

## **KILLER STRATEGIES THAT MAKE SHAREHOLDERS RICH THE TOP COMPANIES THRIVE, SAYS OUR AUTHOR--A LEADING STRATEGY GURU--BY CHANGING THE RULES OF THE GAME.**

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(FORTUNE Magazine) – Ask Nike CEO Phil Knight what he likes to do best, and he doesn't hesitate a beat--he likes to break things. Back in the 1960s, he turned the sleepy footwear industry upside down by betting that joggers would be willing to pay a premium for high-quality running shoes. Then, in the 1980s, he transformed his successful athletic shoe company into a marketing machine, saturating the airwaves with radical commercials that emphasized emotion rather than the product. Now, with the traditional sneaker market getting tougher, he's turning Nike into a sports behemoth that manages events like golf tournaments while it peddles both equipment and apparel.

Nike's stock has been on a roller coaster lately. But over the years, Knight's iconoclastic behavior has paid off for shareholders. Since 1986, Nike stock has posted 47% average annual gains. With returns like that, Knight is part of the most exclusive club in corporate America. Between 1986 and 1996, just 17 companies of the FORTUNE 1,000 grew total shareholder return by 35% or more per year. Their secret? When you dig into the workings of these wealth creators, you find that most managed to grow their return rates by radically changing the basis of competition in their industries. They either invented totally new industries or completely reinvented existing industries.

This is true not only for Nike but for Home Depot, Amgen, Intel, Compaq, Harley-Davidson, Champion Enterprises, and nearly all the others on our superstar list (see table). For instance, back in the 1980s, Harley-Davidson CEO Richard Teerlink had the notion that he was running far more than just a motorcycle company; he turned his operation into a business that sells American nostalgia--and it worked. Amgen's Gordon Binder broke all the rules of the biotech industry by focusing his genetic research not on customers but on the best science money could buy. The result: a 68% average annual total return over the past ten years, the best performance of all FORTUNE 1,000 companies.

Even companies like Coca-Cola and GE, which look like they are winning by execution alone, are also changing the rules in subtle ways. For instance, Coke has dramatically reconfigured its global bottling operation to give the company substantially more distribution and marketing oomph: Over 30% of Coke's global business is now in the hands of nine key bottlers in which the company has an equity stake.

Taking risks, breaking the rules, and being a maverick have always been important, but today they are more crucial than ever. We live in a discontinuous world--one where digitalization, deregulation, and globalization are profoundly reshaping the industrial landscape. What we see is a dramatic proliferation of new economic life forms: virtual organizations, global consortia, Net-based commerce, ad infinitum. Inevitably, the economic sea change now under way will drive an extraordinary amount of wealth creation over the next few decades--just as the move from the agrarian economy to the industrial economy generated enormous new wealth around the last turn

of the century. But just who will capture the new wealth? On the road to the future, who will be the windshield, and who will be the bug?

Unless today's established corporations learn to reinvent themselves and their industries, much of the new wealth will be created by newcomers. Today's CEOs are instinctively aware of this hard truth. In an MCI/Gallup survey of 550 U.S. CEOs, 38% said that industry newcomers--not traditional competitors--had taken the best advantage of change over the past ten years. When asked how the newcomers had succeeded, fully 62% of those polled said they had profoundly changed the rules of the game. Only 31% thought the newcomers had won through better execution. Finally, most of the corporate leaders surveyed thought that in ten years' time the toughest competitors they would face would be newcomers rather than the same old same old. This suggests that corporate leaders are painfully aware that incumbency ain't what it used to be.

While most of today's leaders know they must change the rules of the game, few understand how to create a revolution in their own companies. Assuming Phil Knight can't be hired away from Nike, the only alternative is to unleash the spirit of strategy innovation. I define strategy innovation as the ability to reinvent the basis of competition within existing industries and to invent entirely new industries. It will be the next fundamental competitive advantage for companies around the world. In an increasingly nonlinear world, only nonlinear strategies will create substantial new wealth.

And more companies are proving the point all the time. Who has been creating new wealth in the American grocery business? Though companies like Procter & Gamble, Kroger, and other traditional leaders have created a lot of new value in the past decade, industry revolutionaries like Boston Market, Starbucks Coffee, Trader Joe's, Petco, ConAgra, and Wal-Mart have created even more. While the old guard in the grocery industry has been focusing efforts on rationalizing the supply chain and turning out thousands of almost trivial product-line extensions, the vanguard has been creating entirely new product categories and retailing concepts. Starbucks, for instance, took a sleepy supermarket commodity--coffee--and began selling it in infinite varieties in trendy stores, thereby establishing a whole new market.

Who is going to create the new wealth in the auto industry? Unless they develop new strategies, it probably won't be GM, Ford, Nissan, Chrysler, or their traditional dealers but instead the new megadealers such as CarMax, Auto-By-Tel, AutoNation USA, and Driver's Mart--companies that are reinventing the retailing and distribution of the auto industry from the customer backward. With AutoNation USA, for instance, CEO Wayne Huizenga hopes to do for autos what McDonald's did for hamburgers: consolidate the industry by creating a national brand.

Take another example. Between April 1995 and April 1996, the capitalization of Internet-related companies rose from near zero to almost \$10 billion. Yahoo and Netscape are just two of the new Net-exploiting value generators. True, it's not clear whether companies like these will continue to thrive in this volatile industry. But it seems unlikely that much of this new Internet-related value will be captured by traditional computer industry players like Unisys, Computer Sciences Corp., or Fujitsu.

Let me throw out a proposition: We have reached the end of incrementalism in the quest to create new wealth. Quality, cost, time-to-market, process improvement--these are important, but we are hitting the point of diminishing returns. Ford may be able to take another hour or two out of vehicle assembly time--its Japanese competitors may force it to do so. But if new companies totally reinvent the retailing and service of new and used automobiles, Ford's incremental

improvements won't count for much. Neither will share buybacks, demergers, process reengineering, or downsizing lead to new wealth creation. At best, they simply keep profits from eroding. They may prolong the lives of geriatric strategies and anachronistic companies, but they won't create new business, new revenue streams, and new wealth.

**Now here's the conundrum:** If an innovative strategy drives wealth creation, then why isn't the pursuit of such a strategy front and center in most organizations today? In the MCI/Gallup poll, for instance, a majority of CEOs said that the strategies of their major competitors had become more alike over the past few years rather than more dissimilar. With the strategies of market leaders converging in many industries, it's no wonder many companies are feeling the heat of "hypercompetition." While speed and agility are central to corporate success, they're not enough. To escape, even temporarily, this kind of trench warfare, you need to break the rules of your industry, and that isn't easy. It takes leaders who question conventional wisdom:

**Myth:** Industry analysis is key to strategy. The rule breakers know that it is now increasingly difficult to define precisely where an industry begins and ends. This is certainly true for financial services, telecommunications, health care, and a variety of other industries. The question, "What industry are you in?" is becoming harder and harder to answer.

**Myth:** You should focus on your direct competitors. In the past it was relatively easy to tell who was a competitor and who was not. Today it is harder to distinguish competitors from collaborators from suppliers from buyers. The rule breakers understand that rivalry ain't as simple as it used to be. For many companies, it's getting harder and harder to tell the good guys from the bad guys.

**Myth:** In strategy, it's you against the world. Most managers think they can pretty much control the direction of their business. Yet today's smart leaders understand it is difficult to know just where the boundaries of the firm begin and end--temporary workers, outsourcing, and long-term supply relationships are now the norm. A firm may "own" only a small portion of the relevant value chain. The sort of radical strategy that leads to true innovation becomes substantially more complex in a world where the firm doesn't directly control many of the assets critical to its success.

Knowing that today's world works differently is important but not sufficient. You actually have to know how to create unconventional wealth strategies in your company. Surprisingly, the strategy industry--all those consultants, gurus, and planners--doesn't know how. Of course, everyone knows a strategy once they see one--be it Microsoft's, Nucor's, or Virgin Atlantic's. Anyone can recognize a great strategy after the fact. We also understand planning as a "process." The only problem is that process doesn't produce strategy--it produces plans. The dirty little secret of the strategy industry is that it doesn't have any theory of strategy creation. Whenever we come across a brilliantly successful strategy, we are all inclined to ask, "Was it luck, or was it foresight? Did these guys have this thing all figured out, or did they just stumble into success?"

A key thing to remember is that truly innovative strategies are always, and I mean always, the result of lucky foresight. Foresight, however, doesn't emerge in a sterile vacuum; it emerges in the fertile loam of experience, coincident trends, unexpected conversations, random musings, career detours, and unfulfilled aspirations. But the question remains, can we do anything to increase the fertility of the soil out of which strategy grows? Can we make serendipity happen? Or at least encourage it? I think so.

One good place to start is to develop a deep theory of strategy creation. It's clear that strategizing isn't a "thing," and neither is it a process. Instead, it must be a deeply embedded capability--a way of understanding what's really going on in your industry, turning it on its head, and then envisioning the new opportunities that fall out.

Strategizing is not a once-a-year rain dance, nor is it a once-a-decade consulting project. Strategizing must be a skill as deeply embedded as total quality, cycle-time reduction, or customer service. Just as business processes can be reinvented in ways big and small, so too can business models. This is how new wealth gets created.

**Here are five ways organizations can radically rethink their missions:**

**New voices.** Companies miss the future not because they are fat or lazy but because they are blind. That blindness is a genetic blindness. Land is a mystery to fish--fish are not genetically equipped to understand land. And by the time fish learn about land it is often too late. Many companies are genetically unequipped to see where the future is coming from. A lack of genetic diversity makes it difficult for companies to first encompass and then exploit the various trends and discontinuities that could be leveraged to create new wealth.

New voices, i.e., new genetic material, must be brought into the strategy process. Diversity was a requirement for the development of life; so too is it a requirement for the emergence of new strategy. A journalist recently asked me if I thought IBM had a chance of leading the next stage of the information revolution, as it had led at an earlier stage. I said that to render such a judgment, I would need to know how many of IBM's top 100 executives had grown up on the West Coast of America--where the future of the computer industry is being created--and how many of them were, at the present time, under 40 years of age. If a quarter, or a third, of the senior group were under 40 and possessed of a West Coast perspective on the information industry, then there was certainly hope for IBM. But the point was clear: IBM will need new voices contributing to its strategy if it is to reclaim intellectual leadership in the info biz. To IBM's credit, it has substantially diversified the ranks of top management over the past few years. It is a far more genetically diverse place than it was five years ago.

**New conversations.** Strategy depends not only on a diversity of voices but on the connections between those voices as well. For strategy to emerge, we need new conversations--conversations that cross the boundaries of function, technology, hierarchy, business, and geography. One thing is certain: If for five or six years in a row the same ten or 15 people in a company have the same conversations about strategy in the same way, new insights will be unlikely to emerge. Strategizing depends on creating a rich and complex web of conversations that cut across previously isolated pockets of knowledge and create new and unexpected combinations of insight.

Not all talking and listening amounts to deep conversation. For a meaningful conversation to occur, the participants must create some common context--they must, to a degree, "invade each other's worlds." This takes time. Conversations cannot be hurried. Conversations cannot be tightly scripted. They certainly cannot be shoehorned into the typical planning process or a two-day strategy "retreat" at a posh hotel.

We often lament the fact that it takes so long for a new strategy to rise through the layers of a bureaucratic organization to the level of management where resources can be allocated. At one time or another, many companies have set up orphanages for such ideas--typically labeled "new

venture divisions." But imagine a strategy process where you put senior management (the people who hold all the resources) directly alongside the folks who have typically been disenfranchised from the strategy process--young people stationed out in the field and newcomers. The challenge is to get engaged in deep and meaningful conversations about opportunity and destiny. There's no reason a new and innovative strategy idea should take two years to fight its way up through the ranks of stodgy, uncomprehending managers. The route from insight to commitment doesn't have to be as painful and fraught as it is in most companies.

**New perspectives.** One can't raise an individual's IQ, but it is possible to help someone see the world in new ways. If you ever took an economics course, you probably didn't enjoy it at first. But one day something clicked, and you began to see the world through a new lens. Suddenly you understood how interest rates get determined, how supply and demand work to set prices, and what things influence exchange rates. You became enlightened.

Great strategy requires new ways of seeing. Redefining what a company does best constitutes a new way of seeing. Also, looking at your products or services differently can help. For example, Oracle hopes to create an entirely new business around PCs. How? By looking at the personal computer and then figuring out how to separate form from function. As a consumer, you don't want a PC; you want an information utility (just like you want an electric utility). Oracle's goal is to deliver this information utility in a form quite different from today's PC; the company is working on software for a simple \$500 device that will handle most people's information needs.

But it is not only a new lens that can provide enlightenment, so too can a new vantage point. Sometimes a company simply cannot see the future from where it is standing. For example, Nokia, a Finnish company that makes cellular phones and is based at the edge of the Arctic, may be ill-positioned to track lifestyle trends on the other side of the planet--trends that could ultimately redefine its industry. One possible solution--send Finnish engineers to Venice Beach in California, down Kings Road in London, or to other places on the planet where new lifestyle trends get set. Immerse those engineers in the new cultural milieu; change their experience base. Mining the world for ideas has helped Nokia invent new approaches. One example: Nokia engineers devised the idea of colorful--bright red, yellow, and blue--phones, which opened a whole new market for the company.

Opportunities for innovative strategy don't emerge from sterile analysis and number crunching--they emerge from novel experiences that can create opportunities for novel insights. As the songwriter Jimmy Buffet succinctly put it, "Changes in latitudes, changes in attitudes." Of course, one produces a shift perspective not only by moving people into different geographical settings but by moving them into different industry settings as well. For example, Enron, widely regarded as one of the world's most innovative energy companies, is reconceiving the energy business from the vantage point of the financial industry (see the interview that follows). Enron's financial whiz kids have built sophisticated computer-based tools that enable the company to exploit arbitrage opportunities in energy markets and help customers manage the financial risks associated with buying and selling various forms of energy. Houston meets Wall Street.

**New passions.** We've too often ignored the emotional side of strategy. If strategy is partly about collective purpose and a sense of shared destiny, don't we need to recognize this explicitly in the way we go about creating strategy? For example, has anyone out there looked explicitly at the issue of commitment? I don't mean the commitment of financial resources by senior executives, but the emotional commitment of individuals at the bottom of the organization who are being asked to devote their lives to carrying out a new strategy.

The question is, Can one accelerate the time it takes to get employees committed to a new strategy, and thereby reduce the time between idea and action? I believe that one way of raising commitment is to get individuals throughout the organization deeply involved in the process of creating strategy. Individuals, I would argue, should have a say in determining the destiny of the organizations to which they devote their efforts.

Of course, the concern of top management is that involving so many people will prove chaotic. But most individuals have a deep need for order. When a CEO gets more people to participate in making strategy, things may seem crazy at first, but at some point the natural tendency for order takes over, and individuals begin to work mightily to bring order out of chaos. There is an inflection point where the quest for divergence is transformed into a quest for convergence, and a new collective point of view emerges--but one that is typically much richer, more complex, and more sophisticated than the original orthodoxy about the firm's "strategy." It is possible to get thousands of people passionately involved with an idea like quality and yet still maintain coherence--why can't the same be accomplished with strategy?

I believe that inside almost every individual is a deep passion for discovery and novelty. We try new restaurants, take vacations in new places, and search out new experiences of all kinds. I always find it amazing to see the passions that are unleashed when an organization goes to its members and invites them to participate in charting their collective destiny. We must give employees an emotional stake in the future. I can assure you that it is possible to wrap meaning and purpose around even prosaic products. Listen to David Pottruck, COO of Charles Schwab: "Our employees see themselves as the custodians of our customers' financial dreams." Wow! When was the last time your local bank teller had such a thought? So to all you strategists and corporate leaders eager to create value--get a soul!

**Experimentation.** Passion and foresight will only get you so far. When it comes to executing a strategy, the end target may be clearly visible--"I want to climb that mountain over there"--but much of the route may be invisible from the starting point. The only way you're going to see the path ahead is to start moving. Thus strategy is as much about experimentation as it is about foresight and passion.

In many organizations, the quest for efficiency drives out experimentation. One question I often ask managers: "Can you point to 20 or 30 small experiments going on in your company that you believe could fundamentally remake your company?" In most cases, the answer is no, there is nothing to point to.

In the new economy, we are attempting to explore vast spaces of possibility--how genetics will remake medicine, how biotech will change the chemical industry, how interactive technology will change the very idea of a university, and so on. IBM asks the question, "How will the Internet remake industry structures?" Well, it doesn't matter how many gurus, consultants, and dollars IBM throws at this question; the answer is still going to be at least partly unclear. The breadth of experimentation must be related to the degree of unknowability that confronts the firm. IBM needs to experiment on a broad front.

Kent Foster, president of GTE, puts the problem of unknowability this way: "We are talking about products that are still evolving, delivered to a market that is still emerging, via a technology that is still changing on a daily basis." This must sound familiar to any executive trying to chart a course through the chaotic frenzy that is the new economy. Clearly, experimentation is a must in this

environment. As Apple learned to its sorrow with the Newton (a hand-held computer that fizzled), chutzpah isn't a substitute for learning about your market.

The more experimentation, the faster a company can understand precisely which strategies are likely to work. The goal is not to develop "perfect" strategies, but to develop strategies that take us in the right direction, and then progressively refine them through rapid experimentation and adjustment.

So where does this leave us? Convinced, I hope, that the best way to create wealth for employees and stockholders is to renew our commitment to developing and executing innovative strategies. I believe we should spend less time working on strategy as a "thing" and more time working to understand the preconditions that give rise to the "thing." Science is closing in on the deep secrets of life. We must redouble our efforts to close in on the deep secrets of corporate vitality.

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