What is Strategy?

AGB 450
Agribusiness Strategy Formulation

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The entire realm of strategy is pervaded by a paradoxical logic of its own... Strategy is not a sentimental trade.

– Edward N. Luttwak

In preparing for battle I have always found that plans are useless, but planning is indispensable.

– Dwight David Eisenhower
Planning is Execution of Strategy

- Success Generally Measured in Terms of Profitability
- Systematic Method to Organize Information and Data into a Formal Plan
- Improves Understanding of Business on All Levels
- Poor Execution Kills Good Strategies
- Good Execution Without Strategy Does Not Work
Planning Goes Against Our Nature

- We are Generally Bad at Planning
  - organizations are worse
- We are Risk Averse
  - prefer reward to loss
  - planning forces us to anticipate failure
- Linear Thinking and Short-Term Behavior
  - plan for long-term
  - extrapolating short-term; dangerous practice
- Strategy is Counterintuitive
  - plans are useless; planning is essential
Planning Costs

- Planning is Expensive
  - real value is in the process
  - quick obsolescence
  - why bother?
- Not Planning is More Expensive
  - opportunity costs real but hard to measure
  - near certainty of not maximizing profit
  - increased probability of failure
Planning: a Dynamic Process

- Strategy is a Long Term Process
- Information, Data, and Material are Constantly Changing
- Process and Practice Must Continually be Improved and Reinvigorated
- Internal and External Needs Change
- Feedback Loop Must Exist to Keep Plan Modified and Up-to-Date
- Plans are Useless; Planning is Essential
The Business Planning Process

- Plan Serves Important Purposes:
  - attract additional financing (equity and debt)
  - need to make compelling business case for managers, employees, and investors
  - needs to be user-friendly
  - a common format and methodology are expected
The Business Planning Process

1. Formulation
2. Implementation
3. Evaluation

- External Analysis
- Internal Analysis
- Statement of Purpose
- Formulation of Long-Term Goals
- Strategy Development, Evaluation, and Selection
- Creation of Policies and Annual Goals
- Resource Allocation
- Performance Metrics and Evaluation

Feedback Loop
Dimensions of Strategy (Porter)

- Starting Point: How to Create Value
  - value must be unique
- Trying to “Be the Best” Doesn’t Work
  - impossible task
  - waste of resources
  - cannot please everybody all the time
  - cannot win that game
- Stand Out; Don’t be the Same as Everyone Else
Dimensions of Strategy (Luttwak)

- **Horizontal Dimension**
  - waves and counter waves
  - where paradox lives

- **Vertical Dimension**
  - grand
  - Theater
  - operational
  - tactical
  - technical
What is Strategy?

- Essential Task of Management
- Describes the Position We Hold or Want to Hold in the Industry
- Defines the Approach the Firm Takes to Succeed
- Describes the Advantages We Possess or Create that Make it Possible for Us to Win
What Strategy is Not

• Hopes or Goals
  – “be the best,” “be #1,” “to grow,” “to succeed”

• Vision or Mission or Values
  – “ethical treatment of customers,” “leading company,” “to serve mankind”

• Series of Actions
  – “Step 1,” “Phase A,” “Action Plan B”
Strategy is the “How?”

- Answers the Question, “How do We Reach Our Goals?”
- Yields Very Specific and Concrete Solutions to Problems
- Requires Us to Make Decisions and Implement Them

1) Describe the Situation or Problem
   – starts the process; not the end

2) Analyze Relevant Information
   – steps 1 and 2 begin understanding
   – iteration and experience

3) Act on the Understanding
   – should not act without understanding

4) Back to Step 1; Repeat *ad infinitum*
   – hakuna matata
Hedgehogs and Foxes

• We Must Simplify Reality to Understand
  – models simplify reality
  – right model exists for a particular problem
  – no way to know beforehand what it is

• It is Easy to Rationalize Decisions
  – analysis often used for this purpose
  – often leads to errors and failure

• Hedgehogs Know One Big Thing

• Foxes Know a Great Many Little Things
Paradox of Strategy

- Life is Nonlinear
- Complex Goals Often Achieved Indirectly
- To Achieve Goals, Actions Constantly Revised
- Analysis Involves Iteration and Experience
- World is Full of Risk and Uncertainty
  - known unknowns and unknown unknowns
  - others oppose what we do; counter strategy
Strategic Goals and Problems

• Defining Problems and Goals is Very Difficult
  – multidimensional, imprecise
  – contradict, compete
  – insufficient useful information exists
  – understanding nature of problem keeps shifting

• Understand Problem as We Solve It
  – a limited range of options
  – don’t know what goal is until it’s achieved
  – we learn what they are by pursuing them
ICI – Paradox in Strategy

• Imperial Chemical Company
  – founded in 1926
  – largest manufacturer in the British Empire
  – competitor of duPont and IG Farben

• Market Value Peaked in 1997
  – borrowed £4 billion for acquisition strategy
  – immediately began selling assets

• ICI Bought by Akzo Nobel in 2007
ICI Mission Statement (1987)

ICI aims to be the world’s leading chemical company, serving customers internationally through the innovative and responsible application of chemistry and related science. Through achievement of our aim, we will enhance the wealth and well-being of our shareholders, our employees, our customers, and the communities which we serve and in which we operate.

ICI Mission Statement (1994)

Our objective is to maximize value for our shareholders by focusing on businesses where we have market leadership, a technological edge, and a world competitive base.
Managers and Strategy

- Only Manager Sees Whole Picture
  - drives operational efficiency
  - keeps distinct from strategy
- Commits to Strategy Every Day
- Leads Choosing Company Position
  - gets buy-in from others
- Tirelessly Communicates Strategy
- Holds Company to Strategic Path
Strategy Frustrated

- Strategy is Badly Misunderstood
- Unsound Strategic Thinking Everywhere
- Herd Instinct (Follow Common Path)
- Tendency Towards Conformity
- Regulation Constrains Alternatives
- Customer Demands Sometimes Do Not Fit
Strategy Frustrated

- Consensus Thwarts Tradeoffs
- Cost Allocation Can Spread Strategies Thin
- Markets Push for Short-Term
- Pressures for Faster Growth
- Urge to Copy Success (Herd Instinct)
Structure and Position

- Two Main Factors Drive Strategy
  1) structure of industry (industry analysis)
  2) position within industry (position analysis)
- Structure Concerns How Company Competes
- Position Concerns How Company Stands Out
- Company Must Focus on Both
  - factors determine economic performance
Industry Analysis: Five Forces

- Strategy Attempts to Change Structure
- No Strategy Without Industry Analysis
- The Five Forces Define:
  - characteristics of industry structure
  - competitiveness within industry
  - profitability of companies in industry
- Each Structure Requires Own Strategy
  - some businesses are in different industries
Porter’s Five Forces

- Substitute Products
- Power of Consumers
- Rivalry Among Competitors
- New Competitors
- Power of Suppliers
Five Forces Common to All Industries

1) Nature of Rivalry Between Competitors
   - nasty and brutish (price)
   - less nasty and brutish (features or quality)

2) Power of Customers to Drive Down Prices

3) Power of Suppliers to Drive Up Prices

4) Existence of Substitute (or Complementary) Products

5) Nature of Barriers to Entry to Competition
   - costly or inexpensive?
Unhealthy Competition

• Winners and Losers
  – compete on same dimensions; copying each other
  – zero sum game

• Tends to Undermine Industry Structure
  – losers drop out
  – industry homogenizes
  – revenues stagnant or fall; profits disappear

• Typical of Industries Under No Growth
  – shrinking market
Healthy Competition

• Many Firms Can Win
  – compete on strategy

• Tends to Expand Industry Structure
  – many firms succeed
  – industry diversifies
  – revenues increase; profits improve

• Typical of Healthy Growing Industries
  – competition increases size of market
Levels of Strategy (à la Porter)

1. Business Strategy (aka Competitive)
   - how to compete in each business or industry
2. Corporate Strategy (aka Group)
   - company operates many businesses
   - how to integrate different business strategies
Strategy Dimensions (Luttwak)

1. Horizontal
   - action and reaction
   - playing out over time

2. Vertical
   - technical
   - tactical
   - operational
   - theater
   - grand
Strategic Dimensions (Luttwak)

<table>
<thead>
<tr>
<th>Vertical</th>
<th>Horizontal</th>
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<tbody>
<tr>
<td>Grand/Corporate</td>
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<tr>
<td>Theater/Business/Industry</td>
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<tr>
<td>Operational</td>
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<td>Tactical</td>
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<td>Technical</td>
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Important to understand how all dimensions and levels interact.
Levels of Strategy (à la Luttwak)

1. Technical (Theoretical, No Context)
   - purely analytical
   - everything perfect as assumed

2. Tactical (Applied in Context)
   - strategy applied
   - willful and flawed humans enter picture
     - managers, workers, competitors, markets
   - context narrow; not entire picture
Luttwak Levels Continued

3. Operational (Style)
   - Context more broad; fuller picture; exploit weakness
   - varieties of style
   - #1: routine and repetitive; brute force; high cost
   - #2: more customized to context; high risk
   - scales of operation
   - both use strengths against weakness and threats
   - information is crucial
Luttwak Levels Continued

4. Theater (Porter’s Competitive)
   - industry context
   - how to compete in each business or industry
   - competitive advantage and disadvantage

5. Grand (Porter’s Corporate)
   - company operates many businesses
   - how to integrate different business strategies
Porter’s Generic Strategies

- Competitive Advantage Allows Company to Outperform Competitors
  - industry leaders possess competitive advantage
- Define Company’s Competitive Advantage
  - positions company within industry
- Competitive Advantage Achieved Two Ways
  1. lower relative cost approach (lower price)
  2. differentiation (higher relative price)
- Decide: Do One or the Other
The Value Chain

- Makes Competitive Advantage Possible
- Value Chain is Complex Set of Activities That
  - allows company to compete
  - delivers value to customer
  - defines the company
  - must be done well
- Different Companies in Industry Will Have Different Value Chains
  - strategic differences
Value Chain Components

- Primary Activities
  - logistics, operations, marketing, sales, service
- Support Activities
  - finance, planning, HR, training, technology, R&D, procurement
- Activities Incur Costs
  - to which company adds margin for profits
- Result is Value to Customer (and Company)
- Strategy Defines Value Chain
# The Value Chain

<table>
<thead>
<tr>
<th>Primary Activities</th>
<th>Value Proposition</th>
<th>Margins</th>
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</thead>
<tbody>
<tr>
<td>Supply Chain (In)</td>
<td>(materials and services)</td>
<td></td>
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<td>Operations and Production</td>
<td>(transforming inputs to outputs)</td>
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<td>Supply Chain (Out)</td>
<td>(products and services)</td>
<td></td>
</tr>
<tr>
<td>Marketing and Sales</td>
<td>(generating revenue by selling outputs)</td>
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</tr>
<tr>
<td>After-Market Service</td>
<td>(managing product, customers after sale)</td>
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| Company Infrastructure     |                                    |                                |
| Human Resources Management |                                    |                                |
| Technology Management (R&D)|                                    |                                |
| Procurement Management     |                                    |                                |
Strategic Value Chain

- Value Chain Identifies
  - where competitive advantage comes from
  - strengths and weaknesses of company

- Components Can be Arranged Differently
  - activities occur in different order
  - activities take different scale or emphasis

- Strategy Involves Creation of Value
  - selection of specific components
  - ordering, operating, and managing components
Value Chain and Generic Strategy

- **Lower Relative Cost Strategy**
  - chain is configured to deliver low costs
  - company operates components efficiently

- **Differentiation Strategy**
  - chain is configured to add value
  - company operates components to set itself apart

- **Strategy Involves Creation of Value**
Operations are Not Strategy

- Operational Efficiency is Important
  - do the same thing better
  - utilize best practices
  - execute, execute, execute
  - strategy cannot work without it

- Strategic Position is More Important
  - do things differently; choose to be different
  - creates value proposition
  - creates competitive advantage
Successful Strategy Hard to Copy

- Unique Value Proposition
- Unique and Profitable Value Chain
- Deciding What to Do (and What Not to Do)
  - tradeoffs; can’t make everybody happy
  - recognizing opportunity cost of what you do
  - perfect is the enemy of the good
- Value Chain Components Fit, Work Together
- Continuous Strategic Process
The Value Proposition

• Value Proposition Provides Unique Answers to These Questions:
  – which customers do we want to serve?
  – what products and services do they need?
  – where do we price?

• Hard to Copy a Good Value Proposition
Unique and Profitable Value Chain

- Value Chain Implements the Value Proposition
  - components and configuration define chain
  - each link needs management (making choices)
- Value Chain Must be Consistent with Value Proposition
Making Decisions and Tradeoffs

- Tradeoffs (Choices) Essence of Strategy
- Conflicts Require Tradeoffs
  - necessary to sustain strategy
  - make strategy hard to copy
- Competitive Advantage Means You Choose to Do What You Do Best
  - involves opportunity cost
  - you must choose not to do other things
- Cannot Make Everybody Happy
Making Value Chain Fit Together

- Company is a System of Functions
  - system is the value chain
- Components Must Fit Together
  - each part affects every other part
  - each part must reinforce every other part
  - parts must operate together effectively
- Strategic Decision
  - how to configure and operate components
- Competitive Advantage Comes from the Whole
Continuous Strategic Process

- Strategic Continuity Means Continuous Change
  - continuous learning to adapt and improve
  - do not change value proposition and direction
- Constant Improvement Necessary
  - how to improve value chain?
  - how to better deliver value?
  - where do we price?
Strategy Takes Time

- Strategy is for the Long Haul
- Need to Sustain Competitive Advantage
  - dynamic industry structure
  - build understanding, skills, assets
  - establish reputation with customers and suppliers
  - build and operate effective value chain
  - define position within industry
- Strategy is a Continuous Process
  - if you think you are finished, you aren’t done