MIT Sloan Management Review
The Strategy of Change series #2

The Essence of Strategy is Now How to Change

When environments are complex and dynamic, strategy is about adaptability.

B. Tom Hunsaker and Jonathan Knowles

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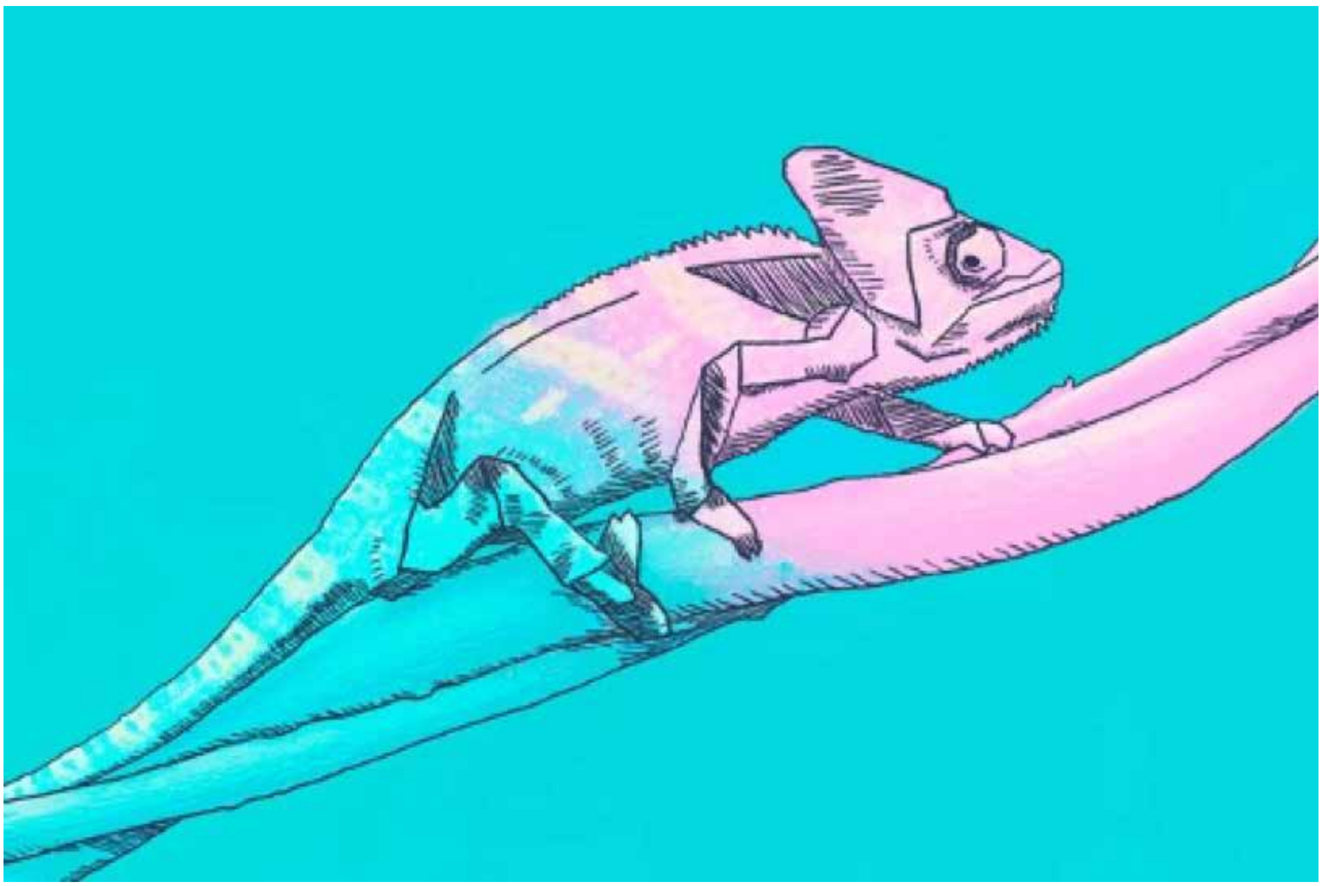

A fundamental assumption underlying traditional approaches to strategy is that industry boundaries and economics remain broadly stable over time. This assumption is no longer realistic, given that digital technologies and other factors have caused the average age of the companies in the S&P 500 to decline from more than 60 years in 1958 to less than 20 years today. This has reduced the relevance of tools such as the GE/McKinsey matrix and the BCG Growth-Share matrix, the diagnostic power of which relies on relatively stable industry structures.

A second dimension on which strategy development has become more complex is the requirement that companies show that they are actively contributing to the broader society rather than simply serving as financial entities seeking to maximize their return on capital. The current emphasis on corporate purpose and environmental, social, and corporate governance are manifestations of the intense pressure companies are under to demonstrate their social legitimacy.

As a result, business leaders need to evolve how they think about strategy in two important ways to be relevant in today's dynamic and complex environments:

First, their focus needs to shift from what is stable to what is changing — and specifically how these changes may neutralize historical sources of advantage and how they may give rise to new opportunities.
Second, they need to broaden the number of stakeholders whose needs and potential contributions are evaluated during the strategic planning, review, and refinement process.

In our previous article, "Changing How We Think About Change," we outlined a framework to help business leaders evaluate the relevance and sustainability of their current strategy and identify what form of strategic adaptation is appropriate to their situation:

Magnitude: "We need to enhance our execution of the current path."
Activity: "We need to adopt new ways of pursuing the current path."
Direction: "We need to take a different path."

The MADStrat framework uses two perspectives to determine which of these forms of change is appropriate in a given context:

Fit to purpose evaluates your market context and involves assessing the closeness of fit between your offering and the needs of customers (both now and in the foreseeable future), and how your business model also delivers value for other stakeholders. What are the outcomes that you enable your customers and their stakeholders to achieve? What wider social value does your business generate? This axis considers differentiation from the perspective of Who are you different for?

Relative advantage involves assessing your capabilities relative to alternatives, not just direct competitors. In which areas can you claim to offer a distinctive advantage to customers and other key stakeholders? This axis considers differentiation from the perspective of How are your offerings valuably different from those of others?

By identifying the factors that underpin the appeal of a company, business unit, or brand to its customers and other key stakeholders, together with the factors that cause it to be regarded as irreplaceable, the MADStrat approach provides the insight for companies to understand whether their context calls for a change in magnitude, activity, or direction.

This more nuanced and context-driven insight serves as an alternative to the polarized advice that companies are presented with today: to either double down on what they're already doing or engage in disruptive transformation.

The MADStrat Matrix

A company's change decision is informed by its performance on fit-to-purpose and relative advantage criteria.

Does your situation call for a change in magnitude to deepen your existing strengths, a reimagination of the activities involved in the design and delivery of your offerings, or a fundamental shift of direction to establish a more sustainable future for your business?

For some companies, this insight can be gained through self-assessment (a version of this self-assessment can be accessed at https://madstrat.com), but others will benefit from primary research among different stakeholder groups to validate that they truly have understood how they are performing on the key dimensions of fit to purpose and relative advantage.

Once a company has established the nature of the change that it should be considering, the task becomes that of identifying the actions that will be most effective in improving their fit to purpose and/or their relative advantage.

In the table “What Strategic Actions Should Your Company Consider?”, we provide some directional guidance for business leaders, depending on whether their situation calls for a change of magnitude, activity, or direction.

What Strategic Actions Should Your Company Consider?

Business leaders can use the following recommendations to stimulate discussion about how to enhance the performance of their company, business unit, or brand according to whether the MADStrat analysis calls for a change of magnitude, activity, or direction.

STAKEHOLDERS	ENHANCE MAGNITUDE	REIMAGINE ACTIVITY	SHIFT DIRECTION
Customers	■ Invest in the growth of your core offerings ■ Emphasize brand equity over price ■ Expand sales and service teams ■ Invest in customer segmentation ■ Monitor industry trends and customer needs ■ Migrate customers to a recurring revenue model	■ Customize service offerings ■ Focus on areas of unique competence ■ Implement pricing optimization and bundling ■ Consider new forms of distribution ■ Outsource business functions ■ Copy rivals or white-label their products and services	■ Redefine your value proposition ■ Enter new product/service markets
Employees	■ Increase training on customer success ■ Increase recruitment ■ Accelerate R&D on next generation of current offering	■ Realign your organizational structure ■ Focus on specific skill sets ■ Fund R&D on next generation of technology ■ Promote cultural adaptation	■ Articulate new corporate focus and purpose ■ Retrain to match new required job skills ■ Offer early retirement and/or implement downsizing
Partners (SUPPLIERS AND DISTRIBUTORS)	■ Enlarge partner ecosystem ■ Rationalize partner ecosystem ■ Lower sourcing costs	■ Offer unique/enhanced value ■ Outsource business functions ■ Drive down partner costs	■ Partner to reduce barriers to entry in new markets ■ Explore potential for vertical integration
Investors	■ Consider economy-of-scale merger ■ Assess opportunity for economy-of-scope merger	■ Initiate industry consolidation ■ Merge to acquire new capabilities ■ Cut costs to enhance margins	■ Engage in portfolio diversification ■ Manage for cash returns ■ Seek potential purchasers
Communities	■ Invest in community economic development ■ Fund employee volunteering	■ Enhance focus on corporate reputation ■ Undertake community-based branding	■ Loan people to community organizations ■ Donate facilities

We have applied a MADStrat lens to our analysis of the 500 largest merger and acquisition transactions over the past 20 years to explore the importance of congruence between actions taken and the type of change recommended by the MADStrat analysis. For example, what explains the divergence of Google's experience between its hugely successful purchase of Android in 2005 versus its largely unsuccessful acquisition of Motorola Mobility in 2011?

Our conclusion is that mergers based on economies of scale are effective for companies seeking changes of magnitude, given that they already enjoy high levels of fit to purpose and relative advantage — think InBev's merger with Anheuser-Busch in 2008.

However, merely getting bigger does not solve the underlying problem for weakly positioned companies (such as Kmart and Sears in 2004) that should have implemented a change of activity (like acquiring access to new forms of digital distribution — as Walmart did in 2016 with its acquisition of Jet.com).

Similarly, mergers predicated on economies of scope are only wise for companies that enjoy high levels of customer equity, since having high fit to purpose is the prerequisite for effective cross-selling. An example is Disney's acquisition of 21st Century Fox in 2019.

A change of direction (often through diversification) is a necessary strategy for a company whose future fit to purpose is threatened by changes in technology (such as the threat to Ford's and GM's businesses from the shift to electric vehicles and alternative mobility options) and/or consumer preferences (such as the threat to Tyson's business from the move toward meatless sources of protein). However, diversification can be a source of management distraction for companies that should really be focusing on changes in either activity or magnitude. GE's forays into mortgages through GE Capital is just one of the company's unwarranted diversifications. In dynamic environments, understanding when and how tochange is the essence of strategy. Tools that help you spot the opportunities and challenges that exist or are emerging in your company's specific context are now more relevant than the traditional strategy frameworks that rely on the premise of long-run industry stability and competitor benchmarking.

The most successful businesses today are those that identify when and how to change to improve their strategic advantage. Whether it is Amazon embracing physical retailing to complement its digital capabilities and enable new business models, or Pfizer leveraging its marketing and distribution capabilities by partnering with other drug development companies, these actions can be traced to acting on change signals that indicated a focus on magnitude, activity, or direction.

Companies that recognize the change signals appropriate to their context are more likely to direct their management and innovation energies most effectively— gaining the advantage.

ABOUT THE AUTHORS

B. Tom Hunsaker is the associate dean of innovation and a global strategy professor at the Thunderbird School of Global Management. Jonathan Knowles (@typetwo) is CEO of Type 2 Consulting, based in New York. A free MADStrat self-assessment survey can be found at **https://madstrat.com**.

MITSloan Management Review

MAD STRATEGY

THE STRATEGY OF CHANGE SERIES

MIT Sloan Management Review describes the goal of the series as follows:

To develop effective strategy amid constant change, leaders must hone their ability to determine which changes will boost their organization's competitiveness. This series examines data from companies worldwide to provide practical insights for business leaders seeking advantage as they navigate complexity and change.

Article 1 – 13 August, 2020

Changing How We Think About Change

Introduces the idea that change can take three different forms – magnitude, activity or direction – and that the form of change that is appropriate for your business depends on how you are performing on the key dimensions of fit to purpose and relative advantage.

Article 2 – 17 December, 2020

The Essence of Strategy is Now How to Change

Argues that traditional approaches to strategy are based on two assumptions that are no longer valid – stable industry structures and shareholder primacy. Demonstrates how a focus on fit to purpose and relative advantage provides a reliable and timely guide for how businesses can improve their performance across multiple stakeholders.

Article 3 – May 20, 2021

Most Businesses Should Neither 'Pivot' nor 'Double Down'

Challenges the received wisdom that business leaders have to decide between doubling down on their existing strategy or pursuing some radical transformation. Shows how the change signal for two-thirds of companies is "reimagine activity" (sticking to an existing strategy but innovating the tactics used to achieve it).

Article 4 – August 5, 2021

Great Strategy Considers More Than Just Customers and Investors

Proposes that companies are social entities that exist in a multifaceted economic environment. By expanding the number of constituencies with whom exchanges of value can be undertaken, this biological mindset increases the variety of strategies available to companies.

Article 5 – October 5, 2021

Effective Innovation Begins With Strategic Direction

Argues that innovation is not an end in itself but the mechanism for achieving specific forms of change. Discusses the type of innovation that are best suited to a goal of enhancing magnitude vs. that of reimagining activity vs. that of shifting direction.