targets. Unfortunately, that often leads to denominator management because executives soon discover that reductions in investment and head count—the denominator—"improve" the financial ratios by which they are measured more easily than growth in the numerator: revenues. It also fosters a hair-trigger sensitivity to industry downturns that can be very costly. Managers who are quick to reduce investment and dismiss workers find it takes much longer to regain lost skills and catch up on investment when the industry turns upward again. As a result, they lose market share in every business cycle. Particularly in industries where there is fierce competition for the best people and where competitors invest relentlessly, denominator management creates a retrenchment ratchet.

The concept of the general manager as a movable peg reinforces the problem of denominator management. Business schools are guilty here because they have perpetuated the notion that a manager with net present value calculations in one hand and portfolio planning in the other can manage any business anywhere.

In many diversified companies, top management evaluates line managers on numbers alone because no other basis for dialogue exists. Managers move so many times as part of their "career development" that they often do not understand the nuances of the businesses they are managing. At GE, for example, one fast-track manager heading an important new venture had moved across five businesses in five years. His series of quick successes finally came to an end when he confronted a Japanese competitor whose managers had been plodding along in the same business for more than a decade.

Regardless of ability and effort, fast-track managers are unlikely to develop the deep business knowledge they need to discuss technology options, competitors' strategies, and global opportunities substantively. Invariably, therefore, discussions gravitate to "the numbers," while the value added of managers is limited to the financial and planning savvy they carry from job to job. Knowledge of the company's internal planning and accounting systems substitutes for substantive knowledge of the business, making competitive innovation unlikely.

When managers know that their assignments have a two- to three-year time frame, they feel great pressure to create a good track record fast. This pressure often takes one of two forms. Either the manager does not commit to goals whose time line extends beyond his or her expected tenure. Or ambitious goals are adopted and squeezed into an unrealistically short time frame. Aiming to be number one in a business is the essence of strategic intent; but imposing a three- to four-year horizon on the effort simply invites disaster. Acquisitions are made with little attention to the problems of integration. The organization becomes overloaded with initiatives. Collaborative ventures are formed without adequate attention to competitive consequences.

Almost every strategic management theory and nearly every corporate planning system is premised on a strategy hierarchy in which corporate goals guide business unit strategies and business unit strategies guide functional tactics.[5] In this hierarchy, senior management makes strategy and lower levels execute it. The dichotomy between formulation and implementation is familiar and widely accepted. But the strategy hierarchy undermines competitiveness by fostering an elitist view of management that tends to disenfranchise most of the organization. Employees fail to identify with corporate goals or involve themselves deeply in the work of becoming more competitive.

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The strategy hierarchy isn't the only explanation for an elitist view of management, of course. The myths that grow up around successful top managers —"Lee Iacocca saved Chrysler," "Carlo De Benedetti rescued Olivetti," "John Sculley turned Apple around"—perpetuate it. So does the turbulent business environment. Middle managers buffeted by circumstances that seem to be beyond their control desperately want to believe that top management has all the answers. And top management, in turn, hesitates to admit it does not for fear of demoralizing lower-level employees.

The result of all this is often a code of silence in which the full extent of a company's competitiveness problem is not widely shared. We interviewed business unit managers in one company, for example, who were extremely anxious because top management wasn't talking openly about the competitive challenges the company faced. They assumed the lack of communication indicated a lack of awareness on their senior managers' part. But when asked whether they were open with their own employees, these same managers replied that while they could face up to the problems, the people below them could not. Indeed, the only time the workforce heard about the company's competitiveness problems was during wage negotiations when problems were used to extract concessions.

Unfortunately, a threat that everyone perceives but no one talks about creates more anxiety than a threat that has been clearly identified and made the focal point for the problem-solving efforts of the entire company. That is one reason honesty and humility on the part of top management may be the first prerequisite of revitalization. Another reason is the need to make "participation" more than a buzzword.

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Programs such as quality circles and total customer service often fall short of expectations because management does not recognize that successful implementation requires more than administrative structures. Difficulties in embedding new capabilities are typically put down to "communication" problems, with the unstated assumption that if only downward communication were more effective—"if only middle management would get the message straight"—the new program would quickly take root. The need for upward communication is often ignored, or assumed to mean nothing more than feedback. In contrast, Japanese companies win not because they have smarter managers but because they have developed ways to harness the "wisdom of the anthill." They realize that top managers are a bit like the astronauts who circle the Earth in the space shuttle. It may be the astronauts who get all the glory, but everyone knows that the real intelligence behind the mission is located firmly on the ground.

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Where strategy formulation is an elitist activity, it is also difficult to produce truly creative strategies. For one thing, there are not enough heads and points of view in divisional or corporate planning departments to challenge conventional wisdom. For another, creative strategies seldom emerge from the annual planning ritual. The starting point for next year's strategy is almost always this year's strategy. Improvements are incremental. The company sticks to the segments and territories it knows, even though the real opportunities may be elsewhere. The impetus for Canon's pioneering entry into the personal copier business came from an overseas sales subsidiary—not from planners in Japan.

The goal of the strategy hierarchy remains valid—to ensure consistency up and down the organization. But this consistency is better derived from a clearly articulated strategic intent than from inflexibly applied top-down plans. In the 1990s, the challenge will be to enfranchise employees to invent the means to accomplish ambitious ends.

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We seldom found cautious administrators among the top managements of companies that came from behind to challenge incumbents for global leadership. But in studying organizations that had surrendered, we invariably found senior managers who, for whatever reason, lacked the courage to commit their companies to heroic goals—goals that lay beyond the reach of planning and existing resources. The conservative goals they set failed to generate pressure and enthusiasm for competitive innovation or give the organization much useful guidance. Financial targets and vague mission statements just cannot provide the consistent direction that is a prerequisite for winning a global competitive war.

This kind of conservatism is usually blamed on the financial markets. But we believe that in most cases, investors' so-called short-term orientation simply reflects a lack of confidence in the ability of senior managers to conceive and deliver stretch goals. The chairman of one company complained bitterly that even after improving return on capital employed to over 40% (by ruthlessly divesting lackluster businesses and downsizing others), the stock market held the company to an 8:1 price/earnings ratio. Of course, the market's message was clear: "We don't trust you. You've shown no ability to achieve profitable growth. Just cut out the slack, manage the denominators, and perhaps you'll be taken over by a company that can use your resources more creatively." Very little in the track record of most large Western companies warrants the confidence of the stock market. Investors aren't hopelessly short-term, they're justifiably skeptical.

We believe that top management's caution reflects a lack of confidence in its own ability to involve the entire organization in revitalization, as opposed to simply raising financial targets. Developing faith in the organization's ability to deliver on tough goals, motivating it to do so, focusing its attention long enough to internalize new capabilities—this is the real challenge for top management. Only by rising to this challenge will senior managers gain the courage they need to commit themselves and their companies to global leadership.

1. Among the first to apply the concept of strategy to management were H. Igor Ansoff in *Corporate Strategy: An Analytic Approach to Business Policy for Growth and Expansion* (McGraw-Hill, 1965) and Kenneth R. Andrews in *The Concept of Corporate Strategy* (Dow Jones-Irwin, 1971).

2. Robert A. Burgelman, "A Process Model of Internal Corporate Venturing in the Diversified Major Firm," *Administrative Science Quarterly,* June 1983.

3. For example, see Michael E. Porter, *Competitive Strategy* (Free Press, 1980).

4. Strategic frameworks for resource allocation in diversified companies are summarized in Charles W. Hofer and Dan E. Schendel, *Strategy Formulation: Analytical Concepts* (West Publishing, 1978).

5. For example, see Peter Lorange and Richard F. Vancil, *Strategic Planning Systems* (Prentice-Hall, 1977).

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