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THE TRUTH ABOUT COMPETITION

Proactively structuring corporate strategy from the front-line back will create opportunities for your business where they matter most.

by Roger Martin

MOST PEOPLE BELIEVE THAT BUSINESS COMPETITION takes place between companies: **Boeing** vs. **Airbus**; **General Motors** vs. **Toyota** vs. **Volkswagen**; **Microsoft** vs. **Amazon** vs. **Google**; **Procter & Gamble** vs. **L'Oréal** vs. **Unilever** vs. **Johnson & Johnson**. It's tempting to think of these great companies as colonizing nations engaged in a world war, fighting for territory and position in multiple theatres of combat — and it's quite likely many CEOs agree, to judge from the emphasis in the press on company market share.

But it's not actually corporations that compete — it's the products and services they provide. For customers of narrowbody commercial jets, the B737 competes with the A320. For buyers of midsize sedans, Malibu competes with Camry, which competes with Passat. For shampoo buyers, Pantene competes with Fructis, which competes with Dove and Neutrogena. You get the idea.

This brings us to a better way of thinking about competition: *It happens at the front line more so than at head office*. Individual customers choose between products and services that hold the potential for meeting their needs. And these customers have only a limited amount of concern about who actually brings the product or service to their front line, let alone the layers between the product on the shelf and where and by whom it is made and delivered. A poor product or service at the front line won't be saved in the eyes of customers by being part of a particular corporation, even if that corporation has other related products that are successful.

Understanding competition in this way upends much of what managers assume about mission, strategy, culture and decision-making. As I'll argue in the following pages, leading a business needs to be seen less as a challenge of managing organizational complexity and more about making sure value is maximized at the front lines. This calls for an approach that is less inspired by hierarchy and more by respect for the insights of the people in direct contact with customers, structured and motivated not around optimizing the use of their existing resources and capabilities but rather around identifying what is needed to deliver value right in front of the customer. In short, leadership must be focused squarely on figuring out how the organization can mobilize its resources to deliver the biggest bang at the front line.

From Optimal Hierarchy ...

Although a product competes on the front line, what goes into making it competitive obviously does not happen there; corporations must bring together many resources and capabilities to create new products. Consequently, firms become complex organizations.

Customers' decisions are far from easy for executives to predict and control — and this changes the power dynamics inside the corporation.

The traditional response to complex organizational challenges is to create hierarchy, an organizational model in which experienced, wise leaders inform themselves of the facts on the ground, reflect and consult, and then give orders to people below them, which inform the orders that those people give to people below them and so on. That's why in every corporation, we see numerous levels above the front line. If the front line is Pantene shampoo, above it is the Hair Care business, and above that is Beauty Care, and above that is Procter & Gamble.

Of course, there is considerable variation around how hierarchy works across different national cultures, but one way or another, in most countries the assumption is that success in hierarchical organizations has traditionally been largely determined by the quality of the judgments cascading down from the people at the top because, so the logic goes, the people at the top have the best view of how the battle is going, where they should send their troops and with what weapons.

But in business, where competition is between products rather than companies, the line of sight between a CEO's decisions and whether a customer will buy a product at any given time is much less clear. The individual outcomes of customers' decisions are far from easy for executives to predict and control — and this changes the power dynamics inside the corporation.

... to Organizing for Value

If the judge of a product's value is the customer who chooses to buy, not the provider, then it is the provider's people at the front line who are best placed to determine what the customer values. It is up to the rest of the company to help the people on the front lines, where the revenues come in, to satisfy those customer needs. In effect, the lower level is the customer of the level above it. And like a customer, it should expect to get more value from those services than it pays to get them. Hair Care needs to add net competitive value to Pantene, whether by doing scale-effective hair care R&D across the six major hair care brands globally or in some other way.

The same rule applies to each subsequent level of aggregation: Just as Hair Care needs to add more value to Pantene than it costs Pantene at the front line, Beauty Care has to help Hair Care in its goal of creating more value for Pantene than it costs Pantene. Perhaps it can add value by developing proprietary understanding of beauty customers across its $13 billion beauty business that would be hard for Hair Care to develop on its own. And P&G has to help Beauty Care to help Hair Care to help Pantene. P&G can do that by making it cheaper for Beauty Care to buy advertising for Hair Care, in general, and Pantene, specifically, thanks to P&G's huge advertising scale.

In every case, if a layer is not generating net value that ultimately helps the product win at the front line, then that layer is at best superfluous and at worst makes the product less competitive. If P&G's Beauty Care division can't help the Hair Care help Pantene more than it costs Hair Care to support it, then P&G should consider whether to eliminate Beauty Care as a layer (which would depend on whether it's adding value to other businesses in the lower level), or to move Hair Care to another division, or even to sell Hair Care to another owner. And if Beauty Care does not get more value from belonging to P&G than it costs to belong to, then P&G should not own and control Beauty Care. No business can compete on the front line with one hand tied behind its back by a layer above that is not creating enough value to counterbalance its cost.

A High Bar

The value that the higher layers need to provide is considerable, because having a level above the front line will automatically and unavoidably add two costs to the front line. First, there will be costs of coordination: Those at the front line won't be in a position to make important decisions on their own without checking with the next level. And that will mean potential delays and maybe not being allowed to make a decision that would be optimal for that business on its own, but not for the rest of the corporation. Second, the extra level will add the direct costs of the managers at that level, their support staff, their expense accounts, the extra office space and IT they will need, and a host of ancillary costs, all of which are supported by the net operating profits on sales at the front line.

So, what can the layers above do to earn their place in the chain? There are many services that higher levels in large firms provide, and most revolve around exploiting the firm's operational scale and scope and cumulated investment in credibility know-how.

- **OPERATING SCALE.** These appear most obviously in manufacturing and distribution. In distribution, for example, **Frito-Lay** can cost-effectively deliver Smartfood popcorn and Grandma's Cookies directly to stores because it is already delivering Lay's potato chips and Doritos to a multitude of stores. In R&D, Boeing can provide cost-effective new aircraft development services to its commercial aircraft business because it also has a large military aircraft business with which it can share the development costs.

- **CUMULATIVE INVESTMENT.** In branding, when **L'Oréal** wanted to launch the Age Perfect Cosmetics line, it was able to provide a trusted beauty brand, L'Oréal Paris, and even a trusted 50-plus sub-brand — Age Perfect Skincare — at a much lower cost than would have been the case for the new business by itself. L'Oréal provides value to Age Perfect not only because of its scale, but also because of its cumulated investment in establishing the credibility of the L'Oréal Paris and Age Perfect brands in the minds of customers. In addition, the company can draw on its cumulated investment in expertise at these and its other businesses in designing the new Age Perfect Cosmetics products and bringing them to market. P&G can, in a similar way, leverage its cumulated expertise in fragrances to brands as varied as Tide, Pampers, Olay, Charmin, Pantene, Dawn and Swiffer because it has for many years been the biggest and most knowledgeable consumer of raw fragrances in the world.

There are many other areas where value can be added by the layers above, including hiring, training and government relations. But whatever type of value is added at each layer, it needs to exceed the inevitable costs that the layer imposes. This poses two challenges. First of all, managers in the layer above must start treating the people below them as customers — understanding their lives and needs and stepping into their shoes. That sounds obvious, but it is surprising how remote executives become as you move up the hierarchy. I worked with a major automotive OEM [original equipment manufacturer] in the mid-2000s and came to realize that every six months, every senior executive automatically received a brand-new vehicle, and every day when they arrived at the parking garage, their car was cleaned, serviced and if necessary, refuelled. Not surprisingly, these executives completely lost touch with what customers experienced when buying, financing, servicing and operating their vehicles.

This mindset must change, and the change has to start from the top. How can you expect managers in your middle layers to treat those below them as customers if you don't pay them the compliment yourself? To remedy this, I had each executive, including the CEO, do in-home visits with both their own and competitor customers to familiarize themselves with life at the front line.

Smart CEOs do this instinctively. During his entire time as CEO, **A.G. Lafley** had a rule that whenever he visited another country, the local P&G office had to set up an in-home visit with a local consumer and a store walk-through at a local retailer. His visit to the bank of a river in rural China to speak to the village women who washed their clothes there became legendary. The message was clear: If the global CEO isn't too busy to do in-home visits and store checks, how can you be?

Once they've ensured that managers at all levels have gotten a good understanding of their customers and what those customers need, corporate executives can start on the second challenge.

Creating a Theory for the Firm

How can the corporation add net value to all businesses in the next level of the portfolio — and how does it ensure that all businesses in that next level are capable of adding value to the subsequent level, and so on? Answering that requires thinking about both what capabilities and resources to acquire and what parts of the business really belong together. This is a classic chicken-and-egg dilemma: You can't build value-adding capabilities until you know the portfolio members for whom you are building said value. But you can't know what portfolio members you should have until you know that it is possible to add net value to each.

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This means that corporate leaders need to iterate back and forth to home in on the combination of portfolio composition and value-adding rationale(s). Let's look at what that involves.

Because every diversified corporation already has a portfolio, the status quo is the practical place to start. The corporate level needs to develop a draft value-adding rationale for the next level. This is just like classic business unit or product strategy, whereby the heart of the strategy is composed of the linked where-to-play and how-to-win questions. In this case, the former question should focus on choosing in which capability domains to invest, and the latter on choosing how to utilize corporate scale or cumulative investment in the chosen capabilities to make the next level net better off. With a draft value-adding rationale for the next level in place, management in each part of that level should ask the same set of questions about its draft value-adding rationale for each business in the next level. And then the next level and the next, until you get to the level directly above the front line.

This first iteration of corporate strategy from top to bottom should produce four intermediate outputs:

1. THE KEY CAPABILITIES NEEDED TO SERVE CUSTOMERS AT THE FRONT LINE

Begin by identifying what capabilities to invest in and at what level you should invest in them in order to support what improvements to which businesses at the front line. Should you invest in creating a shared distribution capability at the business group level that would support multiple businesses across multiple products? Or should you invest in a shared R&D centre that would support multiple products across one business? And what would these capabilities and resources cost?

A.G. Lafley carried out this very exercise shortly after becoming CEO of P&G in mid-2000. In early 2001, he convened an offsite with his global leadership team to determine the key capabilities then underpinning the P&G portfolio — what they came to call the 'reinforcing rods.' Over 100 were posited before being winnowed down to three, which were expanded to five over time in the iterative process:

(1) the ability to go-to-market (GTM) with a broad and important portfolio of products delivered by way of multifunctional, customer–co-located teams (like the P&G **Walmart** team in Bentonville, Arkansas);
(2) the capability to create compelling and meaningful innovations for consumers;
(3) deep consumer understanding that provides proprietary insights;
(4) the ability to build trusted and compelling brands; and
(5) the scale to accomplish all of the above at an effective cost.

2. THE CUSTOMERS, PRODUCTS AND SERVICES YOU SHOULD DROP

If there are businesses at the front line that can't be helped by being part of the organization, they should be removed from the portfolio before the cost to their ability to compete at the front line is reflected in diminishing competitiveness and profitability. Figuring this out sooner rather than later is in the interest of both the corporation and the business in question.

At P&G, the identification of the key corporate reinforcing rods triggered a 15-year process of finding better homes for businesses that corporate could not help enough to cover the costs of P&G owning those businesses. It was a huge effort that involved numerous multibillion-dollar sales. The food businesses (which included Jiff peanut butter, Pringles potato chips and Folgers coffee) were sold because of the limited ability to continuously innovate to produce advantage, even though most were market leaders in their category. The pharmaceutical, pet care and professional salon businesses were sold largely because their specialized GTM was so different from the food, drug and mass merchandiser channels in which P&G had expertise and leverage. Beauty businesses that featured the weakest role for technological innovation like cosmetics, fine fragrances and hair colouring were sold. Finally, over 100 smaller brands across the portfolio were sold because, at their modest scale, P&G could not bring to bear its capabilities in innovation and brand building. By 2016, the remaining 70 brands with attractive scale were clustered in 10 remaining categories (from a maximum of over 20) in which P&G could bring all five of the key capabilities to bear.

3. THE CUSTOMERS, PRODUCTS AND SERVICES YOU SHOULD ADD

If the corporation can bring to bear substantial advantages to either an existing portfolio business or a business not currently in the portfolio, either of these should be taken as a signal for investing to expand the portfolio in that direction. So even as P&G engaged in a monumental paring exercise, which included approximately $30 billion in divestitures, it bulked up in areas in which it could apply the advantages from the key capabilities. It bought Clairol to bulk up its already successful hair care business. It bought the **Merck** consumer health business to strengthen its personal healthcare business. Unlike the divested pharmaceutical business, which required a specialized sales force for a channel unique for P&G (the physician and hospital channel), the consumer health business fit perfectly within P&G's core GTM. With the acquisition of Gillette, it entered grooming, a new category that benefited from all of its key capabilities. Plus, as a bonus, Gillette's Oral-B oral care business fit perfectly with and bulked up P&G's existing oral care business (Crest and Scope).

4. THE LAYERS YOU SHOULD ELIMINATE

As noted earlier, if any layer is incapable of adding net value to the businesses below it, it should be eliminated because it is hurting competitiveness at the front line, whether that is observable yet or not. Note this should not be symmetric: If business group A is not adding value to the businesses below it, that fact does not imply that business groups B and C that are serving other front-line businesses below them should be disbanded — just the offender A that is not adding value to its front-line businesses.

At P&G, this trimming happened with the geographic level of region presidents. Since a major reorganization in 1998, six regional presidents (e.g., North America or Western Europe) coordinated the GTM activities across all categories in their region. But that coordination had a cost, both in terms of the regional president organizations, which were not small, and the time and effort it took for the global category presidents to accomplish their goals for the region in conjunction with the customer teams in that region. So, in 2019, for the top 10 countries accounting for 80 per cent of P&G sales and 90 per cent of profits, the level was eliminated, and the global category presidents were directly responsible for GTM.

In closing

Because most companies don't build corporate strategy from the perspective of increasing competitiveness at their front line, their corporate structures tend to swell rapidly in terms of both costs and decision-making. As a consequence, the dominant motif is cost reduction, delayering and decentralization by pushing decision-making closer to the front line. And if the company doesn't do these things on its own, there are activist hedge funds lurking to force that exact program on them.

To be sure, this delayering may be better than just leaving the organization as it is; but to reduce a company's strategy to the elimination of corporate bloat entails leaving on the table all the value that creativity, energy and imagination can produce. Proactively structuring corporate strategy from the front line back will create opportunities for your businesses at the front line, where it matters most. **RM**

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