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Why are some companies more successful than others?

The real life laboratory

Undoubtedly, strategy is important and it is described in the management literature, in management consulting, and in practical stewardship in private and public companies. Invariably, an aspiration for the adoption of the 'right' strategy prevails.

However, is it true that there is such a thing as the one and only best strategy for a company? Is the market leader of today the industry winner of tomorrow? Is it possible to create sustainable competitive advantage simply by way of adopting a generic strategy? Can you, generally, craft a strategy to create uncontested market space and thereby make the competition irrelevant?

In a world constantly in search of rationalism, it would be nice, if we were able to give the straightforward answer 'yes'.

However, we think that the answer to each question is probably 'no'. When we say probably it is because you should never exclude the possibility that new empirical findings could lead to new insights.

Over the past two decades alone, strategic analyses and books searching for the keys to high performance have included *In Search of Excellence* published in 1982 [1], *Corporate Culture and Performance* from 1992 [2], *Build to Last* from 1994 [3], through to the more recent *Good to Great* [4], *What Really Works* [5] and *Blue Ocean Strategy* [6] published in 2001, 2003 and 2005 respectively. The question within strategic management remains the same, namely 'What is the most successful strategy?' But the answers offered in the literature appear to be many and varied.

Michael Porter's conventional wisdom from the early 80s recommends that you should choose between a differentiator type of strategy or become a cost leader. In recent strategic literature Kim and Mauborgne in *Blue Ocean Strategy* [6] tell you to create uncontested market space and simply make the competition irrelevant. In *What Really Works* [5], Joyce, Nohria and Roberson develop a model known as the 4+2 model as a recipe for success. This model is based on a thorough analysis and argues that focus on four key areas coupled with an additional two areas chosen from a possible four should lead to superior performance.

One of the problems with many of the normative strategy schools is that they cannot adequately explain why winners emerge in hypercompetitive markets. On the one hand, it is about creating superior value and, on the the other, it might be about developing value destruction. However, the notion of value destruction is explored less as a consequence of a strategy aiming to create value. Surely, many are familiar with creative destruction as described by Schumpeter [7] but what if the value destruction doesn't stem from new and improved technology or products alone but also from new and different strategies?

All industries may then be at risk in terms of the potential value destruction lurking in an unknown future. This risk, or opportunity, is precisely the reason for this book and its focus on exploring why some companies are more successful than others. Or rather why some companies successfully bridge the gap between differentiator and cost leader type of strategies and emerge as winners in hypercompetitive markets and what this entails in terms of value destruction and creation.

Creating value and simultaneous destruction

The majority of managers think in traditional terms in which a product is produced at a cost and sold at a margin. This approach is regarded as creating value for the customer in some sense and value for the owner or shareholder to take home. This rather simple concept of business is expressed by the founder of the Body Shop Anita Roddick who states that [8]:

> Business is not financial science, it's about trading . . . buying and selling. It's about creating a product or service so good that people will pay for it.

Now what about creating a product or service, which is good enough for people to use but is free of charge? Is that good business sense, financial science or just plain lunacy? Some would cry out 'madness' while others such as the two founders of Skype, would describe it as good business sense. Such good sense that it has resulted in the sale of Skype to eBay for US$ 2.6 billion only three years after the first user downloaded the Skype software from the Internet.

When pondering what eBay has actually purchased, the immediate answer that it has bought an IP telephone operator appears to be far from the truth as it has bought a company which can provide an added benefit for the users of eBay. As such, Skype is viewed by eBay as an extension of its existing business by extending the Internet infrastructure of eBay with IP telephony. This means that the customers can not only communicate by e-mail but they can also speak to each other at a very competitive rate!

Regardless of eBay's intentions, US$ 2.6 billion has been created for the shareholders of Skype over the past three years along with an overwhelming potential for value destruction across the entire industry of telephone communications. The usage per minute charges of the traditional telecommunications industry are seriously at risk from the free telephony offered to users of Skype who are calling other Skype users.

One reason for this value destruction is technological development and the fact that many Internet connections can support telephony. It is, however, not the only reason as the possibility of Internet telephony has been known for a long time and has been attempted by others. So what is the secret behind the huge success of Skype?

Clear focus and exceptional execution of a discount strategy can be argued to be the main reasons for Skype's success as opposed to, e.g. proprietary technology. A discount strategy of such magnitude may alter the nature of the telecommunications industry. The chairman of the Federal Communications Commission is in fact convinced that not only will Skype change the industry but also the world of communications (Fortune Magazine, February 16, 2004):

> I knew it was over when I downloaded Skype, Michael Powell, chairman, Federal Communications Commission, explained. When the inventors of KaZaA are distributing for free a little program that you can use to talk to anybody else, and the quality is fantastic, and it's free – it's over. The world will change now inevitably.

The founders of Skype had little doubt that the telecommunications industry was about to change and that a value destruction across the traditional providers would be a result of this, as the following quote from Niklas Zennstöm, CEO and co-founder of Skype, shows clearly:

> The idea of charging for calls belongs to the last century. Skype software gives people new power to affordably stay in touch with their friends and family by taking advantage of their technology and connectivity investments.

There is little doubt that technological developments acted as a catalyst for Skype but other more traditional industries have also been exposed to companies who turn things upside down. Companies who create value for themselves while developing the destruction of value for others.

IKEA is one of the more traditional companies which have changed the industry and signalled value destruction for the traditional furniture manufacturers operating in the 1970's. However, this was not due to technological innovation but merely a result of a vision and a strategy devised by the now legendary founder of IKEA, Ingvar Kamprad [9].

> We shall offer a wide range of home furnishing items of good design and function at prices so low that the majority of people can afford to buy them . . . We have great ambitions.

The value created for IKEA and the value destruction this entailed for its competitors was not due to technical innovation but merely to a different way of approaching the market. Is there anything in common between these two companies that can be identified as key factors for their success? Judging by the amount of daily Skype downloads, and the vision of Ingvar Kamprad, volume appears to hold some significance.

The volume game

As not all companies can create value through offering a product or service free of charge, they seek to price it low and make up for this lower margin through volume.

When IKEA opened near Munich in 1974, West Germany was Europe's largest market as well as the largest producer and exporter of furniture. At that time the German furniture retail industry consisted of retailers who were using showrooms, taking orders from manufacturers which resulted in limited inventories leading to long delivery times. IKEA did it differently. They promised low prices, immediate delivery and Swedish quality and 37,000 people visited the store during the first three days.

Despite vigorous responses from German retailers, IKEA and their low cost concept were there to stay and by the late 1970's they had captured a 50 % share of the West German cash-and-carry segment. Today IKEA has locations from Iceland to Kuwait covering all continents, their catalogue has been printed in more copies than the Bible and endless hordes of people are passing through their stores on a daily basis.

The American company Costco is another company which has been instrumental in reshaping the retail industry and looking for high volumes rather than high margins. With a company policy stating that the mark-up of goods may not rise above 14 %, high volumes have been essential in recording annual net sales of more than US$ 40 billion [10].

The sheer size of this volume is further emphasized by the fact that one in four American households holds a membership of Costco [11]. The combination of such volume and the ceiling on mark-ups has had serious consequences for the retail industry as a whole as Costco may not only be cheaper but also reaches a phenomenal number of customers. This customer base has been achieved over the past two decades by breaking the traditional mold of not only retailing but also of strategy making in general.

Volume is the essence of Skype and its impact is not in doubt but the increase in number of downloads since the first software was made available to the public is astounding. Since day one, Skype has maintained its rate of downloads resulting in more than 200 million people who have downloaded the Skype software up to 2005. Looking solely at the American market, research shows that Skype accounts for a large percentage of the IP current telephony (analysis done by broadband management company Sandvine Inc):

> Calls using Skype Technologies SA account for nearly half of the VOIP minutes used (46.2 percent) and about 40 percent of the VOIP bandwidth used in North America.

In addition to the above it should be noted that Skype achieved one billion minutes of Skype-to-Skype usage in 2004, one year after they made their downloadable software available. In 2005 this figure had climbed to 10 billion Skype-to-Skype minutes which, when illustrated in Figure 1.1, shows an astonishing trend.

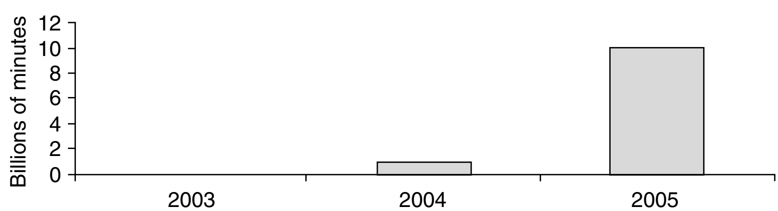

Figure 1.1 Skype minutes of usage

If this trend continues the question becomes whether Skype will reach 100 billion in 2006? Imagine that: 100 billion minutes of free Skype-to-Skype minutes which were previously offered by traditional telecommunications companies at a monopolistic charge. Even if that charge, on average, is assumed to be as low as US$ 0.01, Skype would be causing a value destruction of US$ 1 billion due to high volume.

By comparison, AT&T Communication and MCI WorldCom each recorded approximately 20 billion minutes of international traffic in 2003 [12]. Skype has already grown to half the size of these two operators of international traffic, which is quite an achievement in just two years.

Clearly, volume is instrumental in succeeding with a low price product but is that the only explanation? Low price and high volume? Perhaps, but how to make such a business model work?

How does a company play the high volume, low price game whilst at the same time ensuring that it stands out from its competitors? Is it at all possible to pursue a low cost strategy and differentiation at the same time?

It appears so and not just through inventing new industries, or new markets, which can be considered 'Blue Oceans' in the short-term, but through changing the unwritten laws. This sounds like a complex managerial assignment. However, in this context, there is a need for making things simple. Therefore, simplicity can not be underestimated in the process of succeeding with such a strategy.

Simplicity – the word of the day

A simple message is easier to convey than a complex one.

Simplicity, however, seems also to be the generic theme of many emerging winners in hypercompetitive industries who are seemingly following the condemned strategy of 'Stuck in the middle'. Not only simplicity in how they communicate to the consumers through ads and campaigns but also the simplicity of the product, the supporting of such, internal processes and even down to the lay-out of, e.g. a retail outlet.

How can such simplicity create winners when traditional thinking on differentiation has worked on making products more complicated by enhancing product variations or the services surrounding them? Has this kind of thinking been overestimated or is it just wrong? Neither, as it still works for some. Perhaps too much emphasis has been put on traditional thinking even though other ways would have proven just as successful or in some cases even more successful.

In many places the traditional way of acquiring a telephone line may take some time and in some cases even include the necessity of subscribing to a specific provider. With Skype, free software is downloaded, installed on a PC, plugged into a headset and then you can call other Skype users. For an additional fee non Skype users can be called at prices significantly lower than those offered by traditional providers. Simple indeed and by keeping the very product simple, the administration and back-office processes required to support this should also be simple or simplified. Communicating a simple offer is also easier and leaves more room for the message to actually stick with the customer, as opposed to the increasing number of businesses who are attempting to stand-out with an offer as complex as the one offered by a competitor.

Offering a simple, or simpler, product was one of the main reasons for the success of IKEA as they redefined the industry with furniture manufactured for self-assembly.

As such, a simple product which the customers can assemble themselves enabled instant delivery as the furniture could be stored at the warehouse in flat pack boxes. Not only did this suit the buyers of home furniture, who, prior to IKEA, had to wait weeks for that new sofa or shelf system, but it also lowered the costs borne by IKEA. This allowed IKEA to not only operate at a lower cost but also provided the opportunity to differentiate their offer from the traditional furniture manufacturers.

Costco may not produce simple products but they hold a limited number of articles in their stores compared to, e.g. supermarkets. This leads to simpler processes and systems and therefore lower costs. One could on the back of this fear that the experience of the customer would be diminished by this but apparently the customers of Costco are satisfied, judged by the vast number of members.

This may be due to the fact that they know exactly what Costco is about, large quantities at low prices across a limited selection of articles whereas other retailers are finding it hard to position themselves in the competitive arena. Some are offering an endless amount of goods causing the customer to search aisle after aisle trying to find a pound of sugar or a pint of milk while being distracted by imaginative shop-in-shops or promotional displays.

Simplicity as described above comes in many guises ranging from the product itself to the communication of what value it has for potential buyers. As such it is not a single quick fix of simplifying the product line but perhaps the ability to adopt simplicity as a code encompassing all areas of the business.

Once such a philosophy is adopted throughout the organization it appears that products or services can be offered at a lower cost. Furthermore, the simple nature of the product seems to sit well with consumers as they relish such simplicity as a fresh injection of something that is easy to comprehend.

The mantra is simple then: ‘keep it simple’ and be true to the chosen path of simplicity. The real world however, may be slightly more complex because what is simple? What is a simple product? Or how do you simplify the product that is already there as IKEA, Costco and Skype have done?

Cut to the core

The notion of a simple product is in fact simple. It revolves around what the customer’s actual need is when buying a product. This sounds rather straight forward but when dwelling on this thought and some of the products we all buy, what exact need are we trying to fulfil? When buying telephony are the customers satisfying only their need for voice communication or are they looking to satisfy some need of security through the established quality of traditional fixed line telephony? When buying a sofa are the customers trying to satisfy their need to sit comfortably or the need to decorate their living room aesthetically? When entering a retail outlet are the customers trying to satisfy their need to find the items on their list or are they looking to satisfy the need for a shopping experience and if so what is that?

This line of thought could be extended further for quite some time and offers numerous arguments concerning what needs various goods are looking to fulfil. However, instead of venturing down that path towards complexity we will keep it simple.

Skype is offering very inexpensive voice communication and nothing else. They do not guarantee that your Skype connection is infallible or offer trendy headsets in the light blue colours of Skype. In fact, they offer you a program you can use to call via the Internet and nothing more, which it is argued is the core of voice communication: to enable the customer to communicate with someone else located elsewhere.

The case of IKEA is perhaps better suited to illustrating this point as they do not make furniture according to specification or furniture with complex carving and ornamentation. They make, e.g. simple tables, chairs, sofas and shelf systems which fulfil the needs of the customers: to furnish their homes at a reasonable price. In addition to the simple design of their furniture, IKEA lets the customers collect their items at the warehouse and obliges them to assemble the pieces themselves. The entire value proposition is simple: you look, you decide, you collect and you pay for exactly what is in the box whether it is a table, chair or sofa – and nothing else.

Costco has, like Skype and IKEA, managed to differentiate itself from the competition by stripping all unnecessary evils out of the shopping experience. As such it holds a limited range of articles, which customers will find presented in bulk format and which they may need to unwrap as no unnecessary shop assistants are employed solely for the purpose of unwrapping goods and arranging them on limited shelf space.

This 'cutting to the core' is concerned with stripping the product or offering it in such a way that it meets, and even exceeds, the need of the customer. This notion is somewhat contradictory to the literature concerning relationship marketing and service management, which has increased over the past two decades. Both are areas which add to the possibilities of differentiation.

The notion of providing the customer with exactly what he or she wants is, however, far from novel. Nor is the importance of volume or the fact that such products have the potential of creating high volume sales:

> A market is never saturated with a good product, but it is very quickly saturated with a bad one.
>
> Henry Ford

As Henry Ford rightly puts it, a good product will have a demand attached to it but is the product of our emerging winners necessarily a good product in a traditional sense? Does it offer higher quality than those of the competitor? Does it do something that the competitor's products can't do? Not necessarily, but this may not be required as long as the customer perceives this product as offering a higher value.

One area that has been explored by Skype, IKEA and Costco is the idea of self-service. Such an idea would have been unheard of in the days of traditional telephony, furniture sales and retail but has been instrumental in how these companies have been perceived by the customer.

Service? Something we'd rather do ourselves

When was the last time you were put on hold or forced to listen to dubious music while waiting for your local service representative to retrieve your details? Perhaps you waited for a printed airline ticket to arrive in the mail, growing evermore concerned that it may not arrive and that your holiday to the Bahamas was at risk? These concerns or inconveniences are drastically reduced if there is no need to call for assistance or be at the mercy of a printed ticket, arriving by mail.

So, in conjunction with cutting to the core, it seems that the emerging winners have all introduced self-service in industries where this to some extent was unheard of.

When viewing your Skype account, you log on to your own page and view those details without the assistance of a service representative, which means that you have access to real time information whenever you want it. No more waiting on hold or being transferred back and forth between departments because you are performing the service yourself. The installation of the software required is equally up to you as an individual customer, as well as ensuring that your connection and system meets the requirements.

IKEA is a classic example of self-service where the customers are given access to the warehouse in order for them to pick their chosen furniture, which is found in flat pack boxes. One can only imagine the reaction of traditional furniture producers when this concept was launched in the early 1970's.

This, however, enhanced the customers' perception of service as they could walk through the show room, choose their furniture, go and pick it up at the warehouse and literally be able to change their entire living room in one day.

Therefore, a high level of service may no longer be measured by the number of services but rather the ability to include the customer in the production of services. Who can claim they have received a poor service when they have performed it themselves?

This self-service and the other areas described previously are some of the areas that we argue have been instrumental in the success of our winners and their ability to redefine the industries in which they compete. While being instrumental these described areas also contradict with traditional strategic thinking.

The black box of strategy turned upside down

Value destruction, cost leadership and differentiation are often co-existing. The important thing is to get back to the core and to service as something the customer produces. All seem to contradict traditional strategy thinking.

We argue that the black box of strategy with its current thinking lacks the tools and ideas to explain the phenomenon of how companies emerge as winners in hypercompetitive industries.

In our research, therefore, we have focused on how companies can gain a foothold in hypercompetitive markets and how they can be successful. We have been studying various companies in various markets and in the book we explore in detail the reasons and explanations for their success. Based upon our general observations and three in depth case analyses we outline and develop a framework for how to create and execute discount business strategies. Through this we also add and describe some new dimensions of strategy both in theory and in practice.