

MICHAEL PORTER ON STRATEGY

On January 25, 2007, Michael Porter came to Nyenrode to explain to a focused audience how to develop a successful strategy leading to lasting competitive advantage. In the afternoon, the seminar addressed the health care sector in the Netherlands.

Precisely four years and one day after his last visit to Nyenrode, Professor Michael Porter returned to the campus for a one-day seminar on his expert subject: business strategy and the way it relates to competition. His solo presentations were followed by a panel discussion on health care in the Netherlands. Porter's many authoritative books and inspirational style as an educator have won him the title of the world's most important living management thinker. His professorship at the Harvard Business School gives him a scientific platform that adds to his reputation with companies, business sectors and governments throughout the world.

Word of welcome

Nyenrode's Dean Bert de Groot kicked off the program with a few words of welcome. After thanking Focus Conferences for organizing the event, he pointed out that today management education is not a level playing field, and consequently Nyenrode has to look for competitive advantage like any other business. He introduced Porter by quoting an historic Chinese general, who wrote: "All men can see the tactics by which I conquer, but none can see the strategy by which they evolved."

Finding the essence

If there were an award for the management thinker who most expressively presents his theories and views, Porter would probably win it. His body language, inflection and facial expressions underpin a style of presentation that is never just a series of slides. He starts by expressing surprise at the fact that, although the need for strategy is clear, its principles are frequently poorly understood: "Often the basics are most important."

Porter refutes the widely held belief that in business, the best will win: "There *is* no best. Competing on the same dimensions just makes it hard for customers to choose. Instead, you have to compete to be unique. The essence of strategy is finding out what your unique advantage is. This involves complex discussion."

Flawed concepts

Flawed concepts of strategy confuse it with aspirations, actions and visions. Avon cosmetics, for example, defines its vision as the aspiration to be the company that best understands and satisfies the product, service and self-fulfillment needs of women – globally. "Wow!" Porter comments, not without sarcasm. He goes on to explain that the goal must simply be to create economic value and realize long-term return on capital investment. Profitability is more important than mere growth, and too much is made of shareholder value at the expense of lasting economic performance: "Short-term maximization of shareholder value seems to be what CEOs worry about today. But that is a result – not a goal. Ultimately, stock price will adjust to an organization's true economic value."

Something else that in Porter's view is overrated, is market share. He encourages his audience to step back, look at their position in their specific industry and focus on the health of their own business. Skipping through his slides, he takes food service distribution as an example. He identifies various threats, mentions the bargaining power of different parties and points out ways of reshaping the industry – perhaps by offering value-added services or private label products. Getting more specific, he discusses the success of Southwest Airlines, a US carrier that despite operating in "a terrible industry" has consistently performed well above average thanks to its exceptionally efficient use of both aircraft and manpower. "To establish your relative position," he says, "you have to think of your company as a value chain. Every industry has its own unique value chain, but there are different ways of configuring it."

Focus on principles

Returning to the principles of strategy, Porter frowns on the emphasis on quality: "Strategy is a quantitative subject. Always keep sight of the basics; there's no room for flights of fancy." By juxtaposing operational effectiveness and strategic positioning, he pinpoints the difference between the two: "There is more choice involved in strategic positioning. Usually, this is where long-term advantage comes from. Operational effectiveness, on the other hand, can be achieved by adopting and assimilating best practices. Keeping the difference straight is vital to the success of any organization." As an example of effective strategic positioning he quotes Enterprise Rent-a-Car, a US car hire operator whose strategy is radically different from Avis or Hertz. An organization can only define a strategy, Porter observes, if it knows which customers it is targeting, which needs it wants to meet and at which relative price. The result will be a different value chain from that of its competitors. In the automobile rental example this means that Enterprise delivers cars to where they are needed rather than expecting customers to collect them.

Strategic trade-offs

At this point, the mid-morning break offers the seminar participants a chance to stretch their legs, enjoy a cup of tea or coffee and have a chat with colleagues and acquaintances. After the break, Porter starts the next session by explaining the concept of strategic trade-offs: to achieve certain goals you have to be prepared to give up others and fight the inclination to appeal to everyone. "If you distinguish yourself from your competitor," he says, "the competition doesn't need to fail for you to succeed. It doesn't have to be a win/lose situation." One of his examples is Neutrogena, a mild residue-free soap. After enjoying a deep penetration of a narrow market, a shift in strategy has caused the brand to lose its dermatologists-based market to a competitor.

A complex diagram about Zara, the Spanish fashion chain, shows that this brand's strategic choices reinforce each other – the strength lies in the cohesion. Returning to Southwest Airlines, Porter explains that the carrier is leveraging its competitive advantage to become even more different from the competition: "Strategists can only be successful if they make some customers unhappy. Southwest knows which customers are worth fighting for."

Continuity is key

While conceding that the ubiquitous change on the global business scene can be a good thing if it yields operational improvements, Porter stresses the importance of strategic continuity. "You need an enduring set of customers with enduring needs. Continuity will help you to be recognized and appreciated for who you are." He has mixed feelings about the increasingly popular phenomenon of outsourcing: "It makes your activities less distinctive, thus making it harder to have a competitive advantage. Use it with measure."

Once again, Porter hammers home the point that choices have to be made. Products and services must be defined and geographical boundaries must be drawn. It may also help, he says, to consider your company's history and learn from the past. He suggests studying the various departments and identifying areas of superior profitability that can be further developed. There are various analytical approaches to finding a unique strategic position and it takes a number of integrated competences to arrive at a strategy that works, but success can also spring from building on a single bright idea.

At the end of the morning sessions Porter says a few words about the importance of market research and careful segmentation of customer groups. He shows that the opposite focus on high-risk and low-risk drivers of two car insurers translates into radically different sets of activities and concludes his presentation with some practical words of wisdom: "Over the years, I have learned not to delay lunch."

Growth perspective

At the back of the hall, where lunch has been laid out, participants take the opportunity to discuss the morning's proceedings over sandwiches and salads. Others fan out across the campus for an invigorating walk in the winter sunshine, and alumni in the audience take a trip down memory lane. Around 2pm, they return to their seats for Porter's afternoon presentation, which addresses the development and communication of strategy.

When a unique proposition has been established, when customer needs are understood and when the value chain has been adjusted, organizations face the question of how to grow profitably without compromising their strategies. Porter encourages companies going for geographic expansion to concentrate on the similarities in foreign markets rather than emphasizing the differences. His advice is to penetrate an existing customer base as deeply as possible before reaching out to new ones, which he sees as the most risky way of growing. Companies wanting to grow should set themselves targets, but it's hard to grow faster than the industry you are part of. "I think growth is overrated," Porter asserts. "If you make some money, you won't die of hunger. Shrinking a company can be a good thing. Disney chief Michael Eisner ultimately failed because he was too focused on fast growth."

Formal process

In Porter's experience, the best way of developing and reviewing strategy is in a formal process involving an integrated multi-functional team. Instead of just being the domain of the strategy director, strategic issues should be widely studied and understood: "But there has to be clear leadership. Company strategy is not a democratic process." On the subject of communicating the strategy, Porter says: "It's a big mistake to keep your strategy secret. The opposite should be true: every top executive should be a strategy professor. And don't just follow the popular models. If you work closely with your customer services department, the connection with your client base will be assured. Key people in an organization who refuse to buy into the strategy must ultimately be asked to leave because if they stay, company focus will suffer. It's up to the leaders to guide people away from activities that don't fit the strategy." Rounding up the subject, he again runs through the characteristics of a successful strategy. He also lists a number of things – from best practice improvement to internationalizing – that don't belong in the realm of strategy but are often confused with it.

CSR and its justifications

Since his last seminar at Nyenrode, Porter has conducted in-depth studies into corporate social responsibility (CSR) as it relates to competitive advantage. He addressed the issue with co-author Mark Kramer, for example, in the *Harvard Business Review* of December 2006. Today, CSR is a top-of-mind subject, and companies deemed insensitive to it – like Nike and BP – are likely to run into trouble. However, Porter feels that a coherent understanding of the subject is hard to find, for the thinking on CSR is fuzzy and its overall logic unclear. In the course of his research, he found four prevailing justifications to practice CSR. The moral obligation argument, which begs the question how morality should be defined; the sustainability aspect, which is not always clearly understood either; the 'license to operate' argument designed to keep stakeholders happy, which places the agenda outside the organization; and finally the justification related to reputation. While discussing the latter, Porter points out that many CSR consultants come from the public relations field, which suggests an opportunistic or even cynical mentality. "In CSR, you must be able to step back to get beyond."

Business & society

Porter asserts that synergy at the intersection of business and society is what gives CSR a place in a strategy seminar. He provides context in two diagrams, one on the inside-out links of business with society, the other on the outside-in impact of society on business. "Too many companies take their cue from the CSR community," Porter argues. "They should set their own priorities by categorizing them to see where they can have most impact. The reputation of a company like Starbucks coffee, which benefited from the first-mover advantage, has been enhanced because its CSR is seen to make a difference."

Porter sees an essential difference between the US and Europe in attitudes toward CSR policy: in America, people often treat the subject with cynicism while Europeans – though lacking in discipline – take it seriously. In general, he feels there are too many disconnected activities in the CSR field but he is in no doubt that business has a role to play here: “Business creates wealth. We need an integrated, affirmative approach. The nature of the dialogue between business and society has to change. And for that, society has to be made to understand how to share value.”

Redefining health care

After a 30-minute break halfway through the afternoon, the gathering reconvened for the final part of the program, on redefining the health care sector in the Netherlands. Having authored a book on the redefinition of health care together with Elizabeth Teisman, Michael Porter has expert knowledge on the subject, particularly as it relates to strategy. His reputation is such that Hans Hoogervorst, the Dutch Minister of Health, Welfare and Sport, sought his advice on the situation in the Netherlands.

Seminar host and TV anchorman Rick Nieman invites Johan van der Werf, board member of the AEGON investment and insurance corporation, and Shell Netherlands president Rein Willems to join Porter on the stage. The two industry leaders have been involved in a health ministry program known as Better Faster (*Sneller Beter*), which seeks to raise awareness about health care in the Netherlands as well as increasing transparency, effectiveness and quality in the sector.

Delivering value

Porter kicks off the subject on a light note by joking that he could present a 30-second, a 30-minute or a 30-hour lecture on health care. The key issue, he observes, is how the industry can deliver more value per dollar – or euro – spent. “The trouble is that health care is not designed to deliver value but to minimize costs. If we accept that the best way to cut costs is to improve quality, patients will be guided back to health more quickly.” While this may be true, he concedes that in fact medical practitioners, whose performance varies dramatically, are sometimes rewarded for their mistakes by being paid twice for the same activity. Measuring value in this sector is extremely tricky. Although Porter has interacted with health minister Hoogervorst for over a year, he accepts that many issues remain to be solved.

Prompted by Nieman, Van der Werf describes health care in the Netherlands as a field characterized by great dedication, low accountability and a weak customer position. Willems picks up on the accountability aspect and stresses the need for greater emphasis on safety. “If we’d been stricter in the past,” laments Van der Werf, “we wouldn’t be facing these issues now.” By conducting peer interviews, he says, a start has been made to address the need for transparency about medical specialists’ fees.

US vs the Netherlands

Statistics show that medical costs in the US are twice as high as they are in the Netherlands. Imitating the confrontational interviewing style of the BBC’s Jeremy Paxman, Nieman wonders in light of this why the minister approached Porter for advice. “Hoogervorst called me – I didn’t call him,” Porter retorts. He goes on to list the reasons why health care in the US is so costly: “Most of our patients get primary care; our doctors are paid a lot more than yours; and most Europeans lead healthier lives than we do – though I think we’re pulling ahead in terms of smoking.”

As far as Dutch health insurance with its risk-pooling system is concerned, Porter is favorably impressed. However, he feels that the selection of practitioners should be based on quality, and there should be a greater role for the forces of competition. It is in the area of health care delivery that he sees most urgency for better results, but there is as yet no consistent monitoring of outcomes. “The situation is like it used to be in the Soviet Union,” he quips. “The process is measured, but the outcome is not. The whole system needs to be restructured and re-regulated.”

Changing the financial incentives is just not enough. That doesn't heal the wound – it just puts a band-aid on it.”

Prevention is best

The panel members agree that a new quality system has to be put in place, and that the Internet can play a role in doing so. They expect to see changes in customer behavior, also in the workplace. The importance of risk assessment is touched upon too. Next, an in-depth discussion develops about the prevention of medical conditions.” Why doesn't my health insurer call me at least once a year?” Nieman challenges the panel. “Surely that would help prevention.” Stressing the need for energy and focus, Porter points out that “prevention is the best-value form of health care – but it's fallen through the cracks”. In the US, health care plans offer checks and screening programs, and large corporations have on-site clinics providing customized advice. The other side of the coin, he says, is that those who don't participate have to pay higher insurance premiums. The idea is that the health plans will be held accountable, but this can only be done if the patients' conditions can be reliably measured. Even if the system isn't perfect, Porter feels, doctors have to start measuring outcomes.

When asked how health care in the Netherlands can avoid the legal issues faced by the sector in America, Porter reiterates his belief that measuring results is the best way. “In the US, doctors do too much for fear of not doing enough. The doctor is supposed to be God. But we have to be realistic: patients will die during operations. It is very hard to get the malpractice genie back into the bottle.”

Innovation

Innovation in health care is the next subject of discussion. The panel agrees that medical innovation is extremely costly, but Porter insists that new technology is a friend rather than a foe. “A less invasive procedure in, for example, hip replacement surgery could mean that a patient can be out of hospital within a day. New procedures may initially be expensive, but they can result in giant cost savings.”

Porter feels that too much emphasis is placed on doctors. Dutch medical practitioners, he says, operate too much on their own rather than teaming up with colleagues. In the US there is more teamwork and interaction, and it is easier for patients to seek out excellence. When he asserts that Dutch patients are not prepared to travel, Van der Werf disagrees: “We did some research on that and found that people don't mind traveling so long as the advantage of doing so is clear to them.”

Red tape

At this point, the audience is invited to formulate their questions. In reply to a question, Willems explains that the brief of the Better Faster team was limited: “It's the government's business to develop an overall health care policy. I specialize in managing safety systems.” Van der Werf again insists that a new system should be more transparent, and says that it should offer more options and fewer rules. The latter point is echoed by a member of the audience, who complains of the endless red tape in health care: “We need an independent information provider and health plans that deliver value and don't just focus on cost.” In reaction, Van der Werf points out that the value aspect is already a legal requirement, though the reality may be different.

In light of the risk of litigation, a participant wonders how we can ensure that enough people will opt for a career in medicine in the future, but Willems does not share his concern: “In my work for the Better Faster program I was struck by the high degree of dedication and motivation. Unfortunately, there's not enough openness to what's going on outside the field.”

Strategy survey

During the health care discussion, Rick Nieman briefly presented the outcome of a strategy survey conducted during the seminar by management consultancy Berenschot. The results show

that Dutch companies see their competitive advantages, in order of importance, as: best product/quality, service, brand and image, innovation, and product range.

At the end of the afternoon Nieman wraps up the discussion and invites everyone for a drink. For Michael Porter, it's been a long and intense day. He concludes his presentations by thanking his audience and adds: "I have no definitive answers. Nonetheless, I hope I have changed your way of thinking forever. This should be the beginning of a process – not the end."