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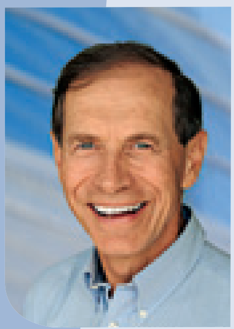
Smart Big Moves

The Learning Logic behind Successful Strategic Shifts



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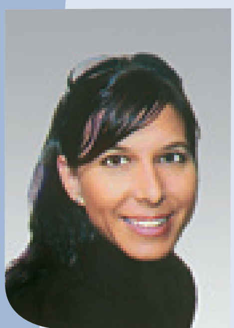

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A big move is one in which a company changes direction with a large commitment of resources. The move typically involves a different set of products, services and/or a new customer base and/or operating activities. Nokia's shift in the early 1990s from forestry, TVs and tires to mobile phones is an example of a big move, as was its shift in the mid-1990s to focus on process efficiency.

These major strategic shifts are recognized as high risk. Companies that attempt them often fail to reach their stated objectives. Yet these moves are essential for value creation in the long run, because while there may be long periods of incremental growth, the constantly changing business environment periodically calls for the need to reposition the business more fundamentally.

To understand why some companies succeed in making smart big moves while others fail to reach their objectives, we studied pairs of successful and less successful multinational companies from a variety of industries and home markets over a 15-year time frame, among them Nokia and Ericsson in mobile phones. Some big moves were industry firsts; others were in response to industry shifts; others still a response to macro shifts or to company-specific problems.

In all the pairs studied, we found that the more successful companies made big moves that were complementary over time – they followed a learning logic both internally and externally with respect to innovation, efficiency and customer intimacy.[1] This complementarity played out in three ways A) roll out of a dominant, successful business model; B) shift in the balance between innovation, efficiency and customer intimacy and C) a sequenced development of capabilities. Together they make up a learning logic that supports companies as they make important strategic shifts.

A. If Your Business Model Is Successful, Roll It Out

This is the first dimension of the learning logic – the safest big moves involve the roll-out of a successful business model.[2] Radical change in the value proposition, or value

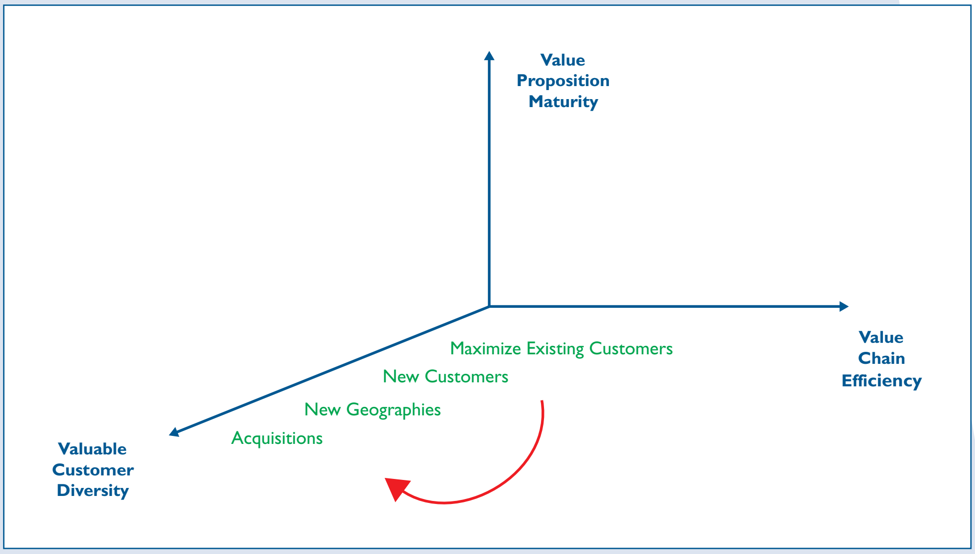


Exhibit A – If Your Business Model Is Successful, Roll It Out.

> "The more successful companies made big moves that were complementary over time – they followed a learning logic both internally and externally with respect to innovation, efficiency and customer intimacy."

chain, is more risky than the acquisition of new customers. So, if the business model ain't broke, don't fix it, roll it out. Go for a much greater *share of wallet* among existing customers, or significantly expand the portfolio of valuable customers with *new customers, new geographies, or digestible acquisitions*. This is what Nokia did in the early 1990s, taking its innovative phones out of Scandinavia into Europe and Asia. Not only did the company spread to new geographies, it constantly added to its product line, wooing customers in different segments, encouraging users to upgrade their phones constantly as they set the trend. As Nokia moved to expand its base of valuable customers, it left Ericsson behind, struggling to make its operations more efficient.

If your business model is not working, you need to reposition it by developing new capabilities and shifting the balance between innovation, efficiency and customer intimacy.

B. Shift the Balance between Innovation, Efficiency and Customer Intimacy

The next dimension of the learning logic involves shifting the balance between innovation, efficiency (in the value chain) and customer intimacy capabilities over time. While all three are needed at all times, it is difficult to pursue them simultaneously because of the need to focus the organization and choose where to allocate the company's resources, depending on the business needs and the return on investment. Innovation requires a looser organization with room for experimentation, entrepreneurship, and readily available resources. Efficiency depends on coordination, leveraging activities in the business system, and the elimination of slack in the organization. Customer intimacy requires a culture of listening, networking and resources focused on relationship building.

Rather than pursuing a simultaneous balance between all three, it is more important to shift the emphasis periodically from one to the other. A typical cycle might involve loosening up the organization to get top line growth by encouraging innovation, followed by a need to tighten the organization to improve margins, followed by a need to get closer to customers again to find out what kind of innovation they want/need with the next product or service line.

Nokia's big strategic moves over the last fifteen years are summarized in the exhibit opposite. Twice within this time frame, periods that emphasized efficiency were balanced with subsequent periods emphasizing innovation. In the early 1990s, the cost cutting drive by the previous CEO, Vuorilehto, provided the financial basis for the pioneering introduction of mobile phones. This pioneering phase ran into growth problems related to logistics, quality control and budgeting, which called for a shift in emphasis away from more innovation towards process efficiency. And the drive for process efficiency, in turn, provided the operating basis for the rapid growth through differentiating innovation in the late 1990s.

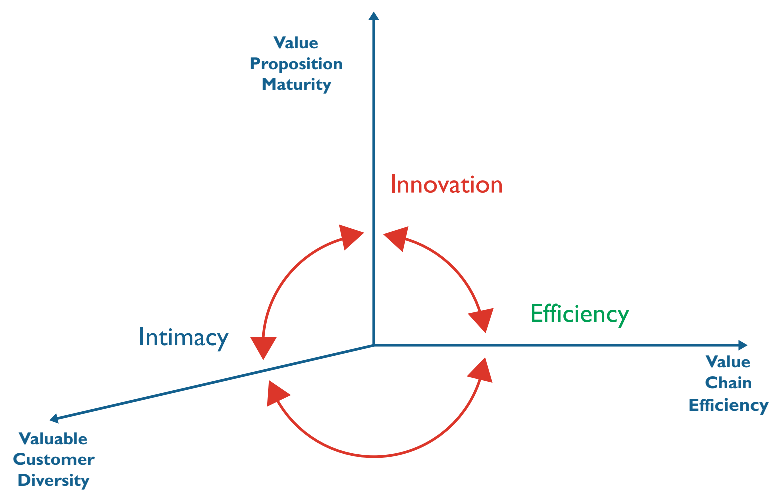
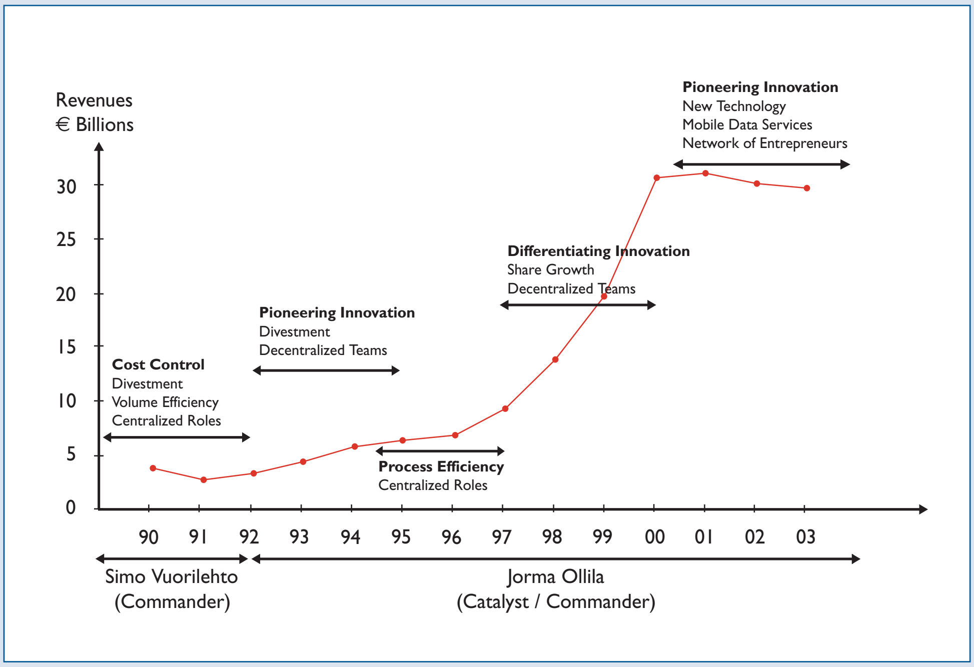


Exhibit B – Shift the Balance between Innovation, Efficiency and Customer Intimacy.
The authors recognize the contribution of Jacques Horovitz in regard to customer intimacy.

C. Sequence the Development of Capabilities

The capabilities needed for the balance between innovation, efficiency, and customer intimacy evolve with the maturity of the value proposition. Exhibit C shows a frequent pattern in the development of a company's capabilities.

The first step is *pioneering innovation*, the potentially disruptive applications and product innovations that open up a new value proposition cycle. This is the first step along the value proposition maturity axis.



Nokia's Big Moves 1990-2004

Once the basic value proposition is standardized, the stage is set to lower costs with *volume efficiency* and mass production, moving along the value chain efficiency axis. Unfortunately, the emphasis on efficiency is often at the expense of customer intimacy. This provides the opportunity for renewed focus on the market with *differentiating innovation* to provide more variety in product features, design and marketing. But, the increased variety typically calls for cost control by streamlining operations with *process efficiency*, obtained from the reengineering of activities combined with continuous improvement. Once again, the drive for efficiency often drowns out the voice of the customer.

Given the wide range of value propositions available at this stage, customers often need/want an integrated solution, or experience, that bundles their varying needs into one package. *Integrating innovation* solves customer problems and/or creates a total experience, by combining customer understanding, consulting and the various value propositions to deliver a tailored solution. Making it work calls for integration across internal and external organizational boundaries. Cost effective integration, in turn, requires *network efficiency*, optimizing the coordination of partners and activities in the value chain, with outsourcing, in-house expertise centers and production platforms. The late 1990s turned out to be the golden years as the market for Nokia's phones boomed and its growth soared. Nokia used differentiating innovation to increase the diversity of its valuable customers and began adding integrating innovation to develop customized solutions for its corporate clients. By the end of the decade, the recognition of Nokia's brand was amongst the highest in the world. From 1995 to 2000 its market cap had increased 21 times to $210 billion.

Competitors that miss or skip stages in the learning logic, invariably fall by the way side when others challenge them with a more advanced value proposition, or value chain. Ericsson went through the pioneering, mass production and volume efficiency stages of the second generation GSM phones. After these stages, however, its trajectory diverged from Nokia's. Whereas Nokia created variety in its value proposition with differentiating innovation, Ericsson stuck to volume efficiency, which meant that it could not compete on perceived customer value. Ericsson's rigid structure and engineering-dominated culture made it difficult to create a more entrepreneurial organization and meet the demand for more variety; its sales people had little clue on how to acquire new market segments. In addition, it was unable to increase efficiency with process improvement, owing to its fragmentation in country and functional fiefdoms, plus a high-cost Swedish location and strong unions. And without process efficiency it was unable to compete further on lower delivered costs.

In 2001, Ericsson announced the largest loss in Swedish corporate history; by the end of 2002, its market capitalization had dropped from $90 billion at the height of the dotcom boom to $15 billion, while its share of the mobile phone market dropped from 20% to less than 5%. The business model had to be changed radically to cope with the newly

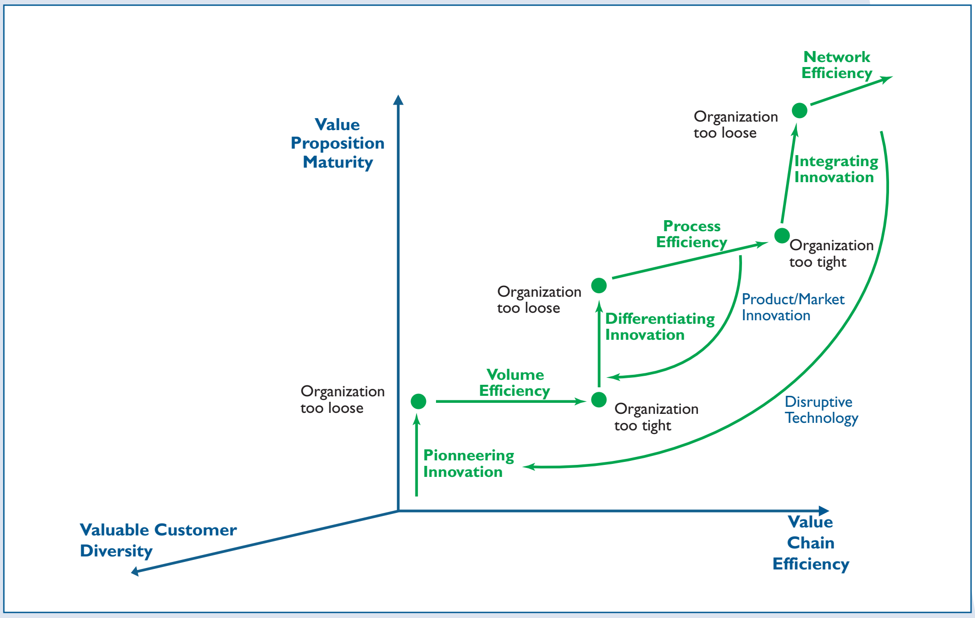


Exhibit C – Sequence the Development of Capabilities. *This chart originated in work on Outpacing Strategies done together with Xavier Gilbert, work on Breakpoints done by Paul Strebel, and was influenced by work on New Competitive Strategies done by Andy Boynton and Bart Victor.*

emerging technologies, but internally the organization was blocked. The only silver lining in the cloud was that its nemesis, Nokia, had also been stopped in its tracks. Between 2000 and 2002, Nokia's market cap dropped by two thirds to $80 billion. To deal with the disruptive convergence between telecoms, computing, and consumer electronics, Nokia shifted its strategic emphasis back towards pioneering innovation. Product and market development in the mobile phone division was first split into eight customer-facing units and then the company as a whole was reorganized into four divisions: mobile phones, telecom equipment, business applications and multimedia devices. But the reorganizations had a negative effect on the rate of new model introduction, which had been the primary reason for the reorganization.

Nobody Has a Monopoly On Smart Big Moves

The learning logic associated with the development of valuable customers and innovative value propositions, supported by an efficient value chain, can be interrupted at any moment by external events, such as the emergence/creation of a new product-market segment, a new disruptive technology, or other events originating outside the industry. Because the internal learning logic is broken, these situations are especially challenging. In the face of a disruptive technology, for example, incumbents can rarely respond successfully. This partly explains the relative decline of Nokia and the rise of Ericsson between 2002 and 2004. By 2002, the market had shifted, driven by the collapse of the dotcom and telecom boom, the emergence of new competitors, like Qualcomm and Samsung, and the intensifying competition for control over the next generation of mobile hardware and software platforms. While Nokia was reorganizing to cope with the increasingly disruptive technology wave, other traditional competitors started offering the market incremental product innovation, in the form of clamshell phones and colour screens. Nokia lost market share. Reorganizing to deal with a breakpoint in the learning logic, it took its eye off the ball in existing markets. Ericsson, in a desperate move to save the mobile phone division, made its best smart big move since the early 1990s. It set up a joint venture with Sony. In terms of complementarity, pioneering innovation was a must. An independent venture with a partner that understood the media technology game was one of very few moves left. With survival on the line, the atmosphere in the joint venture was very much that of a start-up and Sony Ericsson quickly came up with the T68 mobile phone with colour screen for the top end of the market. It struck a consumer chord and was followed by the successful P800 and 900 models, which incorporated email, photo, and digital organizer features. With its smaller start-up configuration, Sony Ericsson now had a more flexible organization for the new technology race than the much larger Nokia. Whereas between 2002 and 2004, Nokia's market cap dropped by $10 billion, Ericsson's increased by $35 billion from its lowest point.[3]

Think Smart before you Think Big

The Nokia-Ericsson case illustrates the need to make smart big moves that are anchored in a complementary learning logic that is both balanced and sequential. Operationally, this involves thinking smart before thinking big: developing new capabilities based on experience, the company already has developed, either in an earlier life-cycle phase, pilot projects, or small business units. The business model, organization, type of leadership, and governance needed for the move, should be known. The subtleties of the related capabilities should be familiar to at least some managers, who are part of the parent company and understand the dominant host culture, but have lived through the time-consuming development of the new capabilities. The big move then involves shifting resources and decision-making power to the standard bearers of the new direction.

1 This is one of three factors we singled out as being specific to companies that mastered the execution of smart big moves.

2 See for example, Zook, Chris (2004) *"Beyond the Core: Expand Your Market Without Abandoning Your Roots"*, Harvard Business School Press, 256 p. and Collins, Jim (2001) *"Good to Great: Why Some Companies Make the Leap... and Others Don't"*, Collins, 320p

3 These market capitalization figures include both the phone and network divisions of Nokia and Ericsson. With its larger network division, the increase in Ericsson's market cap reflects at least in part the pick-up in telecom network spending, which in Nokia's case was not enough to offset the drop in value of the phone division.

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