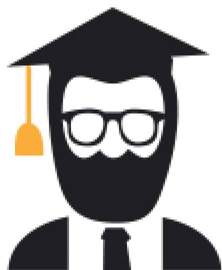

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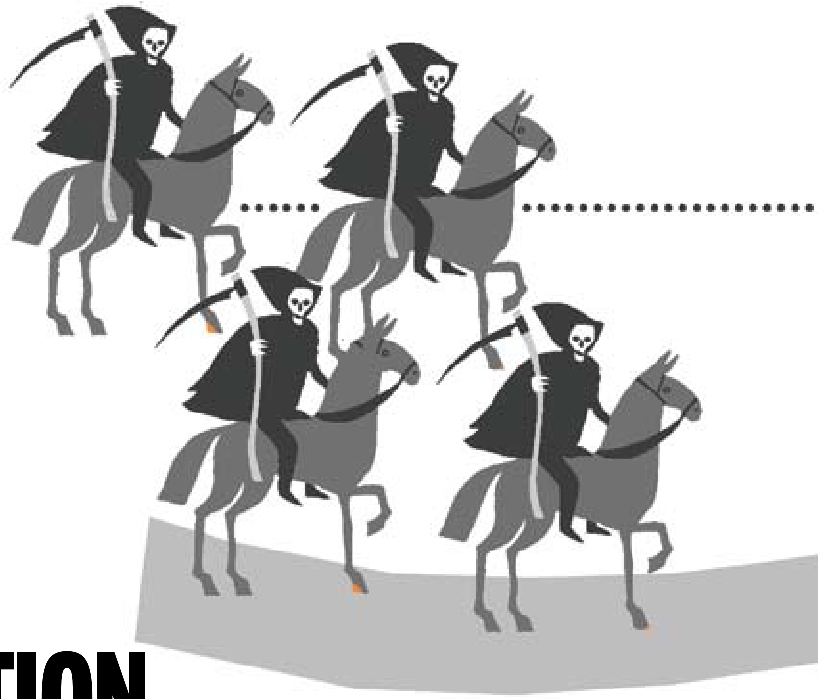

STRATEGIC ORCHESTRATION

Many companies seizing major opportunities in emerging markets are blazing a management path also shared by companies such as Apple, RyanAir and Nestlé. Strategic orchestration allows firms to get to market faster, adapt to changing circumstances and lower their invested capital, thereby allowing them to pursue less profitable opportunities such as serving emerging market consumers. ***Donald L Sull*** *and* ***Alejandro Ruelas-Gossi*** *tell how.*

As the global economic crisis recedes into the past, executives are raising their heads from cost cutting and looking for opportunities to grow the top line. Unfortunately, revenue growth is elusive. The four horsemen of the new normal — insecure employment, stagnant wages, unsustainable credit and low investment returns — cast a dark shadow over consumers who cut back on spending. At the same time, governments are slashing investment and public payrolls to reign in fiscal deficits. Major savers, like China and Germany, cannot shift from exports to consumption fast enough to offset declining demand elsewhere in the world.

How, then, can executives grow revenues despite tepid overall demand? The standard answers are corporate entrepreneurship and innovation. To grow in stagnant markets, managers need to spot novel opportunities or envision breakthrough products or services that will differentiate them from competitors. Unfortunately, established firms often struggle to seize new opportunities, losing out to more fleet-footed start-ups. The failure of corporate entrepreneurship is often blamed on a lack of imagination. To stimulate the necessary creativity, companies send executives to workshops where they use finger paints or pretend to be jungle animals (real examples both) to think more creatively.

These efforts to stimulate creativity are misplaced. In most large corporations, the primary impediment to revenue growth is not a lack of creativity, but an unhealthy addiction to power. Pursuing new opportunities often demands novel resources and competencies not currently at a firm's disposal. In many cases, executives reject out-of-hand any opportunity that doesn't leverage the firm's existing resources and competencies. Like the proverbial boy with a hammer, they reject any opportunity that isn't a nail. If internal champions persist in pursuing the market gap, they often draft detailed blueprints to develop the necessary resources in house. But senior executives often turn down the proposal as too expensive, time-consuming or risky.

There is an alternative, which we call 'strategic orchestration', whereby a firm pursues an opportunity — not by controlling all the required resources and competencies but by assembling and managing a network of partners. Strategic orchestration allows firms to get to market faster, adapt to changing circumstances and lower their invested capital, thereby allowing them to pursue less profitable opportunities such as serving emerging market consumers. We have found this approach to be particularly powerful in seizing opportunities in emerging markets, but it also applies to Apple's iPod, RyanAir's ancillary service and Nestlé's Nespresso.

Strategy is power, but power corrupts

Managers typically discuss strategy as a means to create economic value, but strategic choices have as much

to do with power as value. Indeed, the two dominant streams of strategic thinking — industry structure and the resource-based view of the firm — both connect strategic choices to value creation by way of power. According to the industrial structure framework, firms erect barriers to entry that keep rivals out and confer the market power to set prices. A firm that successfully erects barriers to entry can prevent rivals from entering and leverage its monopoly power to pay suppliers less, charge customers more and squash would-be rivals.

Seen through the resource-based view, firms create and sustain value to the extent they control resources or competencies that share three characteristics: first, a resource or competency must create value by cutting costs — think Wal-Mart's logistics — or increase willingness to pay — Coca-Cola charging twice what a store-brand cola costs. Second, a resource or competency must be rare — if every car included BMW's technology, the German automaker could command no premium. Finally, it must be difficult to substitute an alternative resource or competency — Saudi Aramco's oil stockpiles will remain valuable until mass-market automobiles can run on alternative fuels. Power, in this view, arises from dependence. Coca-Cola exercises power over its bottlers, to the extent these distributors depend on Coca-Cola. Owning a resource, in this case one of the most valuable brands in the world, is the source of both the bottlers' dependence and Coke's power.

The conventional strategic wisdom, therefore, views power as a good thing for the firm that wields it. Powerful firms — think Coca-Cola, Royal Dutch Shell, Microsoft, Roche or Wal-Mart — can capture more economic value by squeezing their suppliers and distributors or charging customers a premium. Strategic power helps firms sustain profits into the future by fending off established rivals or new entrants that might compete away profits. No wonder powerful firms are so attractive to investors, such as Warren Buffett, who described his ideal company as an economic castle protected by an unbreachable moat.

Executives crave strategic power as much or more than investors do, because it makes their life much easier. First, managers can get things done by the raw exercise of power over employees, distributors, suppliers and even customers who are dependent on the firm. Second, strategic power provides greater certainty about future revenues and profits. Finally, strategic power allows firms to weather changes in the marketplace without having to respond immediately. General Motors' market power in the 1950s allowed the automaker to survive decades of changes in technology, regulations, competition and consumer preferences before finally succumbing to bankruptcy.

The GM example hints that strategic power is not an absolute good. The obvious risk of over reliance on strategic power is that no positional or resource advantage lasts forever. The personal computer disrupted IBM's stranglehold on mainframes, just as the tablet threatens Microsoft's dominance in PC operating systems. But we all know that. The more insidious risk is that the very market power that companies use to protect their established business hinders them from seizing new opportunities.

Over time, strategic power tends to pervade a company's culture and not in a good way. When speaking to customers with high switching costs,

company representatives often lecture customers on what they should want rather than listening to what they do want. Sony lost to the iPod, in part, because it forced users of its digital music players to use its proprietary ATRAC software rather than the MP3 standard that customers wanted. In selecting partners to work with, power-drunk executives prefer vassal organisations whose dependency renders them easy to control. Leaders who can exert hierarchal control to get things done within their own company often apply the same heavy-handed tactics to corporate partners.

To grow revenues, companies must often enter new market segments in which they lack power, as Microsoft discovered in the game box, mobile phone and Internet search segments. To seize an emerging opportunity, these companies must also assemble a new set of resources or competencies that they do not already control. The iPod's success depended not on hardware and software alone, but on the cooperation of record labels and producers of complementary products such as speakers and carrying cases. Owning its own record label hampered Sony from striking a deal with other music companies.

There is another way. Strategic orchestration describes a time when a firm pursues an opportunity not by leveraging strategic power, but by assembling and managing a network of partners. This is not about pursuing partnerships for their own sake — the corporate equivalent of having 1,000 connections on LinkedIn. These networks are strategic in the sense that they serve to create, capture and sustain economic value. Strategic orchestration flips traditional strategy on its head. Rather than start with what you control and look for ways to leverage it, managers begin with the opportunity and then assemble the required resources in its wake. (See box for problems that strategic orchestration can help solve).

Strategic orchestration requires a shift in orientation. Existing strategy theory is egocentric — its starting point is the individual firm that exists to create, capture and sustain economic value. The firm focuses on opportunities that it can seize by leveraging its strategic power. The allocentric orientation, by contrast, takes a broader perspective and incorporates the various partners in the network as the unit of analysis. Apple's renaissance began when the newly returned Steve Jobs reframed the company as the hub of a digital lifestyle, rather than a computer maker that had to do everything important itself. An allocentric view allows executives to recognise and, more importantly, seize a whole range of opportunities that could only be pursued by a network rather than an individual firm, no matter how powerful. An allocentric orientation does not imply that managers ignore the interests of their own company. Rather, they recognise that the value lies in the network, which they cannot own.

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Put yourself in your customers' (and partners') shoes

When executives in powerful companies want to grow revenues, they often start with the same basic question: how can we sell more software, pizza, cement, insurance, coffee? Asking the same question leads to the same tired answers — use better raw materials and hope the customer will notice, cut prices to steal share, boost advertising, add features or simply give up and focus on cost reduction. These stale answers are often attributed to a lack of imagination, and they indeed share a tiresome lack of creativity. But that is not all they share. These responses are all actions that are under the company's exclusive control. In taking these actions, companies avoid the difficulties of probing customers' unmet needs or collaborating with partners to provide an integrated solution. How else can one explain the mindless proliferation of features that no one understands (let alone uses) that clutter consumer electronics, other than employees' desire to rely exclusively on actions under their control?

To break out of the arrogance of power, it helps to start with a different set of questions. *What really matters to our customers? What emotional need, beyond the purely functional, is unmet? What do our customers hope for? What do they fear?* You may think these are absurd questions for an insurance or coffee company to ask. You would be wrong. By asking just these questions, Swiss insurance firm Baloise learned that customers bought insurance but craved safety; while CEMEX discovered that low-income customers bought cement to build a legacy that they could pass on to their children. Armed with these insights, these companies could begin to assemble a network of resources to address customers' deep desires and fears.

Customer empathy is the first step in discovering how a product could resonate with a deep emotional need. Empathy is not the same thing as niceness, which is often used as an excuse to avoid hard discussions. Rather it is the ability to put yourself in someone else's shoes. Strategic power erodes the empathy required to understand customers' deepest hopes and fears. When working with a large European bank, for example, one of the authors sat with the top management team as they discussed how to grow revenues. As they spoke, he jotted down the verbs they used to describe what they would do to (never for or with) the customer. The list included 'cross-sell', 'leverage', 'squeeze', 'exploit' and 'penetrate', at which point, he interrupted the proceedings to note that he was not one of their customers and never would be since no one in that room was going to exploit, let alone penetrate, him. A leading technology firm, to give another example, refers to customers as 'sockets', presumably just waiting to be screwed.

How can managers, whose empathy has been blunted by strategic power, see the world from the customers' point of view? Most companies collect reams

of monthly sales data and survey current customers' satisfaction. These quantitative data reveal only those times when a customer is satisfied with a current product but mute on what would delight or surprise a customer or meet his or her deeper needs. Some companies attempt to discover this with focus groups, but this is the equivalent of scientists going to the zoo to study animal behaviour.

To empathise with customers' unmet needs, managers must observe them in the wild, not the zoo. To better understand the needs of Mexico's less affluent customers, CEMEX assembled a cross-functional team of high-potential managers who spent 10 hours each day for a year in an extremely poor neighbourhood in Guadalajara.

This intense observation provided many surprising insights. They noticed, for example, that poorer consumers generally bought less expensive powdered cement in bags, rather than pricier ready-mixed concrete delivered by trucks. In these neighbourhoods, cement is a consumer product. Their observation led CEMEX to market powdered cement like powdered soap, through consumer advertising and sponsoring local football clubs.

More importantly, the team gleaned insight into the subtle emotional benefits of home extension that supplemented the functional benefits of more room. Home improvements not only added space, they learned, but also conferred an important psychological satisfaction by creating 'patrimonio' — something of enduring value that customers could pass on to their children and grandchildren. The insight that buildings represented more than utility inspired CEMEX to create a programme called 'Patrimonio Hoy' (legacy today) that appeals to consumers' aspirations to create an enduring legacy that their children and grandchildren could enjoy.

To help customers realise their legacy, the CEMEX team had to understand obstacles that prevented consumers from building a legacy. Funding was one. They discovered that poor Mexicans raised capital for building by organising 'tandas', a lottery in which a collection of families contribute a set sum to a pool each week and one family wins the entire pot at the end of the week (no family can win more than once). Although these funds were intended for building, winnings were often diverted to alternate uses such as celebrating a wedding or birthday. Lack of building equipment and expertise also hindered construction. Although bagged cement represented a significant expenditure, the CEMEX team discovered that 40 per cent of all cement went bad, because customers lacked the tools or blueprints to complete their construction project.

> Managers aspire to strategic power, but power corrupts. The same power that helps capture and sustain profits in the short term and midterm can limit a firm's ability to thrive in the long term.

Get partners to play ball

Identifying an unmet customer need is one thing, but meeting that need is quite another, particularly when providing an integrated solution would require resources and competencies that your company doesn't control. CEMEX executives had no desire to run hardware stores or provide financing for construction. To provide their customers with an integrated experience, CEMEX needed to work with partners, including mom and pop retailers and banks, over which the company could exercise more power. The team was also charged with observing local hardware stores first-hand to understand what would induce them to work with CEMEX.

When faced with the need to find partners, managers accustomed to exercising power often look for companies they can easily boss around. When that doesn't work, they look to pay the partners to play, but this is not the only or best approach. In many cases, particularly when dealing with customers at the bottom of the pyramid, there is not enough profit to go around. Second, by linking cooperation exclusively to cash payment, companies risk the winner's curse, paying above the odds to woo partners over their next best offer. Finally, exclusive reliance on financial incentives, rebates and commissions to attract and retain partners fosters a transactional attitude in which more cooperation requires more cash. Of course, a partnership must work for everyone financially; but cash need not be the only, or even most important, way to attract partners.

Empathy is as important for partners as it is for customers in order to understand what matters to them beyond money and to structure deals that appeal to their values. CEMEX attracted local hardware stores into a network of Construrama solutions providers, in large part by providing them with access to best practices from CEMEX, the opportunity to learn from other leading retailers and the use of the Construrama brand that signalled quality to customers. Apple's commitment to elegant design attracts accessory producers, apps providers and product reviewers at sites such as iLounge that value aesthetically pleasing products. High-end equipment makers, leading hotel chains, premium airlines and sommeliers at Michelin Star restaurants are attracted to Nestlé's Nespresso coffee system for its luxury and elegance. Nespresso's elegance likewise attracts customers who sign up to the company's Nespresso Club, which might sound like a marketing gimmick until you realise that half of new customers learn about the system through demonstrations by current club members. These evangelists have helped make Nespresso Nestlé's fastest growing brand with revenues approaching $3 billion dollars.

In some cases, a dominant value such as design or luxury will attract partners. In other cases, however, strategic orchestration requires different deals to induce different partners to play ball. Consider the case of JLT, a British insurance and risk management firm, which was attempting to grow its business in emerging markets. JLT's Peruvian management team knew that the government was concerned about its aging taxi fleet that caused pollution

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and traffic accidents and also knew that the country had ample supplies of low-cost natural gas. The JLT team saw an opportunity to convince taxi drivers to buy new vehicles that ran on natural gas and to make money selling auto insurance.

It was a great idea in theory, but it faced myriad obstacles in practice. The banks wouldn't lend to taxi drivers with no credit rating; lacking bank accounts, drivers could not pay their bills; without customers gas stations refused to stock natural gas; and car dealers refused to order natural-gas powered cars. Rather than give up, the JLT Peru team figured out a way to get everyone to play ball. JLT added mortgage insurance to the bundle of insurance it sold drivers, agreeing to pay off the loan on the car if the driver defaulted, which induced the banks to make loans.

To stimulate the use of natural gas, the Peruvian government provided low-cost natural gas to filling stations that agreed to invest to distribute the new fuel and also install a billing system that allowed taxi drivers to pay their bank loan and insurance premium when paying for gas. Facing new demand, auto dealers started stocking vehicles that could run on natural gas. JLT Peru also worked with the national taxi drivers' association to identify drivers who would drive the 200 kilometres per day required to cover the financing charges and with two local companies who installed GPS systems to monitor miles driven and locate the cars if they were stolen.

The Peruvian taxi case illustrates that one company has to take the lead in identifying the pieces needed to seize the opportunity, understanding what matters to each player and structuring deals that make it work for everyone. This may seem like a lot of work — and it is. But it offers several advantages. First, the network is simple for the customer to use, thereby stimulating adoption. Demand for the new taxis grew five-fold in its second year as did the number of filling stations carrying natural gas.

Second, while the network is simple to use, it is very difficult to copy because key partners are already locked in. Finally, the company that orchestrates the network is well-positioned to make money. As a trusted partner within the network, JLT has offered a comprehensive insurance package including damage, theft, liability, mortgage and policies to ensure the bank is paid if the driver is ill or the car is in the shop. The network also provides a platform for offering additional coverage, such as health or life insurance, to existing customers, or expanding the programme to shipping companies or private bus firms.

Guide the network with a light touch, not a heavy hand

Strategic orchestration requires a shift in how executives deal with partners. Executives often brandish their company's strategic power as a stick to threaten partners into compliance with their wishes. But when value creation depends on partners' voluntary participation, firms like Nespresso, CEMEX or JLT can guide a network, but they cannot dictate what partners do. Guiding without power requires executives to exercise diplomacy rather than raw power in dealing with their partners.

Part of guiding a network is dealing effectively with communities rather than engaging in bilateral agreements in which you can leverage your power. JLT's success in Peru, for example, hinged on the insurance firm's ability to work with the local association of taxi drivers. In selecting growers, Nespresso identifies regions with the potential to deliver exceptional coffee and then works with local farmer cooperatives to secure the high-quality beans the company needs for its espresso. To spark continued innovation in coffee machines and the overall drinking experience, Nespresso taps into the global design community by sponsoring design competitions. This diplomatic orientation to partners permeates the coffee makers' language, which refers to customer-facing employees as 'ambassadors'.

It is not enough to talk the talk of communities, but companies also have to actively treat community members as equals, not vassals. With a global brand and billions of dollars in sales, Nespresso could easily use its strategic power to get things done, but it consistently relies on diplomacy in working with its partners. After identifying attractive growing areas, Nespresso offers local farmers the opportunity to 'opt in' by joining neighbouring farms to participate in the cooperative to supply Nespresso.

The lead partner must also be willing to delegate key decisions to partners. It was not the company but Nespresso Club members, the network of millions of customer advocates, who selected George Clooney as the brand's representative.

Networks rely on trust, and the lead partner in an orchestrated network must go out of its way to build and maintain trust among members. Transparent communication is one powerful way to build trust. Transparency does not mean that all information has to be shared with all partners all the time. Apple, for example, maintains a high level of secrecy about forthcoming designs to maintain suspense and ensure product launches are media events. But a bias towards transparency, rather than bilateral deals brokered in smoke-filled rooms, builds trust within a network.

Companies can invite credible third parties to verify that everyone is playing by the same rules. Nespresso works with the Rainforest Alliance, a non-profit dedicated to preserving tropical forests, to verify that coffee-growing partners are farming in an environmentally sustainable way and provide their workers with a fair wage and access to health care and education. Sometimes a company must orchestrate multiple partners to provide adequate verification and sufficient scope. De Beers launched the Kimberley Process to stem the flow of conflict diamonds — rough diamonds used by rebel movements to finance wars against legitimate governments in countries including Angola, Cote d'Ivoire and Sierra Leone. The process requires member countries to certify shipments of rough diamonds as conflict-free, with each individual diamond having its own passport.

Managers aspire to strategic power, but power corrupts. The same power that helps capture and sustain profits in the short term and midterm can limit a firm's ability to thrive in the long term. Power corrupts a firm's ability to work with partners, substituting arrogance for empathy and high-handedness for diplomacy. Strategic orchestration, however, allows firms to assemble and guide the networks necessary to seize many opportunities that lie outside the grasp of any one firm. ◘

IF STRATEGIC ORCHESTRATION IS THE ANSWER, WHAT IS THE QUESTION?

How can we profitably serve emerging market customers at the bottom of the pyramid?
Mexican cement company CEMEX assembled a network of hardware stores, banks and community leaders to help poor customers build extensions to their homes. By relying on partners rather than building the full infrastructure itself, CEMEX earned a healthy return on invested capital despite a relatively low price point.

How can we break out of the commodity trap?
Swiss insurance firm Baloise has partnered with business service providers to move beyond selling commodity insurance policies to making clients safer through prevention. Baloise has partnered with flood prevention, data security and fire safety firms to provide clients with an integrated approach to risk prevention.

How can we grow outside our core market?
Nestlé is the global market leader in instant coffee, but it had no experience selling systems for in-home coffee consumption when it formed Nespresso in 1986. Nespresso has orchestrated a network of coffee growers, machine manufacturers, distributors, service firms and high-end partners (including Ritz-Carlton hotels and first class on Cathay Pacific Airlines) to provide a luxurious experience to coffee drinkers.

How can we provide an integrated customer experience?
From its inception, Apple has aimed to deliver a seamless experience to users, but in the Macintosh era the company tried to do everything itself. With the iPod (and later the iPhone and iPad), Apple has continued to value ease of use but achieved it by stitching together an ecosystem of content providers and accessory makers that provide customers with simplicity.

How do we grow revenues on a low-cost product?
RyanAir offers the lowest prices of any major European airline with an average fare in 2010 of €35, but the company books an average of €10 per passenger from ancillary services. RyanAir partners with Hertz, Booking.com, Costa Cruises and Banco Santander to offer passengers car rental, hotel rooms, cruises and branded credit cards.

How can we solve the world's big problems?
Although everyone recognises the value of an effective vaccine against HIV, pharmaceutical companies lack incentives to develop one because the people who need the vaccine most are too poor to pay for it. The International AIDS Vaccine Initiative works with a host of biotech start-ups, pharmaceutical companies, governments, universities and not-for-profits to secure government funding, stimulate experimentation on vaccine design and development, and run clinical trials in developing countries.

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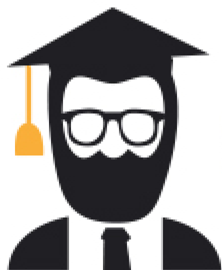
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