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Creating a Strategy That Works

The most farsighted enterprises have mastered five unconventional practices for building and using distinctive capabilities.

by Paul Leinwand and Cesare Mainardi

Illustration by André da Loba

Almost every business today faces major strategic challenges. The path to creating value is seldom clear. In an ongoing global survey of senior executives conducted by Strategy&, PwC's strategy consulting business, more than half of the 4,400 respondents said they didn't think they had a winning strategy. In another survey of more than 500 senior executives around the world, nine out of 10 conceded that they were missing major opportunities in the market. In the same survey, about 80 percent of those senior executives said that their overall strategy was not well understood, even within their own company.

These problems are not caused simply by external forces. They are the outcome of the way most companies are managed. In all too many businesses there is a significant and unnecessary gap between strategy and execution: a lack of connection between where the enterprise aims to go and what it can accomplish.

Yet a few companies seem to have this problem solved. They naturally combine strategy and execution in everything they do. These companies seem to make the right choices about what type of value to offer and how to deliver it — and those choices often run contrary to the conventional wisdom of the industry.

For example: A European retailer–manufacturer sells stylish, functional, inexpensive furniture so that people at any income level can more easily improve their lives. Its large retail stores are designed so shoppers can comfortably spend a whole day there, eating in the store's restaurant and leaving their children in its play area. The enterprise has remarkable capabilities, including an innovative manufacturing process and supply chain; a proficiency in designing attractive furniture that ships in a flat box; and an ability to develop keen insights about the way customers live at home, and to translate those insights into new products. This rapidly growing enterprise, of course, is IKEA. In 2014, IKEA had 361 retail stores in 46 countries, with total annual revenues of €30.1 billion (about US$40 billion).

Another example is a Brazilian purveyor of high-quality, natural personal-care products. Its identity, captured by the Portuguese slogan *bem estar bem* ("well-being, being well") celebrates health and quality of life at every age, rather than a forever-young ideal of beauty. The company has built a network of 1.5 million direct sales consultants, who have close relationships with seemingly every woman in Brazil. To give those consultants a reason to visit their customers every few weeks, the company has developed a proficiency in rapid-fire innovation, releasing more than 100 new products every year. It demonstrates respect for nature and local communities by sourcing many raw materials from remote villages in the Amazon rain forest, and by using its business skills to help make those regions economically and environmentally sustainable. You may not have heard of Natura Cosméticos unless you live in Latin America, but it is the largest personal-care products company in that region. It had revenues of 7.4 billion reals (about US$2.6 billion) in 2014.

Another case is a U.S. enterprise known for buying industrial and technological companies, reframing the way its member businesses operate, and managing them for profitability. It has developed its own rigorous day-to-day disciplines for managerial excellence and continuous improvement. The Danaher Corporation, named after the founders' favorite fishing creek, is recognized among management experts for its remarkable performance and its phenomenal M&A success rate. It had revenues of about US$19.9 billion in 2014. (See "Danaher's Instruments of Change," moderated by George Roth and Art Kleiner, *s+b,* Spring 2016.)

Several other well-known enterprises, including Apple, Haier, Industria de Diseño Textil (Inditex, known for its Zara brand), Lego, Qualcomm, and Starbucks, have also closed the strategy-to-execution gap. These companies are all idiosyncratic; at first glance, they seem to have little in common, and they are rarely thought of together. And yet, they have all built the kind of differentiating capabilities that give them a major strategic advantage.

Extraordinary Enterprises

In our previous book, *The Essential Advantage: How to Win with a Capabilities-Driven Strategy* (Harvard Business Review Press, 2011), we described the financial advantage that companies enjoy when they build their business around a clear, coherent identity: a few distinctive capabilities aligned with their value proposition and their lineup of products and services. It's not enough to simply have good capabilities; every company has them. To sustain success you have to have capabilities that are truly superior, and distinctive enough that others cannot copy them. When you have several such capabilities reinforcing one another, you will be able to both differentiate yourself from and consistently execute better than your competitors.

Distinctive capabilities are not easy to build. They are complex and expensive, with high fixed costs in human capital, tools, and systems. How then do businesses such as IKEA, Natura, and Danaher design and create the capabilities that give them their edge? How do they bring these capabilities to scale and generate results?

To answer these questions, we conducted a study between 2012 and 2014 of a carefully selected group of extraordinary enterprises that were known for their proficiency, for consistently doing things that other businesses couldn't do. From dozens suggested to us by industry experts, we chose a small group, representing a range of industries and regions, that we could learn about in depth — either from published materials or from interviews with current and former executives. The 14 we studied are Amazon, Apple, CEMEX, Danaher, Frito-Lay (the snack foods enterprise within PepsiCo), Haier, IKEA, Inditex, the JCI Automotive

Systems Group (the seat-making division of Johnson Controls Inc., since renamed the Automotive Experience Group), Lego, Natura, Pfizer (specifically its consumer healthcare business, sold to Johnson & Johnson in 2006), Qualcomm, and Starbucks.

To be sure, these are not the only enterprises that successfully use their distinctive capabilities for competitive advantage. You might assemble a different list, and we would probably agree with many of your choices. But these businesses represent a cross-section broad enough to provide us with a clear understanding of what they, and other businesses like them, have in common.

Success has not always come naturally to them. At some point in their history, each moved away from the conventional wisdom of mainstream business practice. Each in its own way, these businesses followed a similar path — a path of five unconventional acts. These five management practices represent an approach to strategy that makes it easier to consistently succeed.

Conventional wisdom	**The unintended consequences of conventional wisdom**	**The alternative: unconventional acts**
Focus on growth	Getting trapped on a growth treadmill: chasing multiple market opportunities where you have no right to win	**Commit to an identity:** Differentiate and grow by being clear-minded about what you can do best
Pursue functional excellence	Striving to be world-class at everything but mastering nothing; treating external benchmarking as the path to success	**Translate the strategic into the everyday:** Build and connect the cross-functional capabilities that deliver your strategic intent
Reorganize to drive change	Falling into a habit of organizing and reorganizing: trying in vain	**Put your culture to work:** Celebrate and leverage your cultural strengths

Conventional wisdom	The unintended consequences of conventional wisdom	The alternative: unconventional acts
	to change behaviors and create success by restructuring alone	
Go lean	Cutting costs across the board: starving key capabilities while overinvesting in non-critical businesses and functions	**Cut costs to grow stronger:** Prune what doesn't matter to invest more in what does
Become agile and resilient	Constantly reacting to market changes: shifting direction in the misguided conviction that if you listen hard and act fast, you will survive	**Shape your future:** Reimagine your capabilities, create demand, and realign your industry on your own terms

Source: *Strategy That Works*

Beyond Conventional Wisdom

Why does it pay to run your business with these five unconventional practices? Because most conventional management practices have developed through trial and error, often without a direct link to a company's strategy. The enterprises we looked at tend to seek success on their own terms. The five unconventional acts embody the attitudes and actions that help them accomplish this, day after day, in their businesses.

1. Commit to an identity. These enterprises may offer a wide variety of products and services in multiple sectors, but their identity is always clear. Everyone who interacts with them — including customers, employees, suppliers, shareholders, and regulators — knows who they are and what they stand for. The identity of a successful company aligns three basic elements: a value proposition (how this company distinguishes itself from others in delivering value to customers); a system of distinctive capabilities that enable the company to deliver on this value proposition; and a chosen portfolio of products and services that all make use of those capabilities.

Why be different? Because most conventional management practices have developed without any link to strategy.

Thus, for example, the Apple value proposition combines the roles of innovator, aggregator, and experience provider. (These and similar terms are defined in our online “way-to-play” tool: strategyand.pwc.com/way-to-play-tool.) Apple’s computers, tablets, and smartphones form the hub of a single digital system that allows people to easily manage media production, media consumption, and communication. The company accomplishes this through extraordinary capabilities in consumer insight, intuitively accessible design, technological integration, and breakthrough innovation of products, services, and software. It has applied these capabilities to its computers, mobile devices, retail stores, online services, wearables (the Apple watch), and media players (Apple TV).

Haier, the Chinese appliance company that has held the world’s largest market share in “white goods” since 2011, competes with Apple in a few categories, including televisions and computers. But it has a very different value proposition: that of an innovator and solutions provider, offering products and services that meet the needs of particular customers and help them deal with problems. For example, Haier makes a small washing machine designed for undergarments (which are washed separately in China) and a large one designed for the robes of Pakistani men. It makes no-frost freezers for countries where power outages are common. It makes air conditioners that clean polluted air (and indicate the level of air quality with colored lights), and water conditioners that can be tailored to filter out the particular chemicals in the water supply of thousands of different

Chinese neighborhoods. To provide products like these (and many others), it has developed its own capabilities system, very different from Apple's. Haier's system combines consumer-responsive innovation, operational excellence, the management of local distribution in a variety of regions, and on-demand production and delivery. Like Apple, Haier applies its capabilities to a broad portfolio of products and services. These include water-quality monitoring for cities in China, interior design for new homeowners there, and microcredit lending for Chinese purchasers who need it. Despite the variance within the portfolio, all the offerings are fitting for a global innovator and solutions provider from a large emerging economy. Haier's capabilities will also fit its expanding global portfolio after its planned purchase of GE's appliance business.

Staying true to your identity doesn't mean becoming complacent or losing your ability to change. It means using your strengths as a guide as you move through a rapidly changing world. When the entire company focuses on a specific way of creating value, employees are not easily distracted. They can concentrate on differentiating the enterprise in ways that naturally outpace their competitors' efforts.

2. Translate the strategic into the everyday. The companies we studied focus on a few capabilities that are worth their full attention, and devote themselves to making them excellent — rather than supporting dozens of capabilities that merely have to be pretty good. To develop these capabilities, the companies often blueprint them (designing in detail how they will work). They continuously build them out with small management changes (we call these "point interventions") and with regular breakthrough innovations in their own technologies and practices. They bring these capabilities to scale by combining tacit (ingrained) and explicit (codified) knowledge. Though these capabilities tend to pay off even in their early stages of development, it usually takes quite some time for them to reach full fruition. After all, if they could be created overnight, they wouldn't be worth very much, because anyone could copy them.

We found many remarkable capabilities among the companies we studied, and few, if any, of them reside within a single function. Instead of aiming for functional excellence or external benchmarks, these capability builders make their processes and practices their own. If you ask people at Starbucks what they know about the customer experience, ask people at Danaher how they manage postmerger integration, or ask people at Natura how they organize their supply chain, they respond with precision and artistry about what they do and why it matters. Each company is a broad ensemble of virtuoso performers, continually learning from one another. Their individual skills and talents become more significant when the company weaves them together to produce something unique to that enterprise.

3. Put your culture to work. Business leaders know that the culture of a company — the way people collectively think and behave — can either reinforce or undermine its strategy. Because culture is difficult to manipulate or control, many executives tend to regard it as an enemy of change. Indeed, at companies stuck in the strategy-to-execution gap, executives tend to complain about cultural resistance and disharmony. This complaint is a symptom of lack of strategic focus. Since the company isn't clear about where it is going, employees don't know where they stand.

The companies we studied, however, view their culture as their greatest asset. The details of their culture may be unique, but all of these companies have a culture that reinforces their distinctive strengths. Within them, people are committed to the work; they feel mutually accountable for results and develop a kind of collective mastery that is hard to duplicate.

You immediately sense the high level of trust and enthusiasm in these cultures in the very specific pride people have about their companies. Natura's people refer continually to the importance of relationships in everything they do, and Starbucks employees speak of their genuine love of coffee, along with the ambience of a barista-style establishment. At Qualcomm, you hear about the company's persistence in solving complex technological problems and promoting its solutions throughout the industry, "even when others doubt us." At Danaher, people refer to their willingness to learn from one another at a moment's notice, taking every opportunity to raise their management game.

4. Cut costs to grow stronger. Companies that close the strategy-to-execution gap spend more than their competitors do on what matters most to them and as little as possible on everything else. Rather than managing to a preconceived bottom line, they treat every cost as an investment. They know that the same sum of cash could be used to fund either powerful, distinctive capabilities or incoherent activities that hold them back. They base their decisions about where to cut and where to invest on the need to differentiate themselves.

These companies don't treat costs as something separate from strategy. Cost management itself is a way to make critical choices about identity and direction. It moves these companies to a high level of financial discipline, redirecting resources to the core capabilities that are strategically important. Even when times are tough, these companies don't cut costs across the board. They find ways to double down on their strategic priorities and cut everything else.

CEMEX, a global building materials company, cut most expenses to the bone when, along with the rest of its industry, it suffered during the 2008 housing crisis and the recession that followed. But even in the midst of a threatening debt crisis, CEMEX continued to develop its internal knowledge-sharing platform, an investment in technology and training that other companies might have considered superfluous. Doing so allowed the company not just to sell cement, which is a commodity, but to offer guidance to its customers (such as home builders and small municipal governments, often in emerging economies) about materials, construction financing, and urban design and development. CEMEX's leaders knew that its return to growth depended on maintaining a distinctive edge with this capability.

5. Shape your future. Over time, most of the companies we studied have developed capabilities that take them far beyond their original ventures. They seek out higher aspirations — applying their capabilities to a broader range of challenges and loftier goals, serving the most fundamental needs and wants of their customers, and ultimately leading their own industries. These companies are relatively unthreatened by disruption, because their capabilities give them opportunities for expansion into new markets. They build on their early success to shape their future.

They tend to work hard to avoid complacency. They explicitly try to anticipate how their capabilities will need to evolve. They build privileged relationships with their key customers, creating demand instead of just following it. In the same way that beavers and earthworms (known as ecosystem engineers) transform their environment to better meet their needs, these companies stake out a dominant role in the sectors where they are clear leaders — using M&A in many cases to influence the structure of their industries.

Frito-Lay was already successful when it faced the prospect of disruptive competition in the early 1990s. It responded by investing more in its most important capabilities, dramatically cutting other costs, taking charge of the snack food retail shelf, and (for at least the second time in its history) using its prowess in distribution to gain leverage over its category that continues today. Danaher did something similar in the early 2000s, when it expanded its innovation capabilities to meet the needs of more scientific and technical businesses. In 2015, it announced a still greater effort to shape its future by splitting into two companies — one a focused science and technology company, the other a diversified industrial enterprise — each of which will benefit from capabilities systems more tailored to its business.

How the Five Acts Fit Together

At one business school where we presented these findings, a student raised his hand. “I get that the conventional wisdom is problematic,” he said. “But most of our professors are telling us to do those things.”

Executives tell us something similar. The five acts of unconventional leadership contradict what many believe is the right way to run a business. Companies that focus on growth are universally applauded, even if the new offerings don’t fit well together. Functional excellence, organizing for success, going lean across the board, and agility are all regarded favorably in business circles. But those are precisely the approaches that often lead to a gap between strategy and execution.

Another insightful comment came from a high-ranking official of a branch of the U.S. military. The conventional wisdom, he said, accurately captured the management style of his overall organization. “But there are small groups that do [the unconventional acts] very, very well.” These groups, he said, were typically the special forces units: Green Berets, Navy SEALs, and other elite groups that take on highly sensitive jobs. Most companies also have similar elite groups, which are insulated from the rest of the enterprise. Company leaders delegate the premium activities to their special forces. But if you truly want to have strategy linked seamlessly with execution throughout your company, you can’t rely on a few extraordinary performers. You have to create distinctive capabilities that will scale across your enterprise, involving everyone in applying them to all the company’s products and services. That takes a level of attention, and a way of thinking and acting, that may seem difficult to achieve at scale. These five acts embody practices that help companies reach that state.

The five acts themselves are so interconnected that you have to adopt them all together. If you overlook any one of them, you fall back. For example:

• When you don't commit to an identity, you risk becoming scattered among a variety of objectives. It is all too easy to continually shift your focus — to deal with exigencies and never quite build the capabilities you need. You gain a right to play in many markets, but a right to win in none.

• When you can't find a way to translate the strategic into the everyday, you have to rely on your existing functions to achieve your strategic goals. You risk becoming a company that perennially promises great things but never seems able to deliver.

• When your company doesn't put its culture to work, your people feel trapped and disengaged. Yours might be one of those passive-aggressive companies where new strategies fail because people pay lip service to them without believing they will last.

• When you fail to cut costs to grow stronger, you starve the parts of your company that matter the most and overindulge those you don't need. Your critical capabilities lose support, and they blend and blur into the rest of the enterprise.

• If you can't shape your future, you run the risk of falling behind competitors that are shaping theirs. You might lose the opportunity to become influential and thereafter be dependent on more coherent and thus more dominant players in your industry.

We do not hold up the five unconventional acts as the only path to success. But it is the only path we know that provides this kind of long-term, sustainable success. It is also an appealing path that feels intrinsically rewarding. Even taking a few steps in this direction can boost a company's energy and morale. To be sure, it requires you to have the courage of your convictions. You have to be discriminating and decisive, willing to say no to opportunities that don't fit the strategy and persistent enough to bring the entire organization along for the ride. But it is not a leap into the unknown. There is a great deal of precedent, and you are in good company: Some of the most renowned, creative, and influential enterprises in the world keep moving forward along this path.

The Idea of IKEA

by Per-Ola Karlsson, Marco Kesteloo, and Nadia Kubis

For a good example of the five unconventional acts of coherent leadership, consider the story of IKEA, the world's largest furniture manufacturer and retailer. The identity of this enterprise is embodied in two simple statements. The first lays out its value proposition, which founder Ingvar Kamprad articulated this way in the mid-1950s: "to create a better everyday life for the many people."

IKEA's Identity Profile

Value Proposition
IKEA delivers value as a low-price player and experience provider. It creates "a better everyday life" at home for many people around the world — providing functional and stylish home furnishings at very low prices with a high level of quality, sustainability, and customer engagement.

Capabilities System
IKEA delivers its value proposition by excelling at four differentiating capabilities:

- **Deep understanding of how customers live at home:** IKEA applies this insight to a variety of design, production, and retail practices.
- **Price-conscious and stylish product design:** IKEA integrates customer engagement, supply chain efficiency, and price considerations into the design process itself.
- **Efficient, scalable, and sustainable operations:** IKEA has developed its own distinctive operational capability integrating supply chain, manufacturing, and retail practices.
- **Customer-focused retail design:** The company knows how to create a distinctive combination of immersive and open-warehouse environments that provide engagement, inspiration, and a distinctive "day out" shopping experience where people can comfortably spend time choosing the things they live with every day.

Portfolio of Products and Services
Known for its flat-packed furniture and its self-pick, self-carry, and self-assemble model, IKEA sells affordable furniture and other home-oriented products.

The second statement embodying the identity of this enterprise is a succinct reference to the way IKEA involves customers in its operating model: "You do your part. We do our part. Together, we save money."

Each store, for example, is laid out so that customers pick up their furniture from the warehouse and assemble it at home.

From its earliest years, IKEA has devoted itself to building and managing this identity. Kamprad started the enterprise as a college-age entrepreneur in 1943, selling seeds, postcards, and stationery. In the 1950s, he realized that furniture in Sweden was so expensive that many people, especially those moving into their first home, could not afford it. Part of the expense came from an elaborate system of middle merchants that bought and distributed furniture. From that moment, Kamprad's company, IKEA, would give people low-cost style at home.

Kamprad demonstrated his commitment to this identity when he began buying furniture direct from manufacturers, bypassing distributors to reduce the prices paid by customers. When Swedish industry leaders saw the threat he posed, they tried to prevent their suppliers from selling to him. So he moved on to producers in low-cost Eastern Europe, where manufacturers could customize the product to his needs and give him an even better price.

The first IKEA retail store opened in Älmhult, a Swedish village, in 1958. Kamprad and his staff began to put a great deal of time and thought into translating the strategic into the everyday: designing and building capabilities that set IKEA's retail stores apart. For example, the company began explicitly creating a capability in consumer insight, learning how IKEA's customers lived, how they aspired to live, and what frustrated them about their current living situation. Kamprad became known for walking up to shoppers in IKEA stores and asking, "How did we disappoint you today?" Today's company-wide requirement that managers visit customers in their homes is a direct extension of this original practice.

As IKEA expanded around the world, it codified and standardized many practices, but it also purposefully reinforced its participative way of bringing capabilities to scale, and thus translated the strategic into everyday practice. IKEA is a place where managers routinely let their coworkers figure out new ways to do things, and it deliberately percolates the best of these ideas back up to the central organization. As Torbjörn Lööf, CEO of Inter IKEA Systems B.V. (which manages the worldwide store franchise system and the "IKEA concept," the intellectual property shared by the full system), puts it: "Of course there are areas where we're very strict and structured. But people don't resist. They know [the IKEA concept] has been extensively tested, [and] they know we're constantly trying out new things, and if they prove out to work, [those ideas] become part of the concept."

IKEA is also known for its ability to cut costs to grow stronger. (See "Is Your Company Fit for Growth?" by Deniz Caglar, Jaya Pandrangi, and John Plansky, *s+b*, Summer 2012.) Its people look for cost-saving opportunities relentlessly in every way that doesn't affect the quality of the merchandise, the customer experience in the stores, or the efficiency of operations. That frugality is reinforced by an annual moment of discipline: The company reduces prices by an average of 2 percent at the start of every fiscal year. "This means we always start with a minus," says Peter Agnefjäll, president and CEO of the IKEA Group. "If our group turns over ¤27 billion [US$28.7 billion], we start with a minus of ¤500 million [US$532 million]. If we don't do more, we're going to lose."

IKEA's culture reinforces all these practices. "The glue, or the inner strength, of IKEA is the cultural part," says former CEO Mikael Ohlsson. If you're an IKEA manager, and you visibly waste resources or reprimand a subordinate for suggesting an idea, you'll hear about it immediately, not just from your boss, but from everyone around you.

Finally, IKEA uses its global scale, and its status as the world's largest home furnishings brand, to shape its future. For example, it purchases furniture in such large volumes that suppliers go to great lengths to meet IKEA's specifications. Although the leaders of this enterprise are conscious of its enviable market position, they are careful not to become complacent. As Jesper Brodin, the range and supply manager for IKEA of Sweden, put it, "Our number one threat is not the markets or the European economy or the recession or anything like that. It is ourselves and our own capacity to transform and deliver."

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