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Achieving the Potentials of Your Organization -- How to Overcome the Dangers of Commoditization

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In Search of a Vision

There is something paradoxical going on in the state of strategy in most organizations – at least the ones that I have happened to run into. On the one hand, the need for strategy is very real and intense. Companies are facing adverse conditions aggravated by increased competition, lack of growth opportunities, and a depressing capital market. They also require making significant investments in hardware and software technologies whose returns seem to be very elusive. But faced with these realities, the lack of proper strategic thinking seems to impair significantly the development of the organization potentials. And seldom executives know how to get started. In particular, there is the elusive “vision thing”. How can we capture the essence of how we want to position ourselves in the marketplace and how to communicate that enthusiastically in and out of the organization. It is a primary concern of this paper to provide the reader with a good understanding of how to accomplish this task.

There are also some other concerns that I feel are critical to apprehend. The new technologies, particularly those around the internet, have allowed us to achieve a degree of interconnection that was never possible with similar ease in the past. This means that the network has become the relevant focus of strategic scope. The firm has to be perceived as part of a coherent system formed by

suppliers, customers, and most critically, what we called complementors – firms that deliver products and services that enhance our own product and service portfolio. This constitutes what we refer to as the extended enterprise. No firm can play the game alone, no one can afford to do that effectively. Therefore, a smart vision should be expansive and outwardly-oriented, so that we can leverage all the extensive set of resources which can be intelligently accessed.

At the same time, the technology is allowing us to treat our customers in a singularly individualized way, if we choose to do so. We can seek a close proximity to the customer and deliver a value proposition that is driven to satisfy the customer specific needs. This simply means that the customer is placed at the center of strategy and the primary objective is what we refer to as customer bonding: establishing a constructive and enduring relationship based on mutual trust, collaboration, and joint benefits.

Under these new conditions, I am dismissing the old paradigm of perceiving the ultimate goal of strategy as achieving competitive advantage. That is a dangerous fallacy which asserts, either explicitly or implicitly, that strategy is war and the way to win it is to beat our competitors, normally by offering superior products.

What is even more concerning is that often this kind of behavior leads towards the commoditization of the product offering.

By being obsessed about competitors, we tend to imitate them. In turn, this leads to the convergence of the industry where all of the key players begin to respond by following in each other's footsteps. Imitation leads to sameness, and sameness will never lead to greatness, which is the required characteristic of an outstanding firm.

I believe in three tenets of strategy: First, the achievement of superior economic performance; second, the establishment of customer bonding through a unique and differentiated value proposition; and third, the creation of a spirit of success that is established by attracting and retaining superior talent. Commoditization attempts against each one of these tenets and should be avoided at all cost. With a commodity business you will never enjoy outstanding economic performance; you will never provide unique offerings to your customers; and – most importantly – you will never be able to attract and retain the most valuable talent.

I view strategy as the pursuit of a strong collaboration between the firm and its logical partners, leading toward the establishment of customer bonding. The task is not easy but it could be immensely rewarding. I will describe how to accomplish it and share with you the lessons and experiences I have collected along the way.

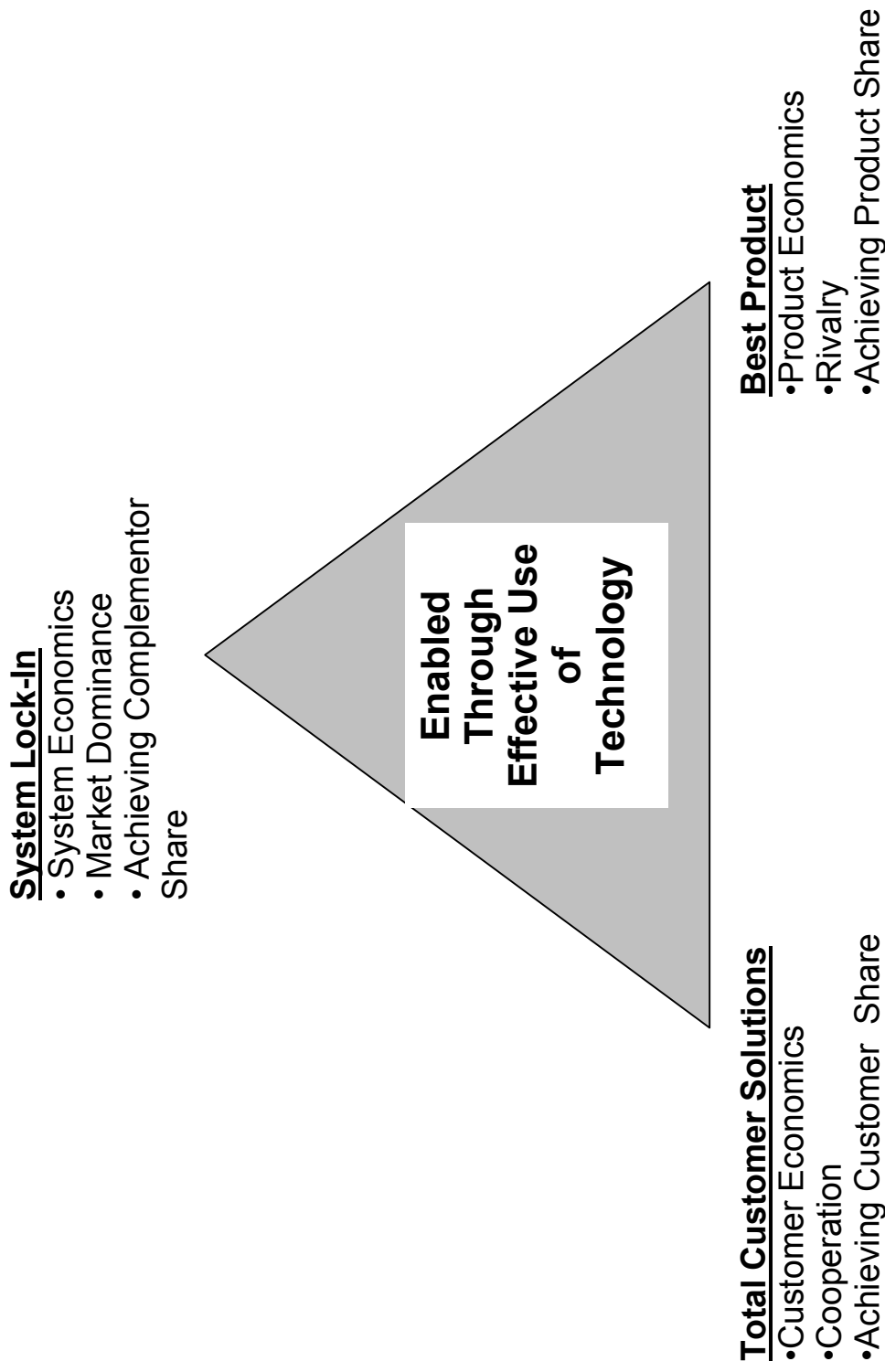
The Alternative Strategic Positionings – the Triangle

The three options represented in the Triangle¹ (Figure 1) are the starting point of the dialogue for the development of a strong vision. I have found very helpful too present to managers three alternative ways that can accomplish the desired customer bonding. Although in practice most organizations find themselves in a hybrid situation, it is useful to reflect upon these options as if they were mutually exclusive options, representing very different approaches to managing the business.

At the right-hand side of the triangle is the so-called Best Product positioning. The way to attract, satisfy, and retain the customer is through the inherent characteristics of the product itself. The position is rather inward and narrow, based upon the prevailing product economics. The major strategic driving forces are the development of an efficient supply chain – which guarantees a low cost infrastructure; a proven internal capability for new

¹ The Triangle is part of a new management framework that we have developed under the title The Delta Model. For a comprehensive exposure, please refer to A. Hax and D. Wilde, *The Delta Project*, Palgrave, 2001.

Figure 1. The Triangle: Three Distinct Strategic Positions



product development – which assures the proper renewal of the existing product line; and the securing of distribution channels – which massively transfer the products to the targeted market segments. The yardsticks for this strategy are the relevant competitors that we are trying to equal or surpass. Frequently the products are standardized and the customers are faceless and generic. Commodization is a real threat and often an unavoidable outcome, as imitation becomes a preferred pattern of competition. The measure of success is product share, which ultimately can fragment the business activities in a disconnected set of product offerings.

In the left-hand side of the Triangle sits the option we called Total Customer Solutions, which represents a 180 degree departure from the Best Product positioning. Rather than selling standardized and isolated products to depersonalized customers, we are providing solutions consisting of a portfolio of customized products and services that represent a unique value proposition to individualized customers. Instead of acting alone, we engage the relevant set of partners that constitute the extended enterprise. Instead of engaging in a war of attrition against our competitors, we seek cooperation that establishes the desired customer bonding. The relevant overall measure of performance becomes the total customer share, whose needs we are attempting to satisfy in as much a comprehensive way as possible. It is not our supply chain that is relevant, it is the combined chain that includes us, the customer, and our key suppliers. It is not our internal product development capabilities that exclusively carry our innovation

initiatives, rather it is the joint development efforts particularly with our customers that are central to our success. What guides us is not exclusively our product economics, but it is the customer economics, since we are trying to help the customer in enhancing his or her financial performance.

At the top of the Triangle stands the most demanding strategic option, which we call System Lock-In. In here we are addressing the full network as the relevant scope, the gaining of complementors' share as the ultimate objective, and the system economics as the driving force. Those who are successful in reaching this position gain a de facto dominance in the market which not only assures them a customer lock-in but also a competitor lock-out. The complementors play a key role because they are the basis for the consolidation of this power. Bill Gates is the richest man in the world not necessarily because he has developed the best product or excels at customer attention, but because he has an army of people working for him who are not on his payroll – all of the application software developers who are writing for the Windows compatible operating systems. Once you reach the lock-in it is hard to be taken away from you because of the so-called network effects, which creates the proverbial virtuous circle: customers want to buy the computer with access to the largest set of applications, and software

developers want to write applications for the computers with the largest installed base.

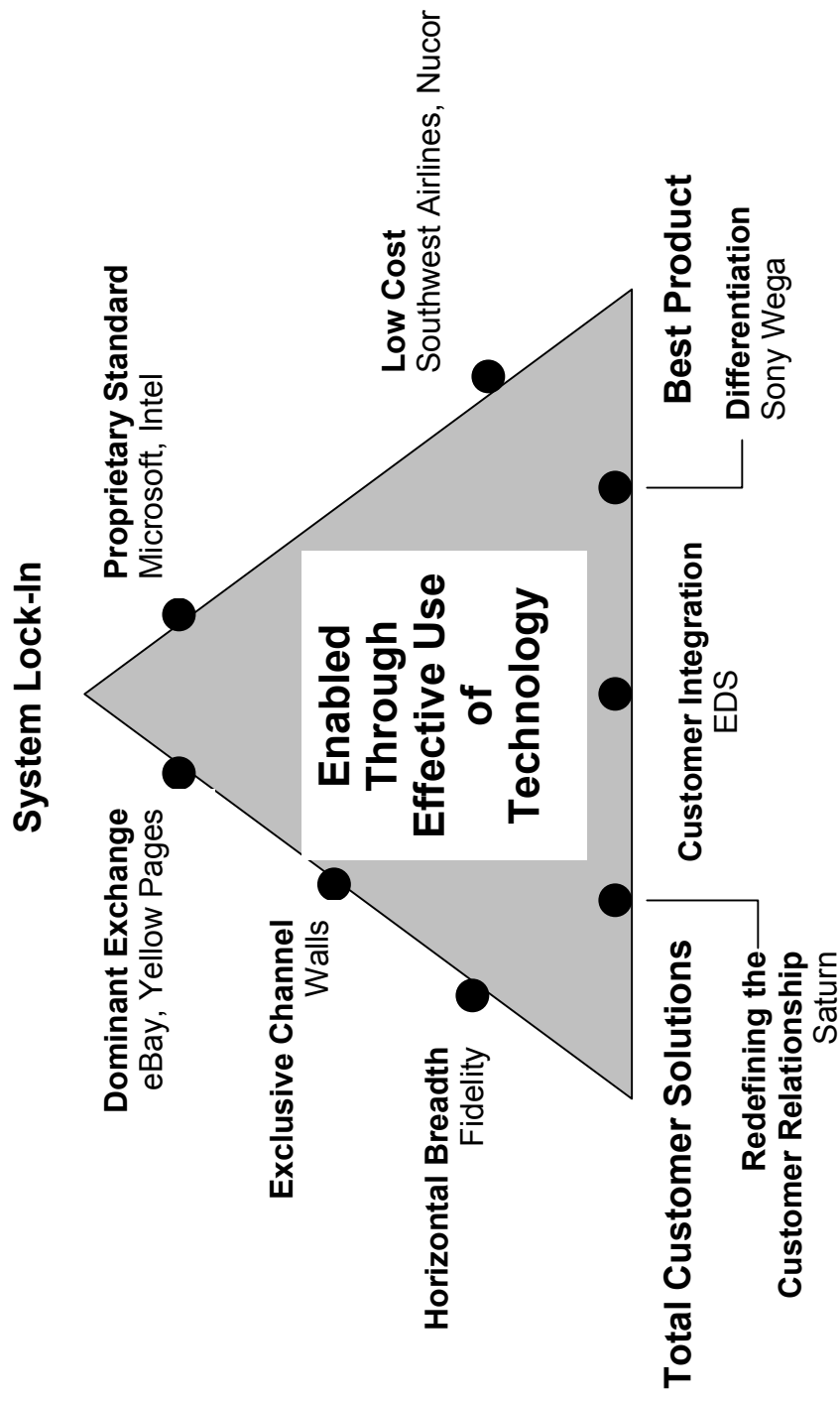
I believe that not every organization has the capacity or the ability to reach a System Lock-In positioning. Nevertheless, the need to consider the full network as the relevant business stage and the pursuit of close linkages with complementors are of great relevance for the development of an effective strategy, no matter which your ultimate goal might be. Moreover, the transformation that a company should undertake to move away from a commoditized product-centric mentality into a Total Customer Solutions position is, in my opinion, a mandatory challenge for all executives. In my work with different firms I have found the Triangle to be an extremely effective tool to open the minds of executives to different strategic alternatives.

The Options for Each Strategic Positioning

Figure 2 illustrates the basic options that are normally available to capture the desired strategic positioning.

The Best Product strategy rests on the classical form of competition that dictates that there are only two ways to win: either through low cost or differentiation. The problem is that differentiation is seldom a source of sustainable advantage since

Figure 2. The Triangle: Options for Strategic Positioning



once the strategy is revealed and becomes publicly known technology often allows a quick imitation that neutralizes the sought competitive advantage. If that is the case, the only viable option available to the Best Product strategy is low cost, which explains why commoditization is such a prevailing outcome in this corner of the Triangle. The low cost position does not provide much room for success, after all how many players can enjoy simultaneously a low cost advantage? This gives rise to the undesirable effects that we have eluded before, including excessive rivalry, imitators and the consequent adverse impact on margins and profitability for all the players. There are obviously successful companies in this corner of the Triangle. In Figure 2 we show Sony Wega as offering a differentiated product in TV sets, although the durability of its differentiation is rather debatable. In the low cost position we show two very successful companies in rather mediocre industries: Southwest in the commercial airline industry, and Nucor in steel. The fact that these are rather exceptions to the rule serve to underscore the difficulties of achieving successful competition in this corner.

Given the adverse structural characteristics of the Best Product positioning in many situations, one has to wonder why so many companies fall into the trap of accepting this option as the only one available. The transformation toward a Total Customer Solutions

position requires a very different way to capture the customer and a very different mindset. There are three options that you should pursue simultaneously. First, redefine the customer engagement process. This means that you should segment your customers carefully, arrange them into proper tiers that reflect distinct priorities, and provide a differentiated treatment to each one tier. That is what Saturn did when they completely redefined the experience of purchasing and owning a car in the U.S. Second, you should think hard about how to use your capabilities to perform some activities for the customers than previously they used to do themselves, because you can execute them much more effectively. This is what we call customer integration, and is the signature business of EDS, a company that redefined IT outsourcing in the U.S. Third, you could consider expanding as much as possible the breadth of products and services you are providing to the customer, what we call horizontal breadth. Paramount example of that positioning is Fidelity, a firm that provides a full coverage of financial services to their customers. These three options should be carried out simultaneously for a most impacting delivery of a Total Customer Solutions strategy.

And then we are left with the exciting but hard to get positioning on the top of the Triangle, the System Lock-In. One very powerful way to achieve it is through the development and

ownership of the standards of the industry. This is what Microsoft and Intel – two magic complementors – have done with the Wintel operating system and chip business in the PC market. Another option to reach System Lock-In is to have the exclusivity of the channels of distribution that customers use to avail themselves of the product. Limited shelf space is a usual trick in this option, what has happened in Europe and Asia with the Walls ice cream that provides a refrigerated cabinet to small merchants that can only be used for that purpose. The final option is what we call dominant exchange, where you have a dominant position, such as eBay and Yellow Pages, in serving as a unique linkage between sellers and buyers.

The Need for Organizational Transformation – Start by Changing Your Mindset

The perception that emerges from the Triangle is quite straightforward. The competencies that are required for a successful positioning in the Best Product strategy are quite critical, namely, a strong product base, a solid supply chain infrastructure, and internal innovation capabilities to match. However often they are not enough to really excel in your business. You should make concerted and deliberate efforts to push the organization closer to a Total Customer Solutions and to seek and seize – whenever possible

- opportunities for a System Lock-In. The rewards that can be obtained by pursuing these strategies could be very significant. (See Appendix for some empirical evidence of the different financial performance of the three strategic positionings of the Triangle.)

The task ahead, however, is not trivial and there are many obstacles to avoid and overcome. We will share with you some valuable experiences and lessons that we have collected by applying these principles in a number of different settings. But first and foremost you should start by changing your mindset, from a product-centric to a customer- and complementor-centric disposition. In the process of doing so, you should challenge the conventional wisdom. Here are some reflections that might help you get started.

Commodities only exist in the minds of the inept. You might think this is an exaggeration. The trap that one could fall into is to concentrate one's attention strictly on the product. Of course there are products that cannot be differentiated in terms of their internal properties, which could define the nature of a commodity. Products such as copper. Who could say that the Chilean copper is superior to the American or the Zambian copper? But that is not the relevant point. What is relevant is that the customers are not commodities, in the sense that they are distinct and unique in the way they use the product and that is what is central. The way in which Carrier –

the world's leader in air conditioner manufacturing – uses copper is completely different than the way General Motors does. If you ignore that and you do not reflect those differences in your product offering you are commoditizing and short changing your potentials. More about copper in the next section.

Select your customer, do not let the customer select you. If the customer is at the center of strategy, this means that customer selection is a most critical managerial decision. From this perspective, it would seem preposterous if you do not exercise the most careful attention to this issue. And yet that is exactly what many companies do, they let the customer come to them without any carefully targeting or screening. It is not surprising, therefore, that often you end up with the customers left over by your competitors, which might not necessarily be on your preferred list.

The customer is not always right. How could the customer be right if they do not know what you can do for them? The proper interaction with the customers is beyond just listening to their needs, it is to develop jointly a mutually acceptable proposition where we uncover how our capabilities, complemented with external parties, can generate products, services, and solutions that were not apparent to start with.

The customer does not have power over you. We have talked about the fallacy of viewing strategy as rivalry against your

competitors. There are now some who want to make us believe that the most serious antagonistic player is the customer! The idea is that the customer has become more sophisticated and informed, therefore able to transform this knowledge into power to use against you. Our belief is that the relationship with the customer should be based on mutual trust, fairness, and win-win opportunities. This is the most intelligent and the only reasonable way to perform business.

Sales are too important to be left to the sales force. In an extreme form of Best Product organization, the sales force of one organization deals with the purchasing department of the other one. This clearly prevents the meeting of all of the capabilities of both institutions to reflect upon the way in which those competencies could generate the greatest rewards. For Tier 1 customers, it is imperative that the top executives of both firms meet to decide on the mutually agreeable value proposition. Direct contact of multifunctional teams is at the heart of proper strategy execution.

Technology is too important to be left to the technical staff. Technology is another critical capability that is often used in a rather narrow way. Often companies limit the use of their technological know-how to imbed it into their products and processes. This works fine if you are deploying a Best Product strategy, but is hugely inadequate in the strategies pertaining to the

other corners of the Triangle. The technical knowledge should be paramount to be used as a key component of the design of the customer value proposition. But this is performed through the joint multifunctional teams we referred to in the previous paragraph, as opposed to dealing with it in the solitude of the laboratories.

Technology is an integral part of the business, influencing and being influenced by all of the business subtleties.

Decommoditize Your Business – The Case of Codelco

In the fight against commoditization you have to start at home, by never accepting the premise that your business is a commodity. To make this point as strongly as I can, I refer you to my work with the copper industry.

Some years ago I was called to assist Codelco (Corporación del Cobre) the largest and most profitable copper company in the world that is owned and managed by the Chilean government. Codelco is an extraordinarily successful company. Just to give you some hard evidence, during the time period covering the years 1990-1995 Codelco had profit margins of 14%, against 7% of the copper industry and 13% of the pharmaceutical industry. What a feast!

The original intent of the assistance that Codelco required was to assess the appropriateness of the existing organizational structure. Codelco executives were very determined that I did not

need to look into their strategies, because they were totally confident on the strategic course they had developed based on the following premises: First, copper is a commodity; second, the primary competitors of Codelco were the other copper producers that they easily outperformed; and third, the winning strategy has to be based on developing the most effective cost infrastructure so that they could retain the significant cost advantage they enjoyed, due primarily to the terrific quality of Codelco mining plants. The logic, at first sight, seems impeccable. However it was faulty in the three basic arguments.

First, copper is not a commodity as we have explained previously. If you observe how the customers use the metal in their own products, you realize that copper has infinite possible applications, far from the stereotype of a commodity. Codelco was reaffirming the commoditization of copper by being completely disconnected from the end users. They had six sales people to sell three billion dollars of copper – and they told me that in fact they had two too many. They simply had long-term transactions with metal traders who had no commitment to the copper industry. Once you begin to understand the specific needs of the end users, you could develop a true strategy to provides unique solutions leading to strong customer bonding.

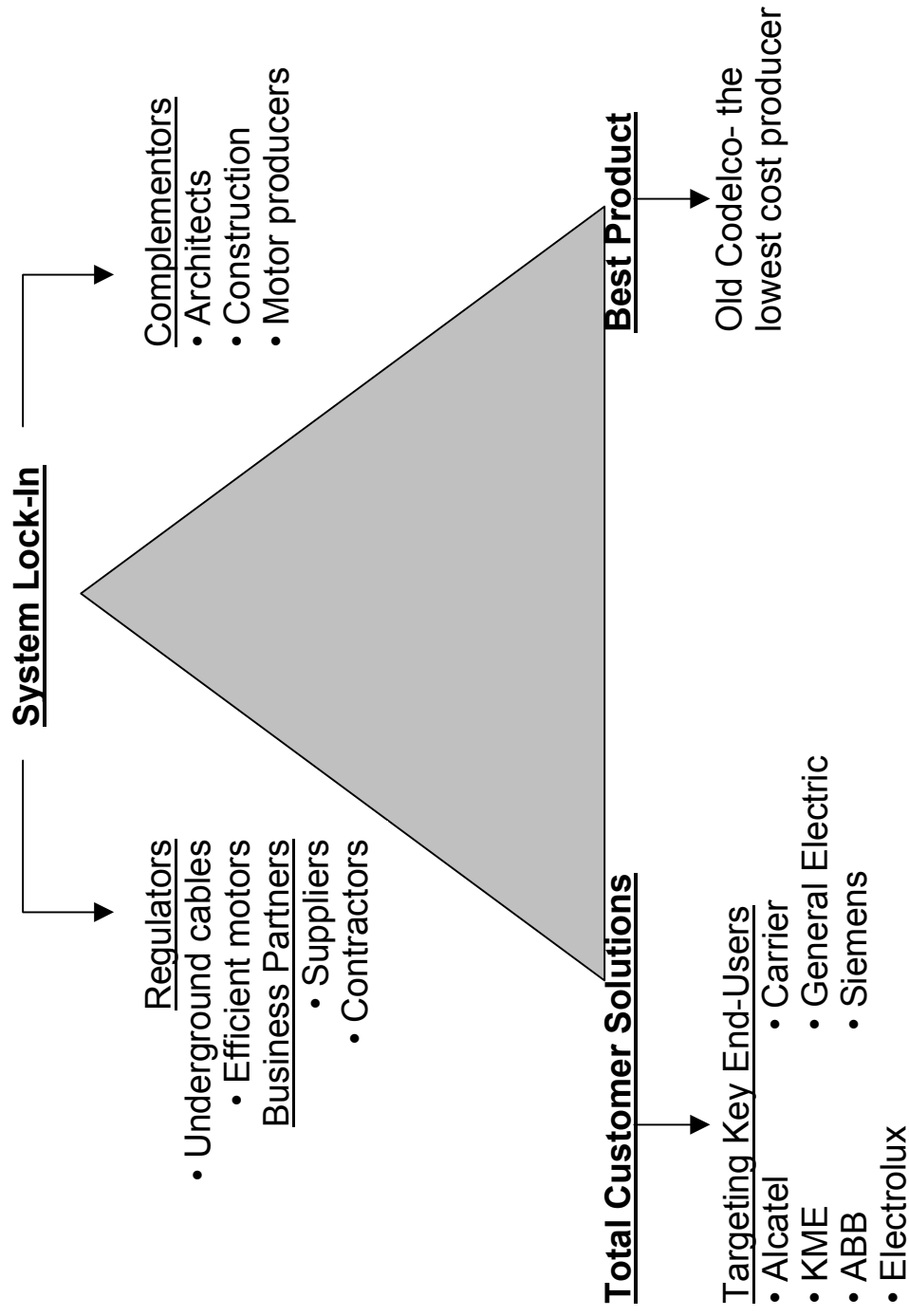
Second, the major competitors of Codelco were not the other copper producers, but rather those engaged in the delivery of major possible substitutes of copper such as aluminum, steel, plastic, and fiber optics. The aluminum industry had been particularly effective at pursuing a strategy of metal substitution to their advantage. They were successful in replacing the copper-made radiator for an aluminum one in the auto industry, and they are making significant progress in developing a technology that can eventually substitute the steel-made chassis for an aluminum counterpart. The copper producers have been caught off guard in all of their developments because they were not directly connected to their relevant end user. That is not a very smart way to play the game! Indeed, if you look at this situation from a broader perspective you can realize that not only other copper producers are not your relevant competitors, but rather they should be your complementors. After we successfully began to redirect the strategy of Codelco, we held an unprecedented strategic planning workshop with all of the key copper producers in the world, which were members of ICA, the International Copper Association. The intent was not to use ICA as a cartel to orchestrate the supply of copper and influence its price (as OPEC in the oil industry does), but rather to stimulate the demand for copper in the world, which is a perfectly legitimate and smart thing to do. The ICA meeting included not only copper producers, but also

fabricators (which added value by further elaborate copper products) and important end users. This constitutes the network in which the copper industry operates, which should have been all along the proper focus of strategic attention.

Third, it was not enough for Codelco to concentrate exclusively in its own cost infrastructure. As the leader of the industry it was expected to assume a more creative role and a customer-oriented strategy.

The lessons of the Triangle for Codelco can clearly be visualized in Figure 3. Codelco should not abandon its commitment to a lean cost-effective organization. However it should in addition

Figure 3. The Case of Codelco and the International Copper Association



to that target its most important end users to seek a better use of copper in the world of applications, and to extend the coverage of complementors, regulators, and other business partners to achieve much wider potentials. The elasticity curve for copper prices makes enormously beneficial to increase copper demand. This has to be a central part of the strategy of all the copper producers and, in particular, that of its leader.

What I find impacting in this story is that if I can convince you that copper is not a commodity, and the most appropriate strategy for a leading copper company is not to follow blindly the Best Product positioning, then I can really convince you that “Commodities only exist in the mind of the inept” is a very proper statement.

Rethink the Customer Engagement Process – The Case of Castrol

Castrol is one of the leading lubricant companies in the world. They realized that playing the Best Product strategy was not going anywhere, since the business was getting commoditized and differentiation through premium products was not generating sustainable competitive advantage. Selling lubricants by the gallon was not a very compelling proposition. At that time they were exposed to the Triangle, and decided to mobilize their efforts toward the pursuit of a Total Customer Solutions strategy.

First, they went through a careful process of customer segmentation. Often companies segment markets. Castrol certainly did that by identifying the major clusters of business applications: cement, sugar, pulp and paper, textile, food and beverage, wood, mining, and glass. But that was not enough. The brilliant next step for Castrol was to identify, within each market segment, which customers to target with varying degrees of priorities. They perform that task by recognizing the attitudes the customers have toward accepting a full Total Customer solutions approach. They considered three Tiers.

Primary Target Segment – Productivity Conscious Customers. These customers are eager to receive support that will enhance their productivity, reduce total costs, and promote higher sales.

Secondary Target Segment – Cost Conscious Customers. These customers are concerned about total costs but they believe new production does not necessarily yield higher sales or economies of scale.

The Least Desirable Segment – Price Conscious Customers. These customers are basically buying from the supplier that offers the lowest price.

This kind of customer segmentation is critical because you cannot and should not treat every customer equally. Not all the customers are equally receptive to an approach which requires

stronger efforts on both parts, but potentially generating much greater benefits. Castrol's value proposition for the primary targeted customers was as follows:

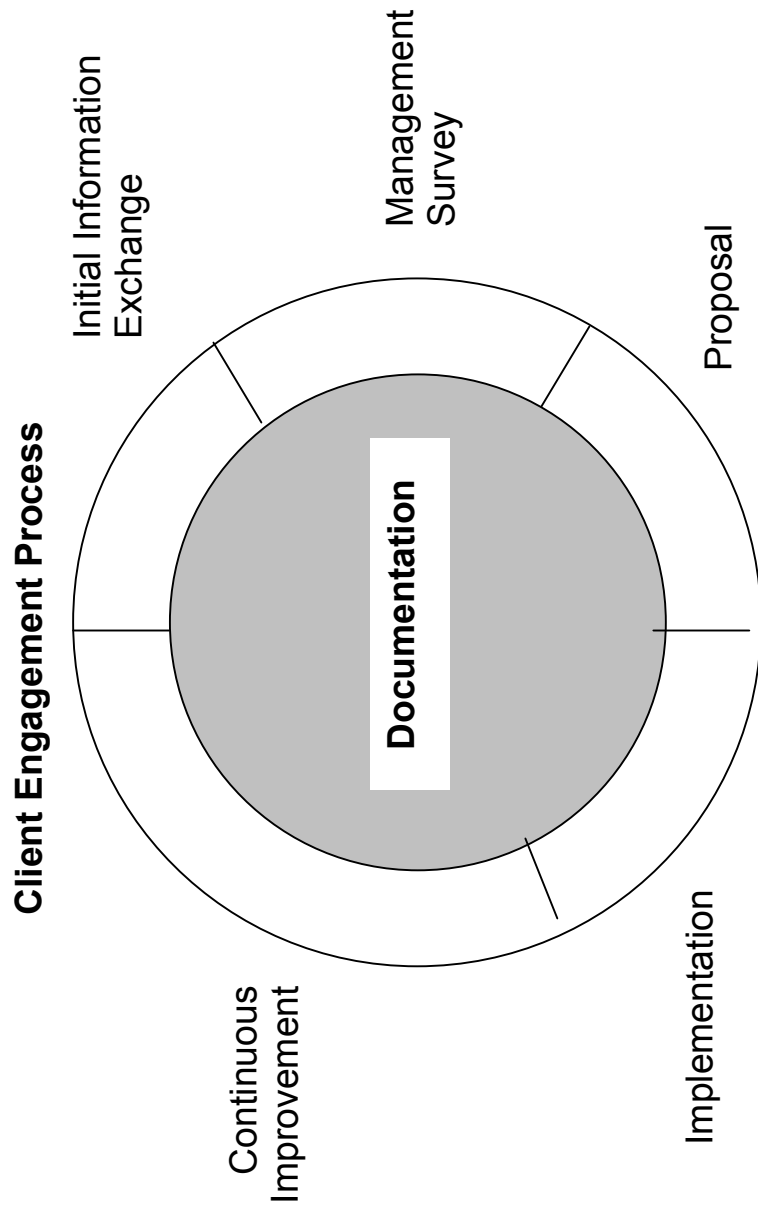
A customized lubrication solution involving products and services that results in documented cost reductions and productivity improvements.

We have underlined in that statement the words customized, solutions, and documented, because they truly capture the spirit of an offering that has nothing to do with a conventional commoditized lubrication. Castrol in fact is selling documented ROI (return on investment) improvements. What a great way to go!

The delivery of this value proposition was supported by a completely different customer engagement process. Figure 4 tries to capture the essence of the process. As we can see, at the heart of it is the documentation pre- and post-sales execution. By quantifying the expected results, the value proposition becomes objective and credible.

The process begins with a joint team of executives who exchange initial information and complete a management survey. A

Figure 4. Rethink the Customer Engagement Process – The Case of Castrol



Source: Castrol

model of a generic plant is used as an initial platform from which to derive a customized version that will reflect the individual plant maintenance tasks to be completed. A proposal is drawn which results in a long-term contract which is properly implemented. Continuous improvement and learning produces the next stage of the cycle.

The lesson of Castrol is enormously impacting for a proper decommoditization of a product offering: do not treat each customer equally, sell solutions not products, document your value proposition, bring in the executive team to develop long-term relations based on learning, trust, and mutual benefits.

Segmentation, the Key to Superior Strategy The case of Unilever in Asia

Proper segmentation is critical for the development of a sound strategy. We saw how Castrol segments the customers according to their attitudes toward establishing a close partnership with them. It is very important to decide on the proper criteria for customer segmentation that is most suitable for the pursuit of your strategic objectives. However, you not only have to segment your customers – those who are the direct buyers of your products and services – but you also have to segment your customers' customers – these are typically the consumers who buy your customer's products and

services. If you want to provide a powerful value proposition to your customers, you have to understand how they make money and therefore how to help them to be as effective as possible with their own customers.

I have worked for many years with Unilever, the giant global consumer company, helping in the development of Unilever strategy in a large number of different settings. In the process, I have uncovered many different ways of performing the appropriate customer and consumer segmentation. Figure 5 illustrates the segmentation we used for the Home and Personal Care Group in Asia, which resulted in three tiers of customers and three tiers for consumers. There are important implications for each of them.

First, in the customer side we have three very different challenges. Tier 1 is composed by the powerful global retailers, such as Wal-Mart and Carrefour. In their own respective countries these companies tend to impose enormous power to their suppliers, creating imbalanced relationships where it is difficult to extract terms which are beneficial to all. The trick is how to establish a closer collaboration, in our case based on Unilever's intimate knowledge of the Asian markets and its superior technological

Figure 5. Customer and Consumer Segmentation – The Case of Unilever in Asia

Customers	Consumers
<p>Tier 1. Modern Trade. Global companies with large established systems and business scale. Conflict anticipation and collaboration.</p>	<p>Tier 1. The affluent high LSM (Life style management) across Asia focusing on Aging, Single/Working Women, and Teenagers Satisfy their needs of vitality, quality time, customized products, and solutions/</p>
<p>Tier 2. Modern Trade. Smaller, more cash driven, largely local Shape and win.</p>	<p>Tier 2. The middle LSM focused on upward mobility and social migration Upgradation to higher aspirational brands and affordable price.</p>
<p>Tier 3. Including small Retailers, Wholesalers, and Drugstores. System Lock-In by being only supplier to produce ECR (Efficiency Customer Response) principles.</p>	<p>Tier 3. The lower LSM, less affluent emerging consumers in developing parts of the region Purchasing basket primarily of essentials.</p>

capabilities that will allow them to customize product offerings, resulting in a more compelling win-win situation.

Tier 2 is composed by regional and local modern-trade retailers, where Unilever can significantly assist in establishing and managing the business through a close partnership that can produce a de-facto customer lock-in.

The third tier includes independent small local retailers, wholesalers, and drug stores which are often fragmented and neglected by the major players. It is here where often one can expect to develop the highest lock-in if we treat the customers in ways that they have never experienced. Critical to this approach is to make accessible to them all the power of modern management systems and IT technology to provide them with the tools for superior management.

The segmentation in the consumer side offers similar types of challenges. Tier 1 identifies the most affluent members of society, highly price insensitive, with sophisticated needs in terms of quality of time, health, physical appearance, and vitality. Tier 2 is the upcoming middle class who aspires to a better standard of living and are driven toward upward social mobility. Tier 3 is the most deprived group of consumers which seek to satisfy basic and essential needs.

The six tiers provide six distinct focuses that require our attention to construct the appropriate value propositions. Each one demands different kinds of solutions, products and services. Each one needs distinct technological support, as well as differentiated channels. If we do not engage in this careful segmentation process we simply commoditize the customer into an “average” entity. By doing so, we lose track of the two extremes: the very rich and the very poor – who often represent extremely attractive business opportunities. It is imperative to “de-average” the customer so that we are exposed to the whole wealth of opportunities that the Total Customer Solutions strategy represents.

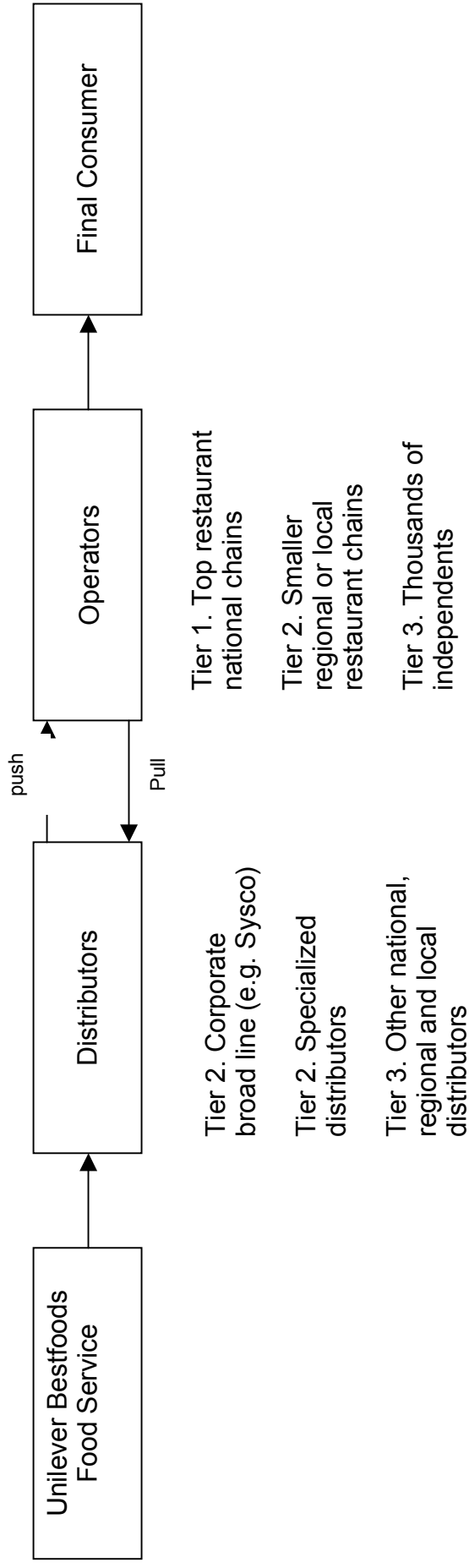
The Channels are Critical, They Own The Customer – The Case of the Food Service Industry

Channels are essential in the development of a proper strategy. Whoever owns them, owns the customer. Therefore, if you are dependent upon generic channels to deliver your products to the final consumers, you have to exercise a high degree of care and attention to this issue. The channels can block you and, most importantly, can make you remote to the final consumer, impeding you to get a first-hand knowledge of the market needs. This is a very vulnerable position to be in since you might start playing the game blindly. Let us again use the case of Unilever to extract the

proper lessons - this time in a different industry. Unilever acquired in the year 2000 Bestfoods, a leading company in the food industry, in order to consolidate a strong position in food services, one of the few growing segments of the food sector. The food service is dedicated to providing consumers with solutions for meals consumed away from home. The industry expanded from \$35 billion in 1977 to about \$190 billion today. Due to the many pressures affecting society, meals prepared away from home are as much a necessity as a choice. The newly-created organization - Unilever Bestfoods North America (UBF) - enjoys a portfolio of extremely powerful brands, well-known in most households: Lipton teas and soups, Ragu pasta sauce, Hellman's mayonnaise and dressings, WishBone salad dressings, Lawry's seasonings, Skippy peanut butter, Bertolli olive oil, I Can't Believe It's Not Butter margarine, and so on. In addition, Unilever global food division also produces Good Humor, Breyer and Ben & Jerry's ice cream, and SlimFast nutritional and health snack products. You might think that with this powerful product base, Unilever will be in an easy position to deploy a very successful business. Think again.

Figure 6 depicts the scope of the food service industry. Unilever Bestfoods (UBF) is one of the major suppliers of the

Figure 6. The Channels are Critical – The Case of the Food Service Industry



industry. Its customers are the operators - restaurants that serve food to the final consumers. Food producers such as UBF do not have the capability to reach directly the thousands of restaurants that operate in the U.S. Besides UBF there are a number of very strong food producers which include among others Kraft Foods, Kellogg's, Nabisco Brands, Campbell Soup, Nestlé, so on. They all depend on well established distributors for the delivery of their products to their customers.

The strongest distributors are those which represent a corporate broad line, which means that they carry a full array of products of all the major food producers. The most important broad line distributors are Sysco and U.S. Foodservice. Sysco is the industry leader with total sales of about \$22 billion in 2001, operating in 142 locations throughout the U.S. and Canada. In the food service industry Sysco carries a weight similar to Wal-Mart in the retailing business. The industry is extremely competitive and the margins are razor thin. The power of the distributors is enormous. They not only impose very tough terms to their suppliers, but they also carry generic brands which they can sell at heavy discounts to the operators, since they do not have to incur significant marketing costs that are needed to support a brand. This represents an enormous threat to UBF since its primary strategy resides in the development of strong brands aimed at high consumer recognition

and an indisputable guarantee for quality. That strategy does not seem to work in this setting because the operators do not exhibit the brand names of their ingredients. This is what the trade calls the “back-of-the-house” and the “front-of-the-house” brands. Let us take the example of Hellman’s mayonnaise, a very important back-of-the-house brand name. When it comes to, say, Applebee’s that brand is lost, the consumer will never know that the mayonnaise she or he is eating is Hellmann’s. In other words, the front-of-the-house brand name has disappeared. Not only that, but the broad line distributor will pressure the operator to buy its generic brand name with a 20% discount over the branded mayonnaise, which for all intents and purposes are indistinguishable from each other as far as taste is concerned. Do you get the idea?

We have a ferociously intense rivalry confronting the food producers and the broad line distributors. The distributors are commoditizing the food manufacturing products and are attempting to displace them by pushing their generic products. This is the utmost of a commoditization game. How can UBF assert itself under these conditions? The answer is, as you would have expected, through proper segmentation and distinct and carefully drawn value propositions for each customer segment.

We start the segmentation with the operators, which are the real customer base for UBF. The fundamental concern is not to

intensify an already conflicting rivalry, but make every effort to decommo­ditize the product offering. If the distributors will not push our products, we should make sure that our customers will have all of the incentives to pull them. How to accomplish this is very different depending on how the customer fits in three very distinct tiers.

Tier 1. The top national restaurant chains. This segment is composed by about 100 national restaurant chains such as McDonald's, Burger King, Kentucky Fried Chicken (KFC), Applebee's, Taco Bell, TGI Friday's, etc. They have an enormous purchasing power and it is quite tempting for them to use it in order to gain price discounts: another pressure toward commoditization of the UBF products.

The way to gain a close customer bonding and to guarantee a pull of UBF products over the distributors is to offer Tier 1 customers unique customized products, services, and delivery systems. This is possible due to the strong technical capabilities in food and flavor existing in UBF. For instance we can offer a bloody mary mix to TGI Friday's that is unmatched by any alternative in the market and it is exclusive for them. We can offer a system to cook beans at KFC that assures an exquisite quality, with enormous consistency to be perfectly prepared by an unskilled labor force.

Customization and system delivery is the central value proposition to this tier.

Tier 2. Regional and local restaurant chains. This customer tier includes about 1500 smaller restaurant chains. They are important regional and local restaurants, but they do not have access to the superior managerial infrastructure that the top national chains have. This creates a unique opportunity for a company such as UBF which has the internal competencies to provide customized services to these customers that could fundamentally enrich their business capabilities.

The value proposition is to offer branded products – so as to regain the “front-of-the-house” branding image – supported by a set of customized services that offer product support and corporate management services. The combination of these two types of services is enormously impacting.

Product support includes transferring of culinary expertise, on-site marketing, improving consumer understanding, brand training, menu design, health and safety measures, merchandizing, diet nutrition, chef product preparation, and equipment utilization and training. Corporate management services transfers knowledge in IT linkages, EDI/Bar codes, logistics and material flow management, ABC costings, HR training, and profit modeling capabilities.

The combined effect of these two types of services has the power to produce a customer lock-in in this tier.

Tier 3. Thousands of independents. What remains are the thousands of fragmented small restaurants spaced all over the country. Customers in the two top tiers are served by a direct sales force of UBF, we certainly cannot offer to do that with this tier of customers. The challenge is to try to give as much of the services outlined for Tier 2 customers except that the delivery will be done through tele-services and e-mail services.

The deliver of this strategy is orchestrated by a careful segmentation of three-tier distributors: (1) The corporate broad line – who are critical because of the reach of their coverage; (2) The specialized distribution; and (3) The smaller national, regional and local distributor. The intent is to make a close alignment between the distributors' objectives and UBF strategy, and to establish close collaboration with Tiers 2 and 3 distributors to make them legitimate complementors. What is intriguing about this case is that, at first sight, it looks as an impossible puzzle to resolve. The powers of distributors and operators seem too immense and disproportionate and a company like UBF seems condemned to be commoditized. The moral of the story continues to be that you should never accept that fate. Ingenuity – matched with proper

segmentation – can always do the trick. Remember: commodities only exist in the minds of the inept.

Using Technology Wisely – This is a Very Hard Task

As I said at the beginning of this paper, technology makes possible this new thinking about strategic positioning and facilitates the development of a new business vision. However, the smart deployment of technology is not easy to do. The evidence is in the enormous amount of technological investments that firms continuously make that do not provide any substantial benefits. I believe that the pitfall is that firms view technology as a way of achieving competitive advantage. This is wrong on two counts. One, competitive advantage is only relevant to the Best Product positioning of the Triangle – which often is not the most desired strategy. And two, this goal is very elusive since technology is very pervasive and accessible. As long the competitors become aware of the winning strategy, they often can imitate and reach parity.

The role of technology, therefore, should be to contribute to customer bonding, which is the basic premise that I am advocating. Figure 7 is useful to make this point. In the figure we depict the different support the technology provides for new product development (at the right-hand side), and the role served by IT (on the left-hand side).

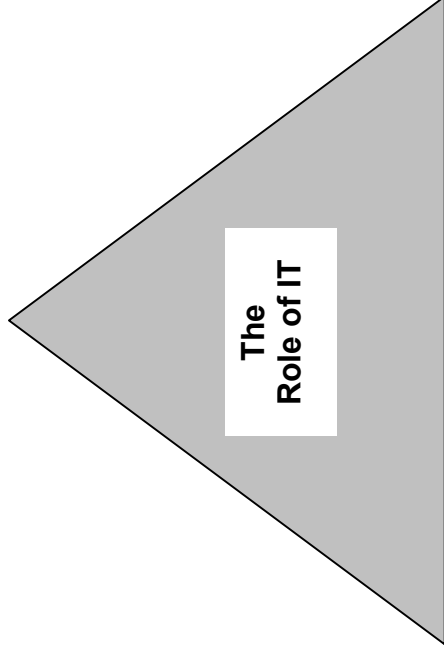
The Role of Product Innovation

In the Best Product strategy, excellence in innovation is associated with the ability to introduce a stream of new products of superior quality with great efficiency in timing and execution. Innovation leadership is being able to be first to market and to create the so-called “dominant design” that gives the innovator the chance to establish the standard of the product characteristics and features. The infrastructure that supports the delivery of the stream of products is normally based on a common platform, which permits the realization of economics of scale and flexibility for the delivery of the members of the product family. These are the basic concepts that prevail in the conventional view of innovation, which is regarded as an internal capability of the firm.

The role of innovation for a Total Customer Solutions strategy is quite different from the conventional one. Instead of deploying internal competencies to generate standardized, high-volume products that satisfy the needs of faceless generic customers, we

Figure 7. Use technology wisely: this is a very hard task

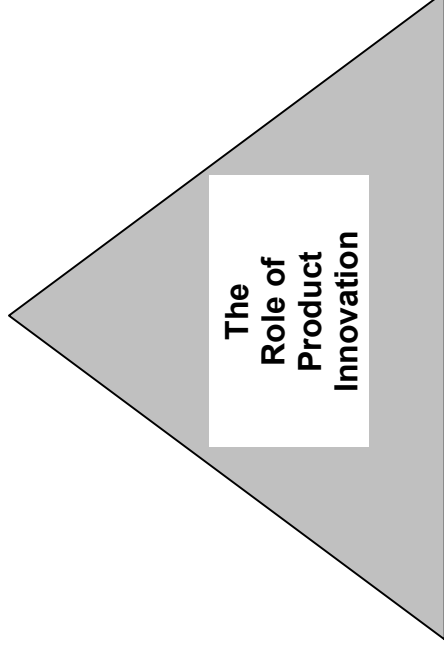
Total Network Support (e.g. e-system)



Customer and Supplier Support (e.g. B2B, B2C)

Internal Support (e.g. SAP)

Open Architecture – Complementors as Key



Joint with Customers

Internal Product Development

focus on a target set of customers whose businesses we are trying to enhance. We tie our product platform to that of the customer to facilitate joint new-product development. The goal is to respond to the specific customer needs by providing a customized and well-integrated portfolio of products. The close association with the customer generates a much stronger form of customer bonding.

The role of innovation in supporting a System Lock-In position is the most decisive and most encompassing. Innovation becomes the centerpiece of the lock-in strategy. We seek to benefit from the innovations carried out by all the relevant complementors in the industry. To be successful, we cannot keep our technological capabilities to ourselves, but we should make them widely available, and encourage as many parties as possible to access our open architecture and to develop their own products, applications, and services in ways that make use of and support that architecture. It sets out to make our technologies and products the common denominator of the entire economy of our industry system.

As we can see, the role of technology becomes harder and more sophisticated, requiring broader collaboration among all the key layers. However, the consequent rewards, if successful, can be spectacular.

The Role of IT

One of the most critical elements of a sound strategy is the support that IT is providing. The internet and all the technologies surrounding it allows for very effective interconnection among the firm, its customers, and all of its key partners. The left-hand-side of Figure 7 captures how IT-support changes with the various strategic positionings of the Triangle.

In the Best Product strategy, the role of IT basically deals with the internal information of the firm. The most extensively adopted software in this corner is SAP or other ERP related software. Indeed, due to the menaces that the Y2K phenomenon presented at the turn of the century, companies hurried to invest billions of dollars in such technology. What they got in return was often disappointing. First, since everybody was doing it, nobody achieved any significant competitive advantage due to that investment alone. Second, the software provided excellent capabilities to manage internal information transactions, but often presented strong barriers to linking the firm with outside partners, which is essential to the pursuit of the other alternative positionings in the Triangle.

Contrary, the role of IT in the support of a Total Customer Solutions strategy is to use the broadly available Internet protocols and infrastructure to inextricably link the customer to the firm, rather than using proprietary internally oriented software. B2B is particularly effective to connect the firm with its extended

enterprise – customers, suppliers, and key complementors –; B2C does the job to connect the firm with its final consumers.

Finally, the role of IT in a System Lock-In positioning is to facilitate the integration, efficiency, and compatibility of the network of complementors – the entire system is the one which is subject to a full interface.

Once again, the tasks become more demanding and complex as we progress through the Triangle, but the pay-offs cannot be compared.

To summarize, the use of technology is heavily dependent upon the strategy we are pursuing. Technology devoid from strategy often leads to great disappointments.

Beware of the Organizational Structure Implications

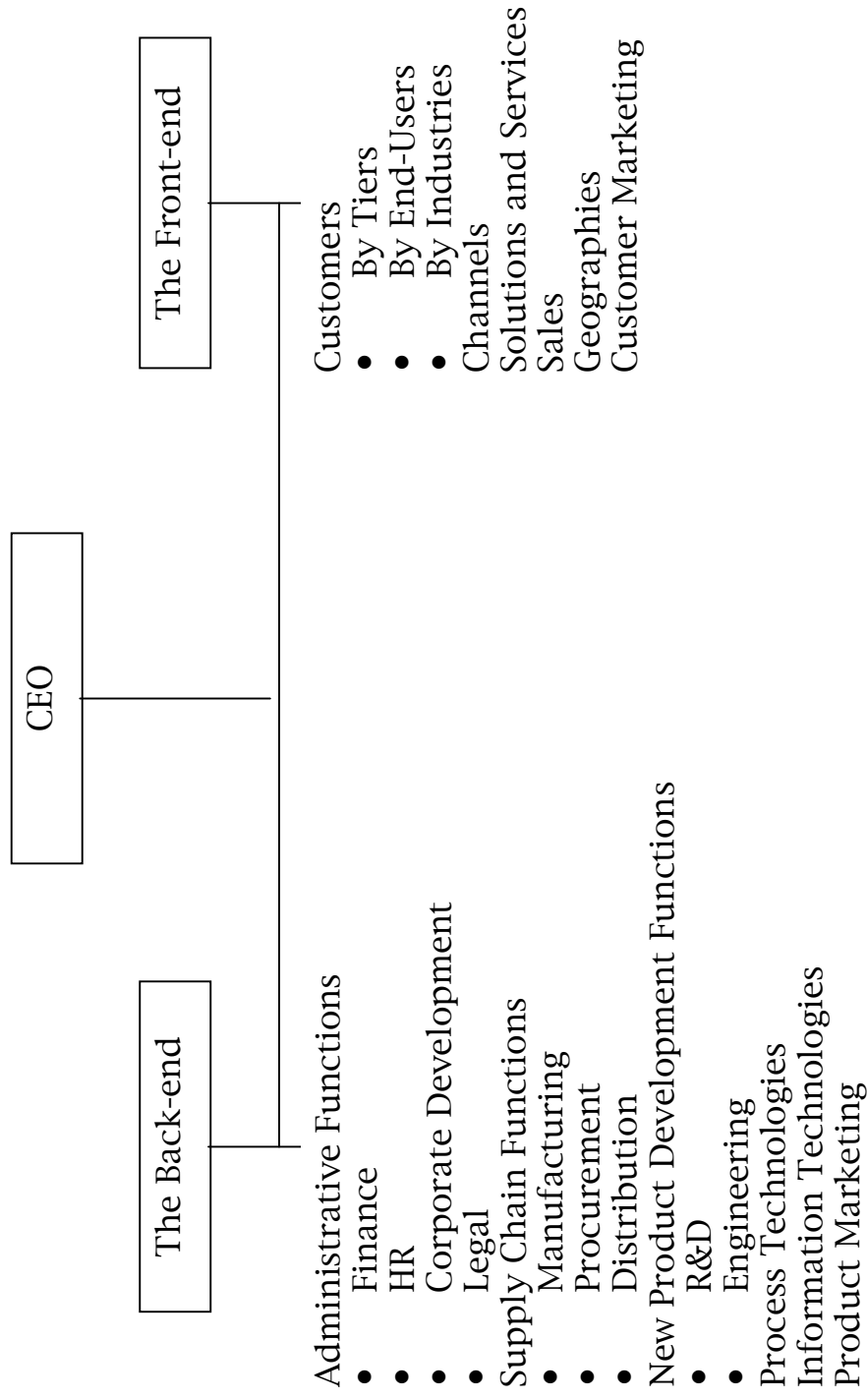
The transformation that takes place after the business is repositioned from a Best Product to a Total Customer Solutions requires fundamental changes in all dimensions of management. We need to review the firm's policies and strategies, the kind of people we attract, the way in which responsibilities are assigned, the form of rewarding employees, the systems to support their work, the metrics used to monitor performance, and the supporting culture of the place.

In my experience, the most effective approach to deal with all these challenges is to adopt the back-end/front-end organizational structure.² By doing so we are attempting to preserve the efficiency that characterizes the Best Product-driven organization, while at the same time securing the proximity to the customer that is essential for the Total Customer Solutions strategy. Figure 8 depicts a highly simplified form of a back-end/front-end organizational structure.

The back-end focus on products and technologies. It includes all those managerial functions that represent capabilities that shape the cost infrastructure of the firm and are needed for the development and delivery of the firm's products. Achieving meaningful critical mass in the functions is essential for the realization of significant economics of scale. We include in the back-end all of the activities of the supply chain, the technologies needed for the development of new products as well as those necessary for process improvement, and all the information

² The principal proponent of the type of organizational structure is Jay R. Galbraith, *Designing Organization*, Jossey-Bass, 2002.

Figure 8. Transforming the Organizational Structure: The Back-end/Front-end Organization



technologies competencies. We also include centralized administrative functions, such as Finance, Human Resources, Corporate Development, Legal, and so on. Finally, the back-end encompasses the functional activities related to product marketing, such as product positioning, product pricing, and development of product features. In this respect, marketing is a singular function because it is split, the product-marketing part resides in the back-end while the customer-marketing component remains in the front-end.

While the back-end allows us to concentrate on product efficiency, the front-end focuses on customers, customer segments, channels, industries, and geographies; namely all of the dimensions that are part of market segmentation. It often happens that firms develop strong capabilities in the back-end but are not equally balanced in the front-end. This is all part of the pervasive product-centric mentality that I have alluded to throughout the paper. The customer marketing activities involve the ability to develop and price bundles of products and services to address the specific needs of individual customers, the careful selection of direct or indirect channels, and the support to be given to the sales force. The proximity of the customer allows the accumulation of superior knowledge about customer needs which translate into a mutually beneficial and constructive relationship with the customer.

As I have said repeatedly, this new state of management development is not straightforward to deploy successfully. There is much ambiguity to resolve among the roles of back- and front-end managers. However, I am convinced it leads to a superior form of organizational structure, much richer in its content and more effective in the execution of a customer-centric strategy.

Achieving Your Potential

In summary, remember one major concept: The way to win is not to beat your competitor but to bond with your customer. If you follow this advice, it will change the way you do business in a much more constructive way.

APPENDIX – Value Creation by Each Strategic Option: Empirical Evidence

Economic returns differ markedly by each strategic position in the Triangle. We collected empirical evidence from over 100 companies occupying a range of strategic positions. Our sample includes firms drawn from the Fortune 500 whose corporate-wide strategies could be clearly categorized as emphasizing one of the three alternatives in the Triangle.

The acid test in terms of the merits of each option is the economic value that the companies are able to create for their shareholders. We use two common, and very popular, measures of performance: market value added (MVA) and market-to-book ratio (M/B).

Market value added measures the difference between a company's total market value of equity and debt and its book value, which is the total amount that investors of equity and debt have contributed to the company. This metric has received increasing currency as a key indicator to rank performance. In particular, *Fortune* magazine and *The Journal of Applied Corporate Finance* use it as the leading gauge of financial attainment. On this measure, System Lock-In businesses produce an MVA, which, on average, is over four times that of Best Product companies; Total Customer

Solutions firms generate over 1.5 times the MVA of Best Product organizations. The results are shown in the Table.

The market-to-book ratio compares the value that shareholders place on the business based upon their assessment of the expected future cashflows relative to the past resources that have been committed to the business. In other words, if a total of \$1 million has been invested in a business that today is valued at \$2 million, then the market-to-book ratio is 2. Obviously, the strategy and execution of the business has a multiplier effect that creates the additional value. The empirical data shows that the System Lock-In companies have an M/B ratio that is on average twice as large as the Best Product companies. The Total Customer Solutions companies have an average M/B that is 20% higher than that of the Best Product firms (see Table).

We have found a significant financial premium for companies that can achieve a Total Customer Solutions position, and a further enhanced premium for those attaining System Lock-In. However, there are important caveats. This conclusion reflects the performance of companies that have successfully arrived at these positions, it does not account for those that have attempted and failed. There may be added risk and greater difficulty in reaching the ultimate performance with System Lock-In or to successfully overcome the challenges attached to Total Customer Solutions.

Table. Value creation by each strategic option: empirical evidence

	Number of firms	Market Value Added			Market-to-Book Value		
		Mean	Standard deviation	Index	Mean	Standard deviation	Index
Best Product	74	14.26	16.57	1.0	5.88	9.33	1.0
Total Customer Solutions	67	22.38	28.14	1.6	7.29	7.7	1.2
System Lock-In	16	57.15	48.67	4.0	11.98	5.86	2.0