1 What is strategy?

This book is about human resource (HR) strategy – *the decisions, processes, and choices that organizations make about managing people*. It is designed as a primer for students in master of business administration (MBA) or HR programs, as well as for HR and organization leaders and general managers. It aims to provide an overview of the elements of human resource plans at the strategic, operational, unit, and functional levels.

It is more than that, however. A unique aspect of this book is that we have incorporated a consistent perspective that human resource or human capital strategy is also about risk optimization and management. It is difficult to consider any arena of management without attention to risk, and this is especially true in the arena of human capital. Integrating risk into human resource strategy is a less traditional way to approach the topic, but an increasingly uncertain world demands such a perspective.

Not only is it important to incorporate risk more explicitly into the framework of human capital strategy, but also, we believe, doing so will enhance and extend the paradigms of human capital planning in new and useful directions, producing a unique perspective for leaders inside and outside the HR function. We will have much more to say about risk optimization and management in later chapters. The purpose of this opening chapter is to explore some of the fundamental ideas that underpin organizational strategy in general, because organizational strategy is the foundation of human resource strategy.

Strategy consists of the decisions, processes, and choices that organizations make to position themselves for sustainable success.[1] These decisions, processes, and choices define a firm's competitive position in the marketplace. This is the most common perspective, and one that we adopt frequently in our examples. This definition also includes organizations that are not companies, that operate in non-market environments, and that may define strategic success differently from financial or competitive outcomes. Nonetheless, the fundamental elements of strategy, including relative positioning, decisions, stakeholders, and dynamism, apply to all organizations.

Think of the automobile industry, for example. Think about the differences between the cheapest cars available (Chevy Aveo, Tata Nano), mid-priced offerings (Honda Accord, Toyota Camry), luxury cars (BMW, Mercedes, Lexus), and ultra-luxury cars (Rolls-Royce, Bentley, Aston Martin). Think about the differences between sedans, sports cars, and sport-utility vehicles, and between convertibles, hard tops, and hard-top convertibles. It is all about positioning a product or service in the marketplace (competitive positioning) so that it appeals to different customer segments.

Strategy answers the following questions. Why should customers buy from your company, as opposed to one of your competitors? What do you do better than anyone else? What do you offer that is valuable, rare, and difficult to imitate? Do you offer products or services that no other competitor can match, such as a patent-protected miracle drug? Do you offer the cheapest products or services? Are your products or services the highest-quality ones available? Do they fill a specialized niche? Do you deliver your products or services more rapidly than any competitor can? Does your company distinguish itself by providing the very best customer service? Competitive strategy is about the choices and trade-offs that firms make. It is about being different. It means deliberately choosing a different set of activities in order to deliver a unique mix of value to the customer.[2]

To appreciate how differences define competitive strategy, consider that a full-service airline is configured to get passengers from almost any point A to any point B. To reach a large number of destinations and serve passengers with connecting flights, full-service airlines employ a hub-and-spoke system centered on major airports. To attract passengers who desire more comfort, they offer first-class or business-class service. To accommodate passengers who must change planes, they coordinate schedules and check and transfer baggage. Because some passengers will be traveling for many hours, full-service airlines serve meals.[3]

In contrast, Southwest Airlines Company offers short-haul, low-cost, point-to-point service between midsize cities and secondary airports in large cities. It does not fly great distances, and, at least in its early years, it avoided large airports. Its customers include business travelers, families, and students. Southwest's frequent departures and low fares attract price-sensitive customers who otherwise would travel by bus or car, and convenience-oriented travelers who would choose a full-service airline on other routes.[4] As you can see from this brief introduction, strategy is the foundation for all organizational decisions.

Strategy provides an overall direction and focus for the organization as a whole, including for each functional area. In this book our primary focus is on one functional area: HR strategy. Overall business strategy, through its hierarchy of goals – vision, mission, and strategic objectives – provides helpful guidance about the type of talent that will be necessary to fulfill the organization's strategic objectives, and to move toward its mission and vision. HR strategy is much more specific with respect to the selection, deployment, and management of that talent.

Corporate identity: fundamental enabler of strategy

A distinctive, coherent corporate identity is the fundamental enabler of strategy and the source of competitive advantage.[5] It is the quality that attracts customers, allies, stakeholders, investors, employees, and suppliers. It is grounded in the things that an organization can do with distinction (its internal capabilities) and in market realities (based on its assessment of the external environment and the industry or industries in which it chooses to compete). To develop its own capabilities-driven strategy, each organization must be able to answer questions such as the following. How do you capture value, now and in the future, for your chosen customers? What are your most important capabilities, and how do they fit together? How do you align them with your portfolio of products and services? The more clearly and strongly a company makes these choices, the better its chances of creating a corporate identity that allows it to win in the long run.[6]

Strategy formulation

Strategy formulation answers the basic question "How will we compete?"[7] Answering this question is a vital role of senior leaders within an organization, and to do so they typically consider trends and forces in the competitive environment, customer wants and needs, competitive positioning, and their firms' internal strengths and weaknesses. In this section we consider frameworks for analyzing the external environment, and in the following section we do the same with respect to internal strengths and weaknesses.

A popular framework for analyzing environmental opportunities and threats in an industry is the "five-forces model" that Michael Porter and his associates have developed. It considers the threat of new entrants, the power of suppliers, the power of buyers, the threat of substitutes, and rivalry among competitors.[8]

Typical steps in the analysis include: (1) definition of the industry (products, geographic scope); (2) identification of participants (buyers, suppliers, competitors, substitutes, potential entrants); (3) identification of the overall industry structure (forces that control profitability, understanding why the level of profitability is what it is); (4) analysis of recent and likely future changes in each force; and (5) identification of aspects of industry structure that might be influenced by competitors, new entrants, or your company. The overall objective is to understand the underpinnings of competition and the root causes of profitability. This is the job of the strategist: to understand and cope with competition.[9]

Strategy can also usefully be viewed as building defenses against competitive forces or finding a position in the industry at which the forces are weakest. Here is an example presented by Porter.[10] Paccar Inc. manufactures premium commercial vehicles sold around the world under the Kenworth, Peterbilt, and DAF nameplates. The heavy-truck industry is structurally challenging. Many buyers operate large fleets or are large leasing companies, with both the leverage and the motivation to drive down the price of one of their biggest purchases. Most trucks are built to regulated standards and offer similar features, so price competition is rampant. Capital intensity causes rivalry to be fierce, especially during recurring cyclical downturns. Unions exercise considerable supplier power. Although there are few direct substitutes for an eighteen-wheeler, truck buyers face important substitutes for their services, such as cargo delivery by rail.

In this setting, Paccar, a company based in Bellevue, Washington, with about 20 percent of the North American heavy-truck market, has chosen to focus on one group of customers: owner-operators – drivers who own their trucks and contract directly with shippers or serve as subcontractors to larger trucking companies. Such small operators have limited clout as truck buyers. They are also less price-sensitive, because of their strong emotional ties to and economic dependence on the product. They take great pride in their trucks, in which they spend most of their time.

Paccar has invested heavily in order to develop an array of features with owner-operators in mind: luxurious sleeper cabins, plush leather seats, noise-insulated cabins, sleek exterior styling, and so on. At the company's extensive network of dealers, prospective buyers use software to select among thousands of options to put their personal signature on their trucks. These customized trucks are built to order, not to stock, and delivered in six to eight weeks. Paccar's trucks also have aerodynamic designs that reduce fuel consumption, and they maintain their resale value better than other trucks. Paccar's roadside-assistance program and its system for distributing spare parts, which is supported by information technology (IT), reduce the time a truck is out of service. All these are crucial considerations for an owner-operator. Customers pay Paccar a 10 percent premium, and its Kenworth and Peterbilt brands are considered status symbols at truck stops.

Paccar illustrates the principles of positioning a company within a given industry structure. The firm has found a portion of its industry in which the competitive forces are weaker – in which it can avoid buyer power and price-based rivalry – and it has tailored every single part of the value chain to cope well with the forces in its segment. As a result, Paccar has been profitable for sixty-eight years consecutively and has earned a long-run return on equity of more than 20 percent.

Strategy formulation may be quite formal and last for long periods, or it may be highly dynamic and adaptive, as was the case during the Great Recession of 2007–9. In response to sharp swings in consumer demand during the recession, many firms discovered that increased flexibility and accelerated decision making were preferable to static five-year strategic plans. What was new was a heavy dose of opportunism based on rough "adaptive strategies" that considered multiple scenarios. For example, before the recession and the housing crisis, appliance maker Whirlpool Corporation considered scenarios based on a 5 percent increase or decrease in consumer demand. During the recession, however, the firm discovered that the rate of change and the width of volatility were considerably greater than it had assumed previously. The company now considers alternative scenarios in response to swings as wide as 15 percent.[11] In the process of strategy formulation, analysis of the competitive environment is necessary, but not sufficient. A complete understanding of the sources of competitive advantage also requires analyses of a firm's strengths and weaknesses.

Analyzing internal strengths and weaknesses

Internal strengths and weaknesses arise from "resources" and "capabilities." In their quest to develop bases for competitive advantage, firms try to offer something that is valuable, rare, and difficult to imitate. This section considers each of these.

A firm's resources and capabilities add value by allowing it to exploit opportunities or to neutralize threats.[12] 3M, for example, used its skills and experience in substrates, coatings, and adhesives – along with an organizational culture that rewards risk taking and creativity – to exploit numerous market opportunities in six broad areas: consumer and office; display and graphics; electro and communications; healthcare; industrial and transportation; and safety, security, and protective services. Some of its notable products include Scotch-Brite™ cleaning products, Scotch® tapes, Nexcare™ skincare products, Scotchguard™ fabric protection, Microtouch™ touch screens, Fastbond™ adhesives, Filtrete™ air filters, O-Cel-O™ sponges, and Post-it® notes.[13]

Strategically, 3M's managers linked their analysis of the firm's internal resources and capabilities with their analysis of environmental opportunities and threats. Those resources are not valuable on their own, but they become valuable when they exploit opportunities or neutralize threats. For example, Post-it® notes exploited an untapped opportunity in the marketplace for adhesive-backed notepads that do not lift the print off of the paper on which they are stuck. The "five-forces model" that we discussed earlier can be used to isolate potential opportunities and threats that can be exploited or neutralized by the resources a firm controls.

As Jay Barney has noted, valuable but common resources and capabilities are sources of competitive parity.[14] To be a genuine source of competitive advantage, a firm's resources and capabilities must be rare among competing firms. Consider, for example, Apple Inc.'s meticulous attention to product design and functionality. These features have made products such as the iPod, iPhone, iPad, and Macintosh computers favorites among consumers. In fact, in 2012 Apple topped *Fortune* magazine's listing of "World's most admired companies" for the fifth year in a row. What makes Apple so admired? Well, for starters, this is the company that changed the way we do everything from buying music to engaging with the world around us (think about instant access to the internet from mobile devices, such as the iPhone and iPad). Its track record for innovation and fierce consumer loyalty translates into tremendous respect across the highest ranks of business; or, as BMW chief executive officer (CEO) Norbert Reithofer put it, "The whole world held its breath before the iPad was announced. That's brand management at its very best."[15]

Firms that possess valuable, rare resources and capabilities can gain at least a temporary competitive advantage – unless or until competitors are able to imitate them. If competing firms face a cost disadvantage in imitating these resources and capabilities, however, then firms with these special abilities can obtain a sustained competitive advantage over time.[16] Such is the case with operating systems for personal computers (PCs), which are exceedingly complex and difficult to imitate. This helps to explain why Microsoft's Windows™ and Apple's MAC OS X™ operating systems have a near-monopoly on the PC market worldwide.

Finally, to exploit its potential fully for competitive advantage, a firm needs "complementary resources," in the form of organizational structure and management systems. These include reporting relationships, management control systems, and compensation policies.[17] To appreciate the importance of these organizational resources, consider an example presented by Barney. Through the 1960s and early 1970s Xerox invested in a series of innovative technology-development research efforts through its stand-alone research laboratory, Xerox PARC, in Palo Alto, California. The innovative scientists and engineers who worked there developed an amazing array of technological innovations, including the personal computer, the mouse, windows-type software, the laser printer, and Ethernet, among others. These technologies were rare, and their market potential was enormous.

Unfortunately, Xerox did not have an organization in place to take advantage of these resources. No structure existed by which Xerox

PARC's innovations could become known to managers at Xerox. When managers finally did become aware of these innovations, in the mid-1970s, very few of them survived Xerox's highly bureaucratic product-development process. Moreover, Xerox managers failed to exploit fully those that did, because their own compensation depended on maximizing current revenue, not developing markets for future sales and profitability. Xerox's formal reporting structure, its explicit management-control systems, and its compensation policies were all inconsistent with exploiting the valuable, rare, and costly-to-imitate resources developed at Xerox PARC.[18] Not surprisingly, then, Xerox failed to exploit any of these potential sources of sustained competitive advantage.[19]

Broad strategies for achieving competitive advantage

At a broad level, firms may achieve competitive advantage through strategies such as cost leadership, differentiation, or speed, or by focusing narrowly on a market segment. For instance, differentiation as a strategy seeks to exploit differences in a firm's products or services by creating something that is perceived industry-wide as unique and valued by customers; examples include:

- prestige (Ritz-Carlton hotels or BMW automobiles);
- technology (Bose sound systems, Apple's iPad);
- innovation (Apple, 3M, Medtronic medical equipment, Intel); and
- customer service (Lexus, Amazon.com).

FedEx CEO and founder Fred Smith claims that the key to his firm's success is innovation. He contends that his management team did not understand its real goal when the firm started operating in 1971: "We thought that we were selling the transportation of goods; in fact, we were selling peace of mind."[20] To that end, by 2000 FedEx was providing each driver with a hand-held computer and a transmitting device, so as to make it possible for customers to track their packages right from their PCs (and, today, from their mobile devices).

While it is possible to provide examples of each of the broad strategies that enable firms to differentiate themselves from competitors, pure forms of them are rare. Consider Amazon, for example, the king of e-commerce, and one of *Fortune* magazine's top five "World's most admired companies" in 2011.[21] Amazon excels in innovation, in cost leadership, and in customer service. Founded in 1994 as an online bookstore, Amazon is now the internet's largest retailer, with some 33,700 employees and 2011 sales of $48.1 billion. In the area of innovation, consider Amazon's e-reader, the Kindle. In 2011 the company sold more than 12 million Kindles, making it Amazon's best-selling product. More importantly, the Kindle allowed Amazon to stake out an early lead in e-books. Since 2010 it has sold three times as many e-books as hardcovers, and it dominates the fast-growing new market. Indeed, creating the hardware helped create the market.

In terms of cost, in a Morgan Stanley survey of fifty products, Amazon sold items for 6 percent less, on average, than Wal-Mart and 9 percent less than Best Buy. Finally, Amazon's customer service (along with that of its subsidiary, Zappos) ranked higher than any other retailer's, according to a recent National Retail Federation survey. Amazon recognizes the need to continue to innovate, for that is the only way to outrun the competition. Recently it introduced Amazon Prime, which offers free shipping for a $79 annual fee. The program is a hit with customers and a way for Amazon to boost repeat sales across its categories – a difficult feat for online retailers to achieve.[22]

Strategy analysis

Strategy analysis is the process that defines the crucial (or pivotal) elements for the strategy's success. It answers the question "Where does superior execution most enhance our strategic success?" Analyzing the overall strategy to reveal the implications of these pivotal elements focuses attention on the execution of the broader business strategy.

As an example, consider Sysco Corporation of Houston, Texas. Sysco is the number one food service marketer and distributor in North America. In fiscal year 2010 its revenues exceeded $37 billion, it employed almost 50,000 people, and it served 500,000 customers with approximately 300,000 different products. What makes Sysco special is that it excels in innovation as well as in the execution of a well-developed strategy. That strategy is based on differentiation. To do that, the company serves not just as a vendor to its customers, but also as a partner, for its objective is to help its customers succeed. One way it does this is by providing third-party financing for its customers – restaurant owners who seek financing for a new kitchen, for example.

In terms of strategy execution, consider just one business process: order fulfillment. Of the more than 4 million cases of food and related products that Sysco ships every day, it receives about 85 percent of its orders after 5:30 p.m. the day before they are supposed to be delivered. The company relies on an enterprise resource planning (ERP) system, an integrated computer-based application, to process orders and to set up routing. Warehouse employees wear wrist computers to ensure correspondence between customers' orders and the items that actually are loaded onto trucks for delivery. This process results in more than 99 percent accuracy.[23]

ERP systems facilitate the flow of information among all business functions inside the boundaries of the organization, and they manage the connections to outside stakeholders.[24] At Sysco, delivery trucks are loaded in the middle of the night from warehouses, and they are dispatched up to 150 miles away, beginning at 5:00 a.m. Such dedication to process has resulted in high levels of control as well as transparency. Beyond that, Sysco's compensation system for drivers – activity-based compensation – rewards them for delivering customers' orders on time and in good condition. This is strategy analysis that leads to strategy execution.

The process of accurate, timely order fulfillment is aligned with incentive compensation to ensure end-to-end excellence in the overall process of order realization. Such alignment leads to solid execution of a critically important aspect of Sysco's well-developed strategy. Execution represents the implementation of strategy and makes it real, so that an organization can sustain its competitive advantages. At a broader level, how firms compete with each other, and how they attain and sustain competitive advantage, constitute the essence of what is known as strategic management.[25]

Before we leave the subject of execution, which focuses on operational effectiveness (OE), it is important to emphasize that OE is not strategy.[26] OE means performing similar activities better than rivals. Execution-oriented ideas, such as reengineering, benchmarking, outsourcing, and change management, all have the same strategic limit; that is, they all lead to better operations, but ignore the question of which businesses to operate in the first place. This is why strategy formulation must precede strategy analysis. First choose industries or markets in which overall conditions are favorable – most companies are relatively weak, suppliers have relatively little clout, and aspiring entrants are few – or in which a company can differentiate itself.[27] Then focus on the pivotal elements of the overall strategy and their implications for operational effectiveness. Outside the corporate world, it is important to note that other organizations, such as the Red Cross or UNAIDS, also consider the vital factors that matter to stakeholders, and then position themselves for strategic success along those factors. We return to the notion of strategy formulation and analysis later, in Chapter 5, when we provide an explicit framework for connecting talent implications to each level of strategy.

A brief history of strategic thought[27]

At a broad level, there are four basic schools of thought regarding strategy: position, execution, adaptation, and concentration (see Figure 1.1). Each has something significant to offer, so long as it is adopted in an appropriately balanced way. Here is a brief description of each approach.

Position – winners select favorable markets as defined by external forces.
Execution – winners gain advantage through operational excellence.
Adaptation – winners develop an overall direction through experimentation and rapid change.
Concentration – winners make the most of current core strengths and businesses.

From the 1960s to today, many companies have bounced from one quadrant to another.

Cesare Mainardi and Art Kleiner built Figure 1.1 from three earlier books on the history of strategy: Walter Kiechel's *The Lords of Strategy*;[28] Kleiner's *The Age of Heretics*;[29] and Henry Mintzberg, Bruce Ahlstrand, and Joseph Lampel's *Strategy Safari*.[30] The grid itself reflects views as to the best approach for developing business strategy. The X-axis represents the point of view on authorship: who is responsible for major strategy decisions? The left side depicts those who favor collective choice (strategic thinking is instilled among as many people throughout the company as possible). The right side depicts those who favor top-down formulation (strategy is developed by the few, the designated expert planners and senior executives, while the rest of the enterprise is dedicated to execution).

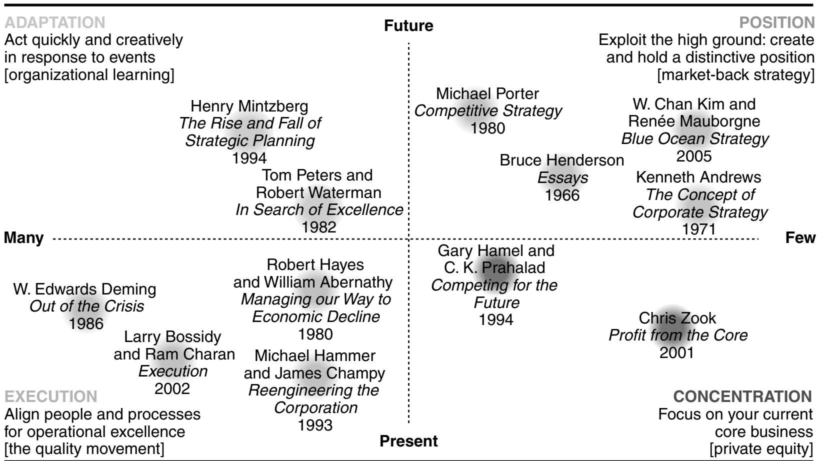

Figure 1.1 A landscape of strategy concepts
Source: Mainardi, C., and Kleiner, A. (2010). The right to win. *Strategy and Business*, 61: 1–12, 4.

The Y-axis depicts time orientation: the degree to which strategy is seen as present- or future-oriented. At the top are those who favor moving toward a long-term destination that may be different from the company's current position. At the bottom are those who favor letting the company's strategic direction emerge from its current state.

Conflicting business realities

Despite their differences, all four schools of strategy represent attempts to resolve the same basic underlying problem: the tension between two conflicting business realities.[31] The first reality is that advantage is transient. Even the most formidable market position can be vulnerable to technological disruptions, upstart competition, shifting capital flows, new regulatory regimes, political changes, and other features of a chaotic and unpredictable business environment.

It might therefore appear that the answer is to become completely resilient, changing to match the shifting demands of the market. Companies cannot do that, however, because of the second reality: corporate identity is slow to change. The innate qualities of an organization that distinguish it from all others – its operational processes, culture, relationships, and distinctive capabilities – are built up gradually, decision by decision, and continually reinforced through organizational practices and conversations. Very few companies have reinvented themselves thoroughly, and those that have managed it typically have had to force many people out, including top executives, and to replace them with new recruits chosen for a different set of attitudes and skills. Even when leaders recognize the need for change or know that the company's survival is at stake, this identity is difficult to shift.[31] In short, it is tough for an incumbent leadership team to refloat the boat. Now let us consider briefly each of the four major schools of thought that have influenced the development of business strategy.

Four major schools of thought

School no. 1: position is the key to winning Starting in the mid-1960s, and based on the early thinking of Napoleon Bonaparte, Carl von Clausewitz, and Sun Tzu, strategy was seen as an overarching plan for growth, usually written up in a formal document and endorsed by the CEO, aimed at creating an unassailable position for the company in the marketplace.[32] These early efforts by the position (or positioning) school assumed that winning companies comprehensively analyzed all critical factors: external markets, internal capabilities, and the needs of society. Inevitably, such analyses evolved into a complex checklist of strengths, weaknesses, opportunities, and threats (the origin of the SWOT analysis still prevalent today).

In the days before the advent of spreadsheets, big companies hired armies of planning staffers to compile all this information into elaborate documents, which were debated in annual strategy sessions that became exercises in bureaucratic complexity. Only gradually did it become clear that the plans did not correlate with real-world performance or issues. For example, Ford and General Motors (GM) both experienced losses of more than $500 million in 1979 and 1980 – their first such losses in decades. In the aftermath of these and other sharp reversals, mainstream business leaders began to question the wisdom of the position school.

School no. 2: execution is the key to winning The first serious contrary reaction came from those in operations management, specifically from Robert Hayes and William Abernathy, both of the Harvard Business School. They introduced a competing school of strategic thought, based on the idea that execution and operational excellence were the real keys to winning in the marketplace. The message to companies was clear: develop and deploy better practices, processes, technologies, and products. The execution message was bolstered by companies such as General Electric (GE) and Motorola, both of which provided examples of operations-oriented strategies, with their reliance on executive training and such practices as six sigma.[33]

Operational excellence was also a basic tenet of the quality movement – the continuous improvement practices that were developed at the Toyota Motor Corporation and a few other Japanese companies in the 1950s and 1960s and are now generally known as "lean management." The most influential strategic thinker associated with the quality movement was W. Edwards Deming, an American statistician who began consulting with Japanese companies after World War II had ended. Deming's most prominent book was entitled *Out of the Crisis*.[34] In his view, winning companies honed and refined their day-to-day processes and practices, eliminating waste, training people throughout the company to use statistical methods, and cultivating the intrinsic "joy in work" that people feel when they are truly engaged in their jobs.

In the early 1990s the execution school received a big boost from Michael Hammer and James Champy, in an approach called "reengineering."[35] This approach encouraged companies to look afresh at all their processes, as if redesigning them from scratch. Unfortunately, many companies used reengineering as a launching pad for across-the-board layoffs that left them weaker. By the end of the 1990s execution-based strategy was largely relegated to the production side of the business.

The idea of building value through managerial methods returned to strategic relevance after the dot.com bubble burst. Its return was symbolized by Larry Bossidy and Ram Charan's business bestseller *Execution: The Discipline of Getting Things Done*.[36] By this time, however, many leaders understood, through experience, the value of improving execution, as well as its challenges. It generally required major changes in managerial and employee behavior.

Porter: new vitality for the position school Harvard Business School professor Michael Porter – probably the most influential thinker on corporate strategy in the institution's history – identified the other major limit of the execution school. In his early publications, from the late 1970s to the early 1990s, Porter brought positioning to a level of unprecedented sophistication. He recast the turbulence of a company's business environment into a "value chain" and "five forces" (as we noted earlier) – two frameworks that could be used to analyze the value potential and competitive intensity of any business.

To Porter, execution-oriented ideas such as reengineering, benchmarking, outsourcing, and change management all had the same strategic limit. They all led to better operations, but, as noted earlier, they ignored the question of which businesses to operate in the first place. After all, the core strategic decision is the pursuit of simplicity through a clear market strategy.

The position school became a major driver of the resurgence of corporate competitiveness in the West during the 1980s and through the mid-1990s, but its limits became evident in the late 1990s and 2000s. Although Porter took pains to explain that industry structures can change and can be shaped by the actions of leading companies, to many his message was that some industries are innately good and others are irredeemably bad. Some companies tried to escape by entering new businesses in which they had no distinctive capabilities, so-called "blue oceans," where they did not know how to swim.[37] These efforts generally failed. As the 2000s unfolded, companies with solid market positions, such as Microsoft, also saw their advantage fade when new competitors, such as Google, emerged. This did not disprove Porter's hypothesis, but it gave others an opening to criticize his thinking.[38]

School no. 3: adaptation and experimentation Perhaps Porter's best-known critic was Henry Mintzberg of McGill University, in his history of strategic planning,[39] who presented strategy as the art of perpetual adaptation and experimentation. In this line of thinking, executives win in the marketplace not by analysis and planning but by experimenting with new ideas and directions, discarding those that do not work, and adjusting their efforts to meet new challenges.

The adaptation school is also limited, though, because its freewheeling nature may lead to incoherent, uncoordinated efforts. As Mainardi and Kleiner note:[40]

> A multitude of products and services that all have different capability needs and different market positions cannot possibly be brought into sync. The more diverse a company's efforts become,

the more it costs to develop and apply the advantaged capabilities they need. Letting a thousand flowers bloom can lead to a field full of weeds – and to businesses that can't match the expertise and resources of more focused, coherent competitors.

School no. 4: concentration The shortcomings of the adaptation school led to the appeal of the fourth group of strategy thinkers – the concentration school – whose early proponents were Gary Hamel and C. K. Prahalad, authors of *Competing for the Future.*[41] They argued that the most effective companies owed their success to a select set of "core competencies": a foundation of skills and technological capabilities (such as new forms of hardware, software, systems, or biotechnology) that allowed companies to compete in distinctive ways. Companies that focused on these would win in the marketplace.

More recently, Chris Zook of Bain & Company, drawing on his firm's experience with private equity, has been the most prominent proponent of this school. In his view, companies that win stick to their core businesses and find new ways to exploit them for growth and value. This means differentiating a company by starting with its central capabilities. For example, Enterprise, Dollar/Thrifty, and Avis all prospered by focusing on, respectively, rentals for people with car repairs, vacationers, and business travelers.[42]

In practice, the concentration strategy often becomes a way of holding on to old approaches, even when they become outdated. To hold on, many companies (and private-equity firms) resort to slash-and-burn retrenchment. They cut costs and minimize investments in research and development (R&D) and marketing. Such a pared-down company produces more profits at first, but cannot sustain the growth required for long-term profitability. Truly successful game-changing leaps, such as Apple's into consumer media or Tata's into the inexpensive Nano automobile, cannot be managed from a concentration strategy alone.[43]

Strategy today

It is important to note that most of the thinkers who introduced the four schools of thought that we have just discussed recognized the challenges and limits of their approaches, and even warned against misapplying them. Businesspeople still misapplied them, however. When actual results failed to match those that each theory predicted, opportunities were created for the next theory to emerge.

Where is the field today? Stepping back, it is important to consider a concept that we identified earlier as the fundamental enabler of business strategy: company identity. This approach encompasses the way a company expects to compete, the capabilities with which it will compete, and the portfolio decisions that fit. Such a capabilities-driven strategy process takes into account the position the leaders want to hold as well as the company's ability to deliver. Today, more than fifty years after the field of business strategy emerged, we recognize that each of the four schools of thought that we have discussed provides important insights that can help a company find and hold competitive advantage relative to its competitors. At the same time, however, each company, with its unique identity and circumstances, has got to find its own answers.

Ensuring coherence in strategic direction: vision, mission, and objectives

Organizations are more likely to be successful if everyone from the mailroom to the boardroom is striving for common goals and objectives. From general to specific, stated goals form a hierarchy that includes each organization's vision, mission, and strategic objectives.

An organization's vision should be massively inspiring, overarching, and long term.[44] Emotionally driven, it is a fundamental statement of an organization's values, aspirations, and goals. Here are some examples.[45]

- "To be the happiest place on earth" (Disneyland).
- "Restoring patients to full life" (Medtronic).
- "To be the world's best quick-service restaurant" (McDonald's).
- "To be our customers' most valued and trusted business partner" (Sysco).
- "Zero new HIV Infections. Zero discrimination. Zero AIDS-related deaths" (UNAIDS).

A vision may or may not succeed. It depends on whether everything else happens according to a firm's strategy.

A mission statement differs from a vision statement, in that it includes the purpose of the company as well as the basis of competition and competitive advantage. Here is FedEx's: "To produce superior financial returns for our shareholders as we serve our customers with the highest-quality transportation, logistics, and e-commerce."[46]

The most important audience for a mission statement is employees, as it helps build a common understanding of an organization's purpose and the basis of its intended competitive advantage in the marketplace. Strategic objectives operationalize the mission statement. They may be either financial or nonfinancial, but in both cases they need to provide guidance on how the organization can fulfill or move toward the higher-level goals: vision and mission. For example, Walgreen's set itself a strategic objective of operating 6,000 stores by 2010, up from 3,000 in 2000. Fortune Brands set the strategic objective of reducing corporate overhead costs by $30 million a year. These objectives are SMART – that is, they are specific, measurable, appropriate (consistent with the vision and mission), realistic (challenging but doable), and timely.

SMART objectives have several advantages. They help to channel the efforts of all employees toward common goals. They can motivate and inspire employees to higher levels of commitment and effort. Finally, they can provide a yardstick to measure performance, and thus the distribution of rewards and incentives.

Although planning business strategy clearly offers a number of benefits, there is also a potential downside, in that it may lock companies into a particular vision of the future – one that may not come to pass. This poses a dilemma: how to plan for the future when the future changes so quickly. The answer is to make the planning process more democratic.

Instead of relegating strategic planning to a separate staff – as in the past – it needs to include a wide range of people, from line managers to customers to suppliers. Top managers must listen and be prepared to shift plans in midstream, if conditions demand it. This is exactly the approach that Cisco Systems takes. It is not wedded to any particular technology, because it recognizes that customers are the arbiters of choice. It listens carefully to its customers and then offers solutions that customers want.

Our final section addresses the relationship between HR and business strategy in more detail.

Relationship of HR strategy to business strategy

Human resource strategy parallels and facilitates the implementation of the strategic business plan. HR strategy refers to the processes, decisions, and choices the organization makes regarding its human resources and how they are organized. HR strategies are often formulated to align with the organization's strategy, by creating the capacity in the workforce and how it is organized that is necessary to achieve the organization's strategic objectives. It requires a focus on planned major changes in the organization and on critical issues, such as the following:

- What are the HR implications of the proposed organizational strategies?
- What are the possible external constraints and requirements?
- What are the implications for management practices, management development, and management succession?
- What can be done in the short term to prepare for longer-term needs? In this approach to the strategic management of human resources, a firm's business strategy and its HR strategy are interdependent.[47]

Figure 1.2 is a simple model, which we elaborate more completely in later chapters, that shows the relationship of HR strategy to the broader business strategy.[48] Briefly, the model shows that planning proceeds top down, while execution proceeds bottom up. There are four links in the model, beginning with the fundamental question "How do we compete?" As we noted earlier, firms may compete on a number of non-independent dimensions, such as innovation, quality, cost leadership, or speed. From this, it becomes possible to identify business or organizational processes that the firm must execute well in order to compete (e.g., speedy order fulfillment). When processes are executed well, the organization delights its internal and external customers through high performance. This may occur, for example, when an employee presents a timely, cost-effective solution to a customer's problem.

At a general level, high-performance work practices include the following five features:[49]

(1) pushing responsibility down to employees operating in flatter organizations;
(2) increased emphasis on line managers as HR managers;
(3) instilling learning as a priority in all organizational systems;
(4) decentralizing decision making to autonomous units and employees; and

Figure 1.2 The relationship of HR strategy to the broader strategy of a business
Source: SHRM Foundation (2004). *HR in Alignment*, DVD. Alexandria, VA: SHRM Foundation (available at www.shrm.org/Foundation).

(5) linking performance measures for employees to financial performance indicators.

To manage and motivate employees to strive for high performance, the right competencies, incentives, and work practices must be in place. Execution proceeds from the bottom up, as appropriate competencies, challenging incentives, and work practices inspire high performance, which delights internal and external customers. This, in turn, means that business processes are being executed efficiently, enabling the organization to compete successfully for business in the marketplace.

HR metrics serve as a kind of overlay to the model itself. HR metrics should effect the key drivers of individual, team, and organizational performance. When they do, the organization is measuring what really matters. Like any other aspect of business, HR issues, sometimes called talent-related issues, carry risk. Prudently managing those risks is a never-ending challenge. It is also a critical component of value creation, as the next section makes clear.

Strategy and risk

When we use the term "risk," we are referring to an undesirable outcome and its consequences, usually when that outcome or its consequences are uncertain. While risk cannot be eliminated, given the many uncertainties in the environment and the sudden, violent changes that sometimes occur in the business world, it is possible to optimize the kinds of risks that organizations face. Chapter 4 provides a framework for integrating risk optimization into human capital strategy. Here we note simply that the concept of risk management is rapidly becoming an integral feature of business strategy and operational management. As we move deeper into the twenty-first century, a variety of outside agencies and observers are beginning to recognize talent-related risks as important features of organizations.

Thus the global accounting firm Ernst & Young identified this category of risk as "one of the key business risks of our time."[50] Its survey of Fortune 1000 executives from finance, HR, and risk management reported that the top five HR risks are: talent management and succession planning; ethics and tone at the top; regulatory compliance; pay and performance alignment; and employee training and development.

At a general level, the recent global financial crisis exposed the weakness of risk-management systems in many organizations: boards that did not consider macroeconomic factors when assessing risks, and risk committees that did not receive accurate information regarding mission-critical risks and the effectiveness of their organizations' responses to mitigate them. It is not surprising, then, that the global spotlight on risk management has intensified. The US Securities and Exchange Commission now requires that proxy statements filed by public companies include the role of the board of directors in risk oversight, the nature of communications between executives and the board on risk issues, and the disclosure of risk-based compensation policies. The US National Association of Corporate Directors' report on risk governance urges boards to assess strategic risks, closely monitor risks in culture and incentives, and consider emerging global risks to the firm's business. In a related development, the International Organization for Standardization's recent ISO 31000 guidance defines a common global approach to risk management.[51]

Finally, a 2010 Korn/Ferry survey of several hundred executives in more than sixty-five countries found that boards and CEOs are reporting that the overriding lesson of effective risk management is that it must become an integrated element of strategy. Corporate leaders increasingly see the levels of risk and the metrics of risk as inherent components of developing and executing strategies, and in evaluating the appropriate tolerance for risk.[52] As we noted earlier, risks tend to fall into one of two classes: (1) those associated with the protection of existing assets (e.g., intellectual property [IP], physical assets); and (2) those associated with the creation of value (e.g., new products or services). Both inherently incorporate the potential for failure if they are not managed well.

The 2004 risk-management report of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) provided a more specific framework of risk categories. The commission notes that risk mitigation is only one element of a complete approach to risk:[53]

> Events can have negative impact, positive impact, or both. Events with a negative impact represent risks, which can prevent value creation or erode existing value. Events with positive impact may offset negative impacts or represent opportunities. Opportunities are the possibility that an event will occur and positively affect the achievement of objectives, supporting value creation or preservation. Management channels opportunities back to its strategy or objective-setting processes, formulating plans to seize the opportunities.

Figure 1.3 shows enterprise risk management (ERM) in three dimensions, with the top face of the cube reflecting the risk-management objectives:

- *strategic* – high-level goals, aligned with and supporting the company's mission;
- *operations* – the effective and efficient use of its resources;
- *reporting* – the reliability of reporting; and
- *compliance* – compliance with the applicable laws and regulations.

The front face of the cube reflects the risk-management activities (objective setting, event identification, etc.), and the side face of the cube reflects the organizational entity or level of analysis at which

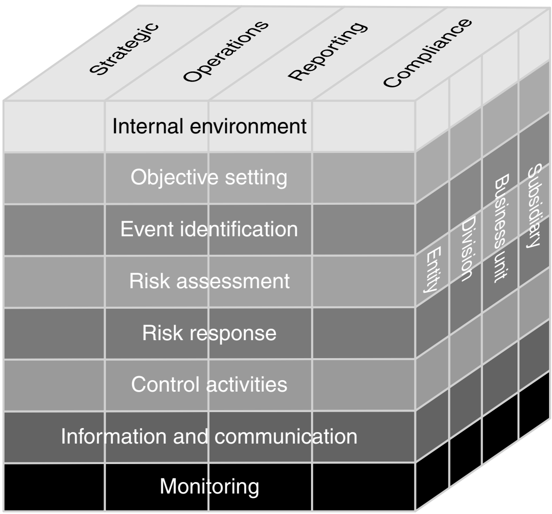

Figure 1.3 Enterprise risk-management framework
Source: COSO (2004). *Enterprise Risk Management – Integrated Framework: Executive Summary*. Chicago: COSO, 5.

the risk management occurs (subsidiary, division, etc.). The risk-management "cells" represent the intersection of each of the three dimensions, and COSO suggests this as a way to describe the domain across which opportunity, risk, and uncertainty can be managed.

With regard to human resource strategy, we return to apply the COSO "cube" in later chapters. For now, simply understand two general points: (1) human resource or human capital "risk" management should distinguish among uncertainty, risk, and opportunity; and (2) human resource strategy can address risk management either by managing the HR issues that affect the elements of the risk "cube" (e.g., by preparing the workforce to be better at event identification) or by applying the elements of the cube directly to HR issues (e.g., by evaluating the operational risk associated with HR processes such as staffing and payroll).

Conclusion

Strategy comprises the decisions, processes and choices that organizations make to position themselves for sustainable success. These decisions, processes, and choices define a firm's competitive position in the marketplace. Strategy provides an overall direction and focus for the organization as a whole, including for each functional area. At a broad level, there are four basic schools of thought regarding strategy: position (winners select favorable markets as defined by external forces); execution (winners gain advantage through operational excellence); adaptation (winners develop an overall direction through experimentation and rapid change); and concentration (winners make the most of current core strengths and businesses). Each has something significant to offer, so long as it is adopted in an appropriately balanced way.

With respect to HR, overall business strategy, through its hierarchy of goals – vision, mission, and strategic objectives – provides helpful guidance about the type of talent that will be necessary to fulfill the organization's strategic objectives, and to move toward its mission and vision. Nonetheless, there are significant risks associated with managing talent. These risks can be managed, but, to do so, HR professionals need to act now to raise awareness in their organizations about current and impending talent risks, to identify workable strategies to address emerging needs, and to implement action plans to operationalize those strategies. To do otherwise is to ignore human capital risks that can threaten the success of the business strategy that the enterprise has worked so diligently to develop. In order to develop a framework for addressing these risks, our next two chapters address the external environment that underpins decisions about business and HR strategies (Chapter 2), and the context and levels at which HR strategies develop (Chapter 3). Following that, we consider more explicitly how risk optimization and management can be incorporated into HR strategy (Chapter 4).

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