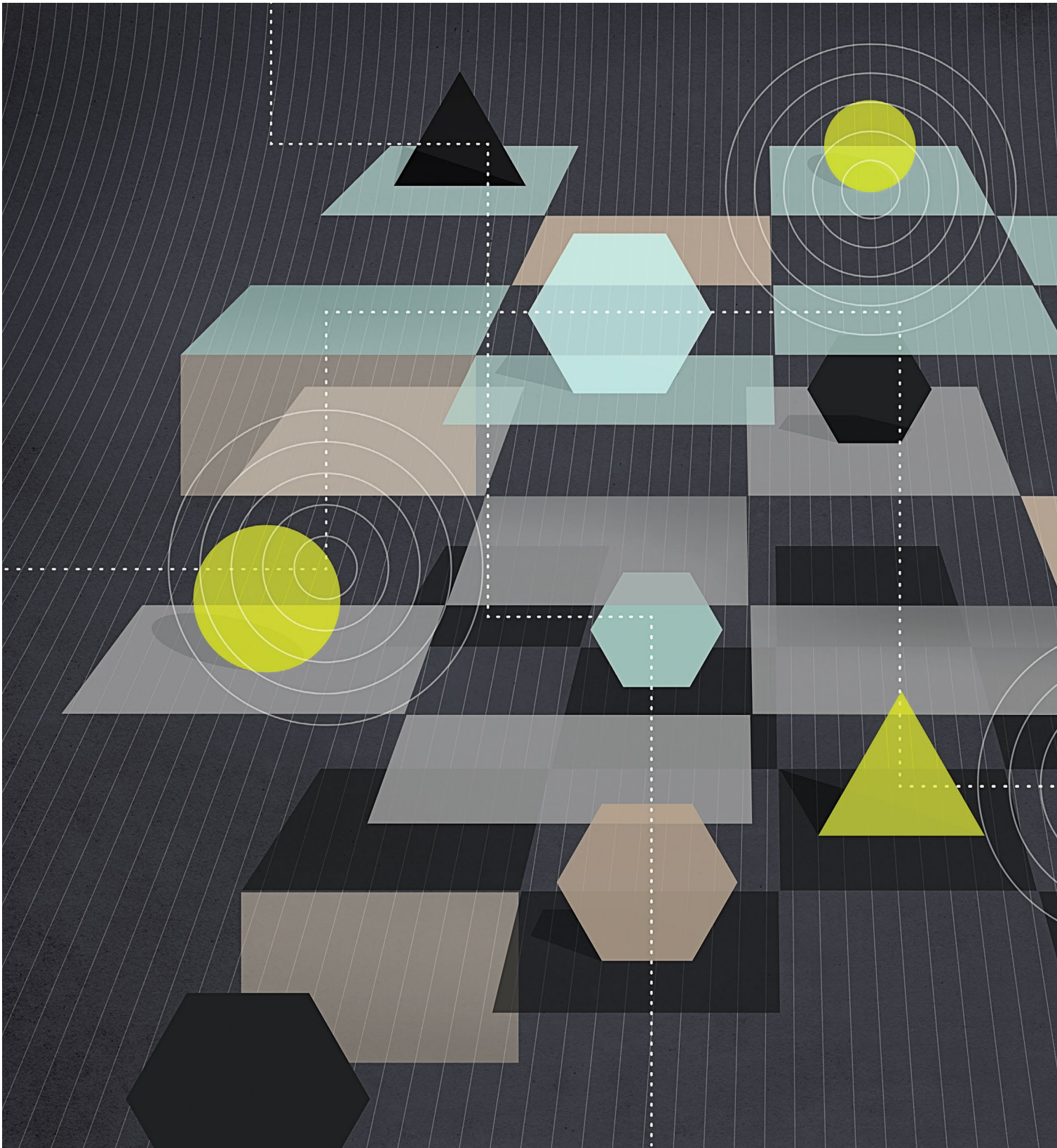


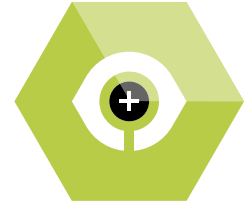


Strategy

Eliminate Strategic Overload

by Felix Oberholzer-Gee





STRATEGY



ILLUSTRATOR CHAD HAGEN

Eliminate Strategic Overload

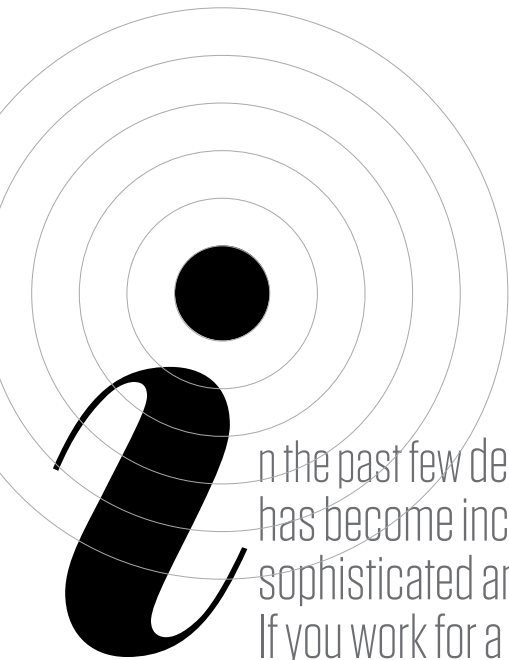
How to
select fewer
initiatives
with greater
impact

 AUTHOR

**Felix
Oberholzer-Gee**
Professor, Harvard
Business School



STRATEGY



In the past few decades, strategy has become increasingly sophisticated and complicated. If you work for a sizable organization, chances are your company has a marketing strategy (to track and shape consumer tastes), a corporate strategy (to benefit from synergies), a global strategy (to capture worldwide business opportunities), an innovation strategy (to pull ahead of the competition), a digital strategy (to exploit the internet), and a social strategy (to interact with communities online). In each of those domains, talented people work on a long list of urgent initiatives.

Companies are right, of course, to consider all these challenges. Rapid technological change, global competition, and ever-evolving consumer tastes—to name just a few of the pressures companies confront—all conspire to upend traditional ways of doing business. By responding to each of the new challenges, we ask ever more of our organizations and place ever-higher expectations on our employees. When I visit companies to do research and write cases, I am astonished by how much people accomplish in short periods of time with limited resources—but also very concerned about their long work hours and seemingly impossible stretch goals.

With alarming frequency, all these well-intentioned initiatives don't add up to corporate success. Take firm profitability as one example: A quarter of the firms in the S&P 500 earn long-term returns below their cost of capital. How can it be that so many companies, their ranks filled with talented and highly engaged employees, have so little to show for so much effort? Why do hard work and sophisticated strategy lead to enduring financial success for some companies but not for others?

I believe that strategic management faces an attractive, back-to-basics opportunity. By simplifying strategy—by selecting fewer initiatives with greater impact—we can make it more powerful. In this article, I describe an easy-to-use framework called value-based strategy, which gives executives a common language for evaluating strategic initiatives and developing a holistic view of the many activities taking place within their organizations.

The Elements of Value-Based Strategy

There's a simple principle at the heart of this approach: Companies that achieve enduring financial success create substantial value for their customers, their employees, and their suppliers. Therefore, a strategic initiative is worthwhile only if it does one of the following:

Creates value for customers by raising their willingness to pay (WTP). If companies find ways to innovate or to improve existing products, people will be willing to pay more. In many product categories, Apple gets to charge a price premium because the company raises the customers' WTP by designing beautiful products that are easy to use,



Unless an initiative creates value for customers, employees, or suppliers—unless it moves willingness to pay or willingness to sell—it's not worth doing.

for example. Gucci increases customers' WTP by creating products that confer social status. In casual conversations, we often use WTP and price interchangeably. But it is helpful to distinguish between the two. WTP is the most a customer would ever be willing to pay. Think of it as the customer's walk-away point: Charge one cent more than someone's WTP, and that person is better off not buying.

Too often, managers focus on top-line growth rather than on increasing willingness to pay. A growth-focused manager asks, "What will help me sell more?" A person concerned with WTP wants to make her customers clap and cheer. A sales-centric manager analyzes purchase decisions and hopes to sway customers, whereas a value-focused manager searches for ways to increase WTP at every stage of the customer's journey, earning the customer's trust and loyalty. A value-focused company convinces its customers in every interaction that it has their best interests at heart.

Creates value for employees by making work more appealing. When companies make work more interesting, motivating, and flexible, they are able to attract talent even if they do not offer industry-leading compensation. Paying employees more is often the right thing to do, of course. But keep in mind that more-generous compensation does not create value in and of itself; it simply shifts resources from the business to the workforce. By contrast, offering better jobs not only creates value, it also lowers the minimum compensation that you have to offer to attract talent to your business, or what we call an employee's willingness-to-sell (WTS) wage. Offer a prospective employee even a little less than her WTS, and she will reject your job offer; she is better

off staying with her current firm. As is the case with prices and WTP, value-focused organizations never confuse compensation and WTS.

Value-focused businesses think holistically about the needs of their employees (or the factors that drive WTS). When the Gap learned that one of retail workers' biggest problems was the lack of predictable and personalized schedules, it experimented with standardizing the start and end times of work shifts and scheduled employees for the same shift every day. In addition, Shift Messenger, an innovative app created specifically for the multistore experiment, allowed workers to trade shifts freely. During a 10-month test period, labor productivity went up 6.8% and sales rose nearly \$3 million in participating stores. By creating value for its workers, the Gap increased employee well-being—workers even reported better sleep quality—and the company's financial performance improved.

Creates value for suppliers by reducing their operating cost. Like employees, suppliers expect a minimum level of compensation for their product. A company creates value for its suppliers by helping them raise their productivity. As suppliers' costs go down, the lowest price they would be willing to accept for their goods—what we call their willingness-to-sell (WTS) price—falls. When Nike, for example, created a training center in Sri Lanka to teach its Asian suppliers lean manufacturing, the improved production techniques helped suppliers reap better profits, which they then shared with Nike.

Value-focused executives evaluate every strategic move, every idea that comes across their desk, through the lens of

IDEA IN BRIEF

THE PROBLEM

As companies respond to intensifying competitive pressures and challenges, they ask more and more of their employees. But organizations often have very little to show for the often Herculean efforts of their talented and engaged workers.

THE APPROACH

Leaders can address this problem by simplifying strategy—that is, selecting fewer initiatives with greater impact. A value-based strategy gives executives a holistic view of the many activities taking place within their organizations.

THE PROCESS

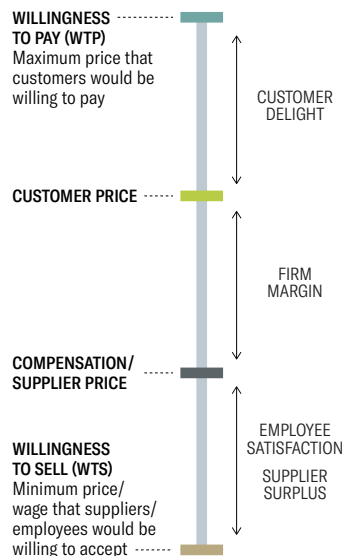
A strategic initiative is worthwhile only if it does one or more of the following: creates value for customers by raising their willingness to pay, creates value for employees by making work more attractive, or creates value for suppliers by reducing their operating cost.



Value-focused companies get to serve the very customers who like their products best, and they attract talent that values the organization's strategy and culture.

The Value Creation Opportunity

When companies find ways to increase customer delight, employee satisfaction, and supplier surplus, they expand the total amount of value they create and position themselves for extraordinary financial performance.



value creation. Unless an initiative creates value for customers, employees, or suppliers—unless it moves the needle on WTP or WTS—it's not worth doing.

This idea is captured in a simple graph, called a value stick. WTP sits at the top and WTS at the bottom. When companies find ways to increase customer delight and increase employee satisfaction and supplier surplus (the difference between the price of goods and the lowest amount the supplier would be willing to accept for them), they expand the total amount of value created and position themselves for extraordinary financial performance. (See the exhibit “The Value Creation Opportunity.”)

Value-Based Strategy in Action

The strategic insight is simple; implementing it requires discipline. In my research work with organizations that exemplify value-based strategy, I've observed some key patterns.

They focus on value, not profit. Perhaps surprisingly, value-focused managers are not overly concerned with the immediate financial consequences of their decisions.

They are confident that superior value creation will result in improved financial performance over time.

By contrast, companies obsessed with short-term returns often undermine value creation. In 1997, Excite, one of the original internet portals, declined to purchase the search technology that ultimately became Google for a paltry \$1.6 million because it was *too good*. Excite's business model depended on advertising. The longer users spent on its site, and the more often they returned, the more money the company would make. In Excite's world, it was a terrible idea to quickly send users elsewhere by providing highly relevant search results. To optimize profitability, the company thought, it was best to have a search engine that was about 80% as good as other engines. Had its executives been thinking about value for their customers rather than their own bottom line, they would have made a different—and ultimately far more profitable—decision.

They attract the employees and customers whom they serve best. As companies find ways to move WTP or WTS, they make themselves more appealing to customers and employees who particularly like how they add value. Uber has twice the share of female drivers that taxi companies have because it made the job safer, increasing satisfaction for those drivers in particular. Florida's BayCare health organization is nationally recognized for the quality of its training programs. Not surprisingly, it is an attractive employer for health care professionals who value continuing education.

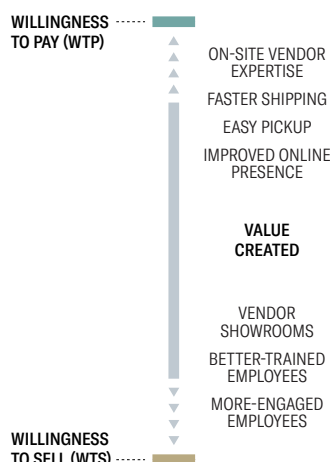
Similar dynamics play out in competition for customers. South Africa's Discovery insurance company creates value by offering an entire suite of health-improving services, including access to fitness clubs, health wearables, and even incentives to buy healthful foods in supermarkets. Predictably, individuals who are especially health conscious find Discovery's policies extra appealing.

It is an unfair advantage, really. Value-focused companies get to serve the very customers who like their products best, they attract talent that values the organization's strategy and culture, and they boost corporate performance.

They create value for customers, employees, or suppliers (or some combination) simultaneously. Traditional thinking, informed by our early understanding of success in manufacturing, holds that costs for companies will rise if they boost consumers' willingness to pay—that is, it takes

Best Buy's Value-Based Strategy

In response to increased competitive pressure from online and low-cost rivals, Best Buy transformed its physical stores from a liability to an asset. It invited suppliers to develop stores-within-the-store, raising willingness to pay and greatly increasing value for customers, vendors, and employees.



more-costly inputs to create a better product. But value-focused organizations find ways to defy that logic.

Best Buy, circa 2012, illustrates the point. Amazon was threatening the big-box giant by offering consumers a broad selection of products, aggressively priced. Walmart and other brick-and-mortar competitors were stealing market share by focusing on the most popular electronic devices and selling high volumes of them at low prices. Consumers had started to “showroom,” visiting stores to decide what they liked and then buying products elsewhere online. In response, Hubert Joly, Best Buy’s new CEO, led a far-ranging strategic and operational overhaul. Rather than thinking of Best Buy’s more than 1,000 stores as liabilities, the company turned them into assets. They invited suppliers to create stores-within-the-store as a way to draw customers in and hold on to them. Apple, Samsung, Sony, and eventually even Amazon signed on, investing hundreds of millions of dollars in Best Buy’s stores and subsidizing the company’s employees. The stores-within-a-store concept allowed Best Buy to offer deeper product and sales expertise (raising customers’ WTP) and also benefited the vendors by lowering their operating costs, thus increasing supplier surplus. In addition, the retailer started using the stores as distribution centers, which allowed it to beat Amazon on shipping times. And finally, the initiative changed how managers thought about Best Buy’s online presence. The company had long seen its website as a substitute, threatening the core business, and so it had underinvested in it. Now the company reimagined the website as a way to allow customers to explore their options before coming to a physical store—and invested in building a strong online presence. (See the exhibit “Best Buy’s Value-Based Strategy.”)

The turnaround provided Best Buy with a new lease on life. As is typical for value-focused companies, the retailer found many ways to simultaneously increase WTP and WTS.

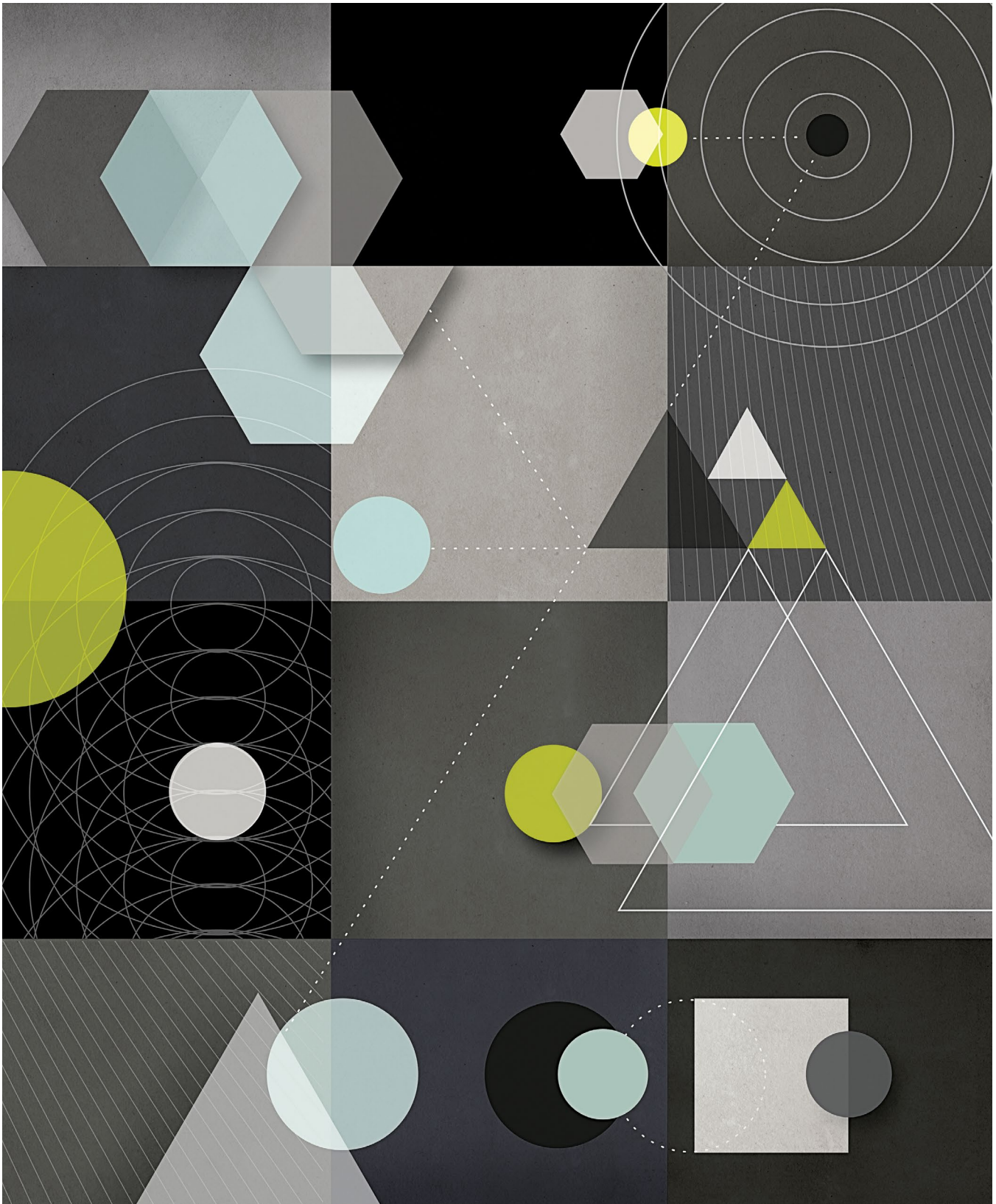


Predictably, profits followed. By 2016, Best Buy’s return on invested capital had climbed from negative territory to 23%, and its pretax margins had doubled.

Additional examples, from a variety of industries, abound. When Quest Diagnostics created more-attractive work conditions for its call center employees, attrition dropped, unplanned absences fell, and the percentage of calls answered within 60 seconds rose. In other words, employee-related costs went down (even though opportunities to make more money through exceptional performance increased) and the value created went up. Because of the improved service quality, Quest customers’ willingness to pay went up at the same time. Zara’s fast-fashion model reduces inventory (lowering suppliers’ required working capital and increasing their surplus) and provides customers with the latest trends in cuts and color (increasing their WTP). Progressive’s fleet of emergency vehicles allows the insurer to take better care of customers who have had an accident, increasing WTP, and it lowers fraud and administrative expenses, reducing costs and WTS.

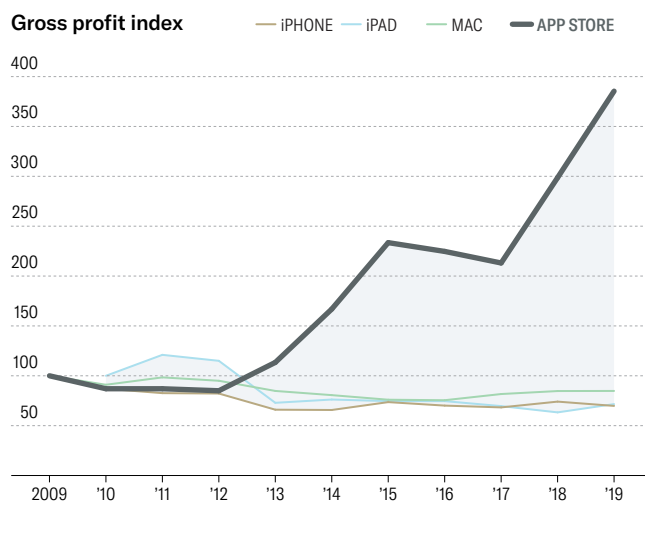
They pursue complements as a rich source of value creation. Value-based organizations are good at spotting complements, or products and services that enhance the value of their core offering. Complements are a familiar feature of the strategy landscape—think printers and cartridges, coffee machines and capsules, tablets and e-books. But at the outset, they can be difficult to identify. When I ask students what would complement a movie theater’s offering, they think of popcorn and Coke, advance ticket sales, and more-comfortable seats. They rarely suggest childcare services—but that’s what Harkins Theatres, an Arizona-based chain of movie theaters, offers its patrons. It staffs its play centers with trained professionals who look after children while their parents watch a movie, pager in hand to inform them if problems arise. As this example illustrates, complements often seem unrelated to the core business. Identifying them requires you to think creatively about customer journeys.

Even if a new offering is quite obviously a complement to an existing business, keeping a close eye on the customer’s journey can uncover new ways to use it to create customer value. Amazon beat Sony on e-readers even though it was late to the market, had no technology advantage, and



Apple's Shifting Profit Pool

As competition in hardware intensified, it became tougher for Apple to earn a higher WTP on its devices, so it shifted its profit pool to software, increasing gross margins in its app store fourfold from 2009 to 2019. (Calculating Apple's margins is tricky, but detective work by analysts Horace Dediu and Kulbinder Garcha reveals the dramatic shift.)



was working with a more limited marketing budget. How? Wireless access. The Kindle's free 3G internet access made books an impulse purchase and turned out to be of huge value to customers—and thus to Amazon.

Complements raise customers' willingness to pay for the core product, whereas substitutes have the opposite effect—so you might think that it's easy to distinguish between the two. But this is true only in hindsight. Personal computers were supposed to be a substitute for paper. (Remember the paperless office?) They turned out to be a complement: As personal computers became ubiquitous, the demand for paper exploded. ATMs were thought to eliminate bank teller positions. They didn't. Digital music formats proved to be a substitute for CDs—but a complement for live concerts. Across many examples and industries, business history reveals a clear pattern: Companies often mistake complements for substitutes. Value-focused organizations are better at spotting the true relationship between new technologies and legacy products because they are keenly aware of how customers benefit from technological changes. By contrast, companies that focus on sales growth and monetization see most advances as threats to their business models. They habitually take a defensive stance, missing important opportunities to create value in novel ways.

They shift profit pools to capture value over time. Traditionally strategists have differentiated between value creation (the topic of this article for the most part) and value capture

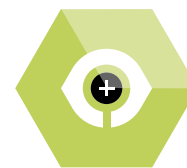
(how to make money from the value you've created). Value-focused businesses concentrate on the former, but they tend to be flexible about the latter. Because they take a broad view of customer needs, they frequently offer solutions that go beyond their core products. These product-and-service bundles enhance value capture opportunities because they allow businesses to shift their profit pools from one offering to another as the life cycle of the product—or the market overall—changes.

Apple's mobile devices are a good example. Early in its history, the iPhone was clearly differentiated from competing products and provided substantial value for its customers. Apple later created services like iTunes, but it barely monetized them. Keeping the price of complements low, the company understood, further increased the appeal of Apple hardware. More recently, however, it is harder to argue that customer WTP for Apple's devices is far higher than the WTP for competing phones. How did Apple respond to the increased competition? It shifted the profit pool from hardware to services (or apps), the segment where its competitive standing is barely contested. (See the exhibit "Apple's Shifting Profit Pool.")

Shifts in profit pools are not unique to Apple. Amazon subsidizes the Kindle to boost the WTP for e-books. Microsoft shifts profits from its game console to the games. The Indian ride-sharing company Ola created an entire suite of payment options (including Hospicash, an innovative offering that covers travel to hospitals and postdischarge expenditures) that contribute to Ola's strategic flexibility. Two patterns are noteworthy. First, businesses tend to shift profit pools away from hotly contested markets to segments where it is easier to defend high margins. Second, the financial consequences of these shifts are particularly favorable if the products are complements: As the price of one product declines, WTP (and value capture opportunities) for the complement increases.

Getting Started

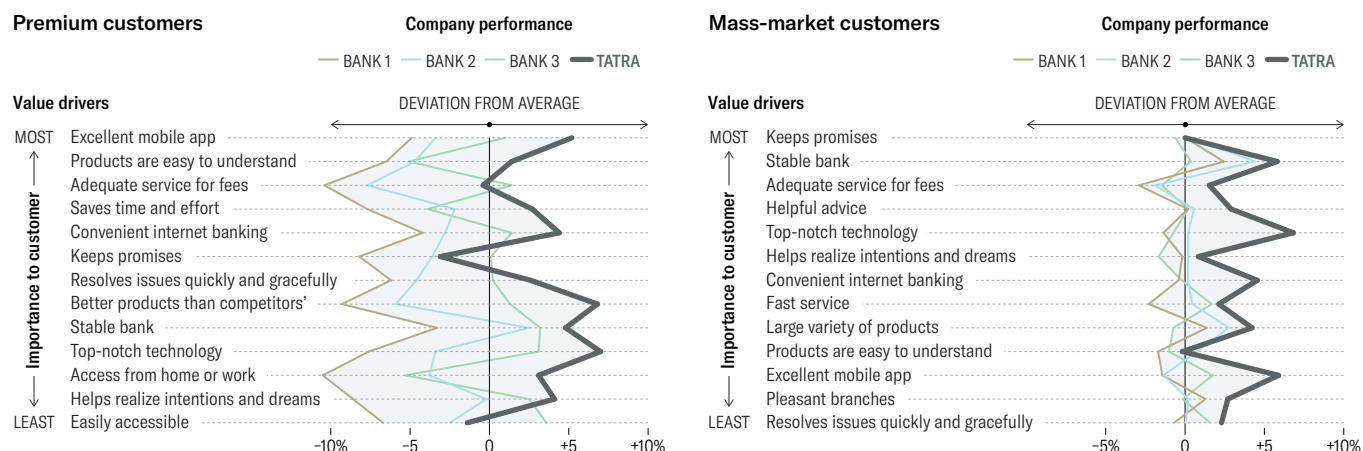
WTP and WTS sit at the core of value-based strategy, but because the concepts are quite abstract, it can be challenging to see how to bring them to life in your organization. At Harvard Business School, we often use a visualization tool



STRATEGY

Tatra's Customer Value Maps

As these value maps demonstrate, Tatra banka's value proposition is better aligned with the preferences of premium customers than its competitors'. It has more room for improvement with its mass-market customers.



Source: Tatra banka and Kantar Slovakia

called the value map to help executives identify strategic opportunities. It's proven helpful for anything from a half-day examination of a particular business to a full-bore strategy overhaul, and it's useful for testing the tenets of value-based strategy against whatever's happening in your company.

You begin by selecting a group of customers: your most profitable segment, perhaps. Next you compile a list of criteria that are important to those customers when they make a purchase. These criteria are called value drivers. Think of them as the product and service attributes that determine WTP. You then rank the value drivers from most to least important from the customers' point of view. In a final step, you determine for each driver how good your company is at meeting customers' expectations and do the same for your major competitors.

It's important not to make assumptions about what your customers value most and how well you deliver. If you're going to reformulate your strategy on the basis of your value map, you need good data to assist you in building it. When I see companies undertake a serious value-map analysis, there is almost always a surprise—a driver that turns out to be less critical than commonly thought or an unexpected level of performance on another dimension. These surprises aside, I find that most companies have a fairly accurate sense about their own performance but tend to know far less about how their customers view the performance of their competitors. That too requires research and data gathering.

Consider the two value maps for Tatra banka, Slovakia's first postcommunist private bank. Founded in 1990, Tatra quickly led European banking in the adoption of digital

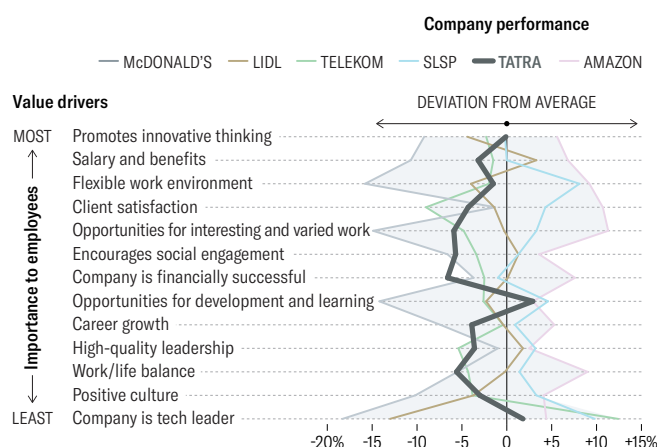
technology. It first offered mobile banking in 2009 and introduced voice biometrics in 2013 and facial recognition in 2018, earning more than 100 awards for its innovative services. As I worked with Tatra to develop its strategy, the bank collected data from customers through surveys and interviews and used it to create value maps for premium and mass-market customers. Looking at the maps, it is evident why Tatra had particular success with the former segment: Excellent mobile technology is what premium customers value most, and the bank led its competitors on that measure. Mass-market customers, by contrast, were most concerned with whether the bank kept its promises, one of the areas where Tatra did not stand out. (See the exhibit "Tatra's Customer Value Maps.")

Value drivers can serve as innovation engines because they live midway between the rather abstract notion of WTP and WTS and the very specific attributes that describe your current product or service. This has two advantages. First, value drivers are useful for analyzing the existing business. It's a straightforward task to link a given value driver to operating models and KPIs and to compare performance with that of competitors. Second, they can be helpful in thinking about opportunities, because they don't specify in any detail how you will meet a particular customer need. They help you explore new ways to satisfy customers, employees, and suppliers. Focusing on value drivers, rather than patterns of past success or industry trends, you are less likely to equate business success with selling more of what you already offer. (See the exhibit "Value Maps for Employees and Suppliers.")

Once you've created the map, it's time to identify the drivers that offer the most potential for future value creation and

Value Maps for Employees and Suppliers

Value maps also provide a deep understanding of employee or supplier willingness to sell. Here we see that Tatra lags competing employers in satisfying the value drivers that matter most to tellers.



to think through strategic initiatives that will support them. That work is too nuanced and company-specific to do justice to here (a fuller description is available in my book *Better, Simpler Strategy*), but keep these three principles in mind.

Invest in a small number of related value drivers.

Choosing how to improve your company's value proposition is ultimately a question of forecasting the return on various investment opportunities. How much does it cost to move a particular value driver, and what increase in WTP can you expect in return? Many companies find it beneficial to identify a cluster of related value drivers that add up to a bigger theme. This helps them stand out in the minds of their customers ("Tatra is the technology leader in banking"), and it is operationally efficient because closely related drivers are often supported by similar activities. For instance, building digital capabilities allowed Tatra to improve on several important value drivers.

Resist the temptation to play catch-up. When executives first study their value maps, many concentrate on drivers where their company lags, and they quickly identify initiatives that would allow them to catch up with the competition. This is a mistake. The ability to capture value depends on differences in value creation. When a customer is choosing between two companies with nearly identical value maps, her attention will go to price. The greater the similarity between two companies' value maps, the greater the pressure to compete on price. The goal is to increase differentiation, not to close gaps.

Insist on making trade-offs. When I work on value maps with executives, they understand in the abstract that all

companies need to choose where to focus their energy and resources. But when they examine their own value maps, they want to bring every value driver up to the maximum rating. I see this so often that I know it's a powerful impulse—but it needs to be quashed, because a strong strategy always involves trade-offs. No company can be good at everything.

CREATING VALUE FOR customers, employees, and suppliers sits at the very heart of strategies that result in stellar performance. In the best companies, this orientation toward value creation is reflected in every decision made by employees at all levels of the organization. The focus on creating value shows up in big strategic plans and in small everyday choices.

A few years ago, I had an interaction with a salesperson at a flower shop that illustrates how a focus on value creation can permeate an entire organization, even in the briefest of customer interactions. I had meant to send flowers to a friend for her birthday, but her day came and went and somehow I forgot. A few days later, I remembered and called the shop to place an order. It was late afternoon, and the salesperson asked whether I wanted to have the flowers delivered that day or the next. I confessed to being late for my friend's birthday and urged the salesperson to send them as quickly as possible. Her response caught me by surprise. "Shall we take the blame for the late delivery?" she asked.

I didn't want her to lie for me, of course, so I didn't take her up on the offer. But even in that brief conversation, I recognized that this salesperson didn't see her job as simply selling flowers. Rather, she was focused on creating value for her customers by increasing their WTP—which she did. The following year, I received an email from the flower shop a few days before my friend's birthday, reminding me it was time to place an order. I did so, at what seemed to me an inflated price. But I was willing to pay it as a fair trade for the shop's solving my problem—a win for the flower shop's strategy. ☺

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FELIX OBERHOLZER-GEE is the Andreas Andresen Professor of Business Administration at Harvard Business School. He is the author of *Better, Simpler Strategy: A Value-Based Guide to Exceptional Performance* (Harvard Business Review Press, 2021), from which this article is adapted.