Heracleous, L., Wirtz, J. & Pangarkar, N. 2009. Flying High in a Competitive Industry: Secrets of the World's Leading Airline. Singapore: McGraw-Hill.

7

HOW TO WIN IN CUT-THROAT INDUSTRIES I: ACHIEVING STRATEGIC ALIGNMENT

We undertook this study in order to gain a deeper understanding of the factors that can help a company achieve sustainable success in extremely tough industries. Our findings are based on a detailed study of the strategy and organisational features of a company that has achieved just that. In the next two chapters, we outline some strategic lessons from this study that we believe can be applied to any company that wants to achieve sustainable advantage. We do not aim to provide silver bullets (and in any case silver bullets are not possible since the right strategic decisions depend on the specific circumstances and challenges of each organisation) but rather to suggest useful strategic principles and to help executives ask the right questions. This is in our mind the only avenue to effective strategic thinking.

In this chapter, we address one of the most important findings and also a key principle for success: achieving strategic alignment, and recognising and dealing with misalignments before they become destructive. We begin with a reminder of why it is so hard to be successful in the airline industry and proceed with a discussion of the nature of strategic alignment, as well as the main misalignments that companies should be vigilant of. One important message of this chapter is that achieving strategic alignment is a pre-condition for achieving sustainable competitive advantage.

Why Is It so Hard to Be Successful in the Airline Industry?

We have discussed the airline industry features and dynamics in detail in Chapters 1 and 2. It is worth briefly reminding ourselves, however, of the main characteristics of this industry, and why it is so hard to be successful in it. At first sight, the airline industry might seem relatively healthy, since the service is widely available and demand enjoys reasonable growth in several markets. Over the last 20 years, airline revenue-passenger kilometres have been growing at over 5% annually, passenger numbers at 4.2%, and world gross domestic product at 3.5%. In some countries such as India and China, growth has been exceptional. Airline revenue growth has been lower, however, at around 2.8%, and industry net profits have been negative over half of the years.[1] The lower rate of revenue growth indicates a squeeze in prices charged and a squeeze in margins, which airlines have tried to deal with by seeking efficiency increases. These pricing pressures reflect the effects of supply increases brought about by deregulation that closely match demand. The industry suffers from significant over-capacity, where on average one quarter of airplane seats and almost half of cargo capacity are unutilised. The bargaining power of buyers, in addition, has been increasing due to technological advances allowing customers, who have low switching costs, to have high transparency of prices and choices through buying on the Internet. These factors have fostered a commoditisation of air travel, where in the absence of significant differentiation, many buyers make purchasing decisions in terms of price.

The rivalry among established firms has risen substantially, often degenerating in vicious price wars that ultimately make the whole industry worse off in terms of returns. High barriers to exit, the entry of low cost rivals, over-capacity and the maturity of the industry in most parts of the world only serve to raise rivalry to unsustainable levels. Airline alliances such as Star Alliance, SkyTeam and Oneworld, offering the options of more destinations with less hassle to passengers, often achieve little in terms of granting competitive differentiation to incumbents, since most major competitors belong to such an alliance. To make things worse, in many cases structural inertia due to regulatory or nationalist constraints does not allow industry consolidation that could raise industry efficiency and control rivalry. Finally, many suppliers can squeeze airlines and also pose uncontrollable cost fluctuations, such as the oil prices and charges of leading airports where demand outstrips supply. All of the above factors can shed light on the abysmal performance of the airline industry in terms of returns on investment. Even among the low cost carriers, only a handful have been relatively profitable (Ryanair, easyJet and Southwest Airlines).

In this challenging context, Singapore Airlines (SIA) has not only never made a loss on an annual basis, but has delivered superior returns to its competitors consistently over the years. We have aimed to understand more about SIA's exceptional performance, and offer our own interpretation of its success in this book. We suggest that one key reason for SIA's success has been its high levels of strategic alignment, and vigilance in identifying and dealing with misalignments before they become destructive. We have offered one representation of SIA's tight alignment in terms of the activity map presented in Chapter 4. We will discuss SIA's alignment further in terms of the ESCO model (environment, strategy, core competencies and organisation) as well as the McKinsey 7-S model in this chapter.

What Is Strategic Alignment?

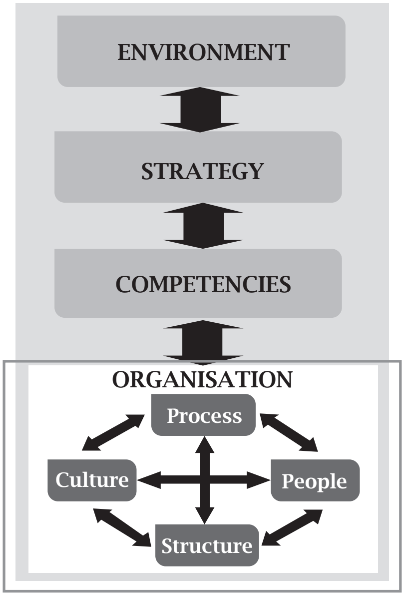
There is no shortage of management ideas and frameworks that aim to help managers achieve strategic alignment in their companies. These include ideas about adapting strategy to the competitive environment, configuring organisational functions to implement or operationalise the strategy, or developing the right organisational and people competencies that support the strategic direction. The well-known McKinsey 7-S model, Kaplan and Norton's balanced scorecard and Michael Porter's value chain are all implicitly or explicitly about strategic alignment.

The idea of strategic alignment is simple, but the challenges it raises are numerous and frustrating. One useful and straightforward way to diagnose the level of alignment in any organisation is to distinguish between and map four levels: the environment (at various levels such as the competitive, macro-economic and institutional), the strategy of the company (at the business or corporate levels depending on the purposes of the analysis and the level of application), the organisational core competencies supporting the strategy, and the organisational functions and processes that should work in an integrated manner to deliver these core competencies. We have labelled this the ESCO model (environment, strategy, core competencies and organisation) (see Figure 7.1).

This sort of analysis can easily be paralysed by information overload unless a proper perspective is kept. Even though there are many potentially relevant aspects of the environment, many facets of strategy, many kinds of competencies needed and several minutiae of operations, it is important to be able to distinguish the wheat from the chaff, look at the big picture, and ask what are the key issues involved.

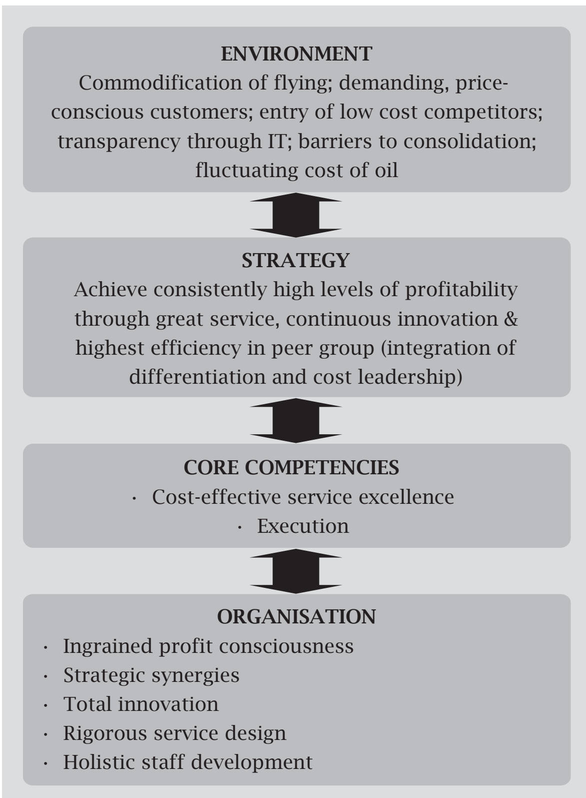
Figure 7.1
The ESCO model

- Competencies must be aligned with the strategy, and the organisational configuration must be aligned to deliver the desired competencies
- All of this must support the strategy, which must be right for the competitive environment



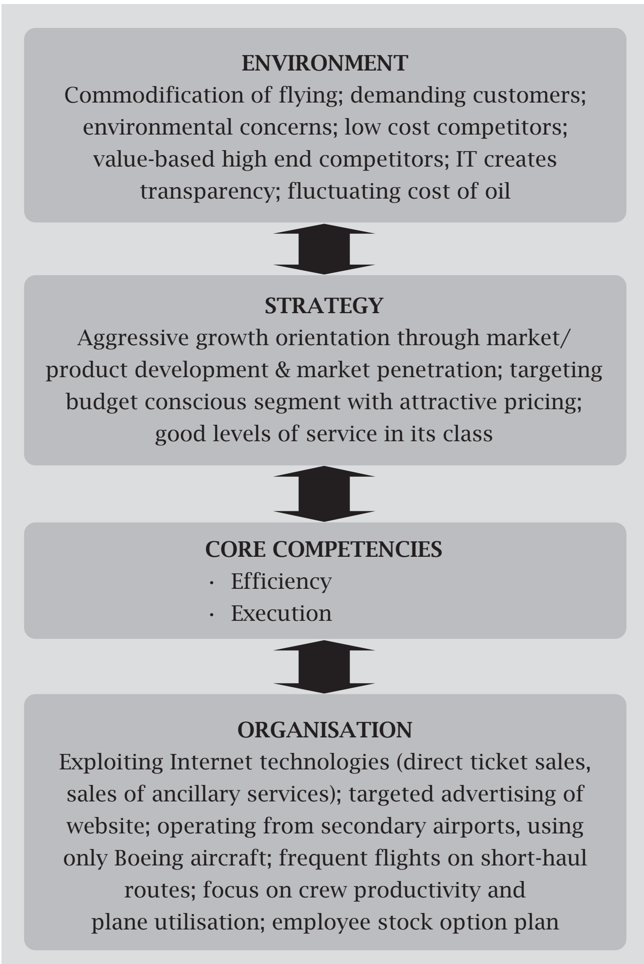
Even though it is far from easy to achieve, leading companies exhibit effective strategic alignment that they can sustain over time in the face of industry shifts, competitor actions and changing customer demands. It is no surprise that these companies also consistently outperform most of their competitors. If we apply the ESCO model to SIA (see Figure 7.2), we can see (as elaborated in Chapter 4) that its strategy is aligned to its environment, the right core competencies support the strategy, and the organisational five pillars give rise to these competencies.

Figure 7.2
Strategic alignment at SIA



We can also apply the ESCO model to an airline such as Ryanair (see Figure 7.3), a pioneer in the European budget segment, which has also outperformed its segment, exhibiting high levels of strategic alignment.

Figure 7.3
Strategic alignment at Ryanair



More elaborate frameworks can also be used to represent alignment, such as the classic McKinsey 7-S framework. In Figure 7.4, we apply the 7-S model to SIA.

In addition to the ESCO model and the McKinsey 7-S model, we can also employ the value chain to examine strategic alignment. If we consider strategic alignment at IKEA, arguably the world's most successful furniture maker, all the elements of the value chain are mutually consistent in support of a business strategy of cost leadership. Figure 7.5 portrays the value chain of IKEA in the bottom two rows as compared with the value chain of many traditional furniture manufacturers in the top two rows, competing with a business strategy of differentiation.

The crucial point to note from the perspective of the sustainability of competitive advantage is that whereas it is easier to copy isolated elements of a successful system, it is much more difficult to copy the whole system and the synergies that arise from the way the various processes interact and interconnect. A highly aligned system arises through a mixture of effective execution of plans, evolution and fine-tuning of the organisation design and processes, and even opportunism, as managers address misalignments, integrate systems and processes, remove elements that are outdated or do not fit desired arrangements, and generally resolve issues as they arise. What underlies this process is an attitude and culture of continuous improvement, and a continuous search for better and more efficient ways to do things.

Further, it is beneficial to employ different frameworks so that a variety of perspectives can be gained. What matters even more, however, is asking the right questions: Given what is happening in our environment, do we have the right strategy? If not, how does it need to change? Do we have the right core competencies at both the organisational and people levels to pull our current or intended strategy off? Do our operations deliver the organisational core competencies we need in an integrated, mutually supporting manner? Finally, where are the key misalignments and what can we do about them? These questions are inevitably hard to answer, and involve difficult choices, uncomfortable evaluations and political battles. But there is no alternative than to ask

Figure 7.4
Strategic alignment at SIA through the McKinsey 7-S model

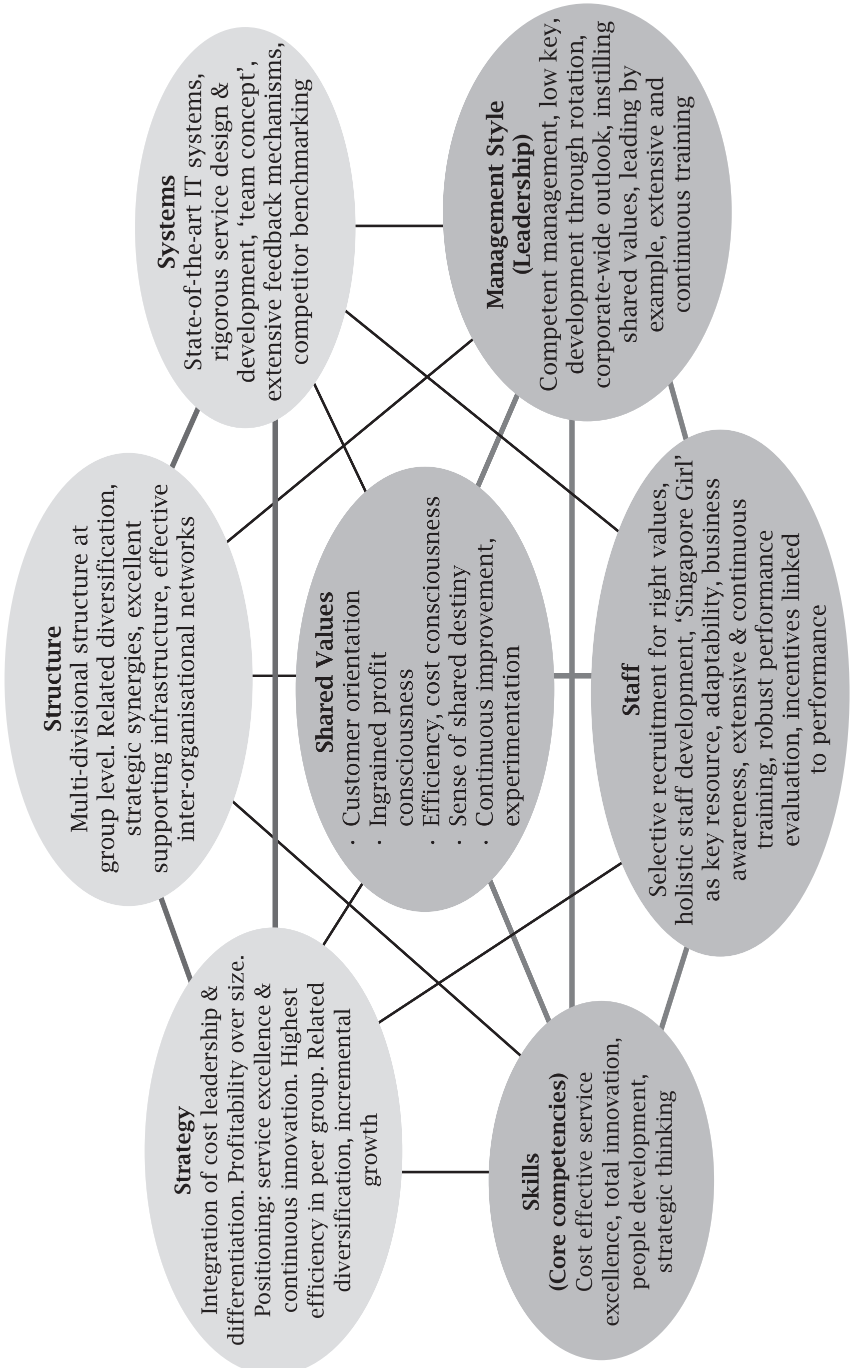


Figure 7.5

Strategic alignment at IKEA vs traditional furniture makers

	Design	Parts	Assembly	Logistics	Marketing	Service
Traditional furniture makers	Independent designers	High levels of work-in-progress	Labour intensive	Relatively inefficient supply chain	Fragmented across geographies	'Full service'
	Complex, tailored designs	Handicraft, custom manufacture	Built to order	Transport costly, bulky finished product	Expensive, high-street display	Small lot delivery to customers
IKEA	In-house designers	Modular, inter-changeable parts	Minimal assembly by company	Computerised/ efficient	Leverage Scandinavian image	Self-service
	Simple designs	Cheaper materials, mass production	Assembly by customer	Transport modular parts	Cheap out-of-town display	Customer transports home

Source: Adapted from Kumar, N., Scheer, L. & Kotler, P. (2000) From Market Driven to Market Driving. European Management Journal, *18 (2), pp. 129–142.*

and address them, otherwise inertia and even chance would be allowed to play a dangerously influential role.

Commonly Found Misalignments

If there are so many frameworks to help us diagnose and map the levels of alignment in organisations, why are misalignments so common and why do they persist? What are the main types of misalignments we find, and what can we do about them? Virtually all organisations have some misalignments; what is important is to regularly identify them and address them before they have the chance to become destructive. Strategic alignment is a simple idea to grasp, but it is surprising how difficult it is to get it right in practice, or how many misaligned or even conflicting activities and practices can be observed in organisations.

Strategic Misalignments

We outline below six of the most common types of misalignments that can be found in organisations, and offer examples of each.

Strategy Is Out of Line with External Competitive Environment

In some organisations there are high levels of alignment internally (among operations, core competencies and strategy), but all of this is misaligned with the demands and features of the competitive environment. For example, many Western brewing giants rushed into the Chinese beer market in the mid-1990s, collectively investing billions of dollars in building state-of-the-art factories, and producing premium beer sold under their global brand names for around five to six times the price of locally branded beer, which sold as cheaply as soft drinks. These new entrants painfully discovered that the premium segment of the beer market was only around 5% of total demand and was too small to support so many simultaneous new entrants, consumers were fiercely loyal to their local brands, local competitors were quick to engage in predatory price competition, the weak transport infrastructure made it harder to transport beer to other regions efficiently and therefore to build up demand and achieve capacity utilisation, and finally local bureaucrats were not always transparent or easy to deal with.

While these global competitors had high levels of internal alignment, there was a critical misalignment between their strategy of differentiation (high quality, premium price, state-of-the-art factories, global branding) and the competitive environment. What they offered was neither consistent with what the market wanted or could support, nor with the institutional environment. The result was that most of them had to exit the China market, unable to keep sustaining huge losses year after year, and had to sell their newly built factories to local competitors such as Tsing Tao at bargain basement prices.[2]

However, South African Breweries (now SAB Miller) was successful in China, by employing a strategy that was in many ways the opposite of the strategy of other multi-national beer companies, and that was highly aligned with the demands of the competitive environment. SAB got it right because it was able to learn from prior experience in other emerging markets such as sub-Saharan Africa and Eastern Europe, environments that posed many similar challenges, and could then effectively transfer that learning to its China operations. Further, SAB gave high priority to strategic alliances as a means of gaining local knowledge, entering local networks and getting a deep understanding of local consumer behaviour. This enabled SAB to keep its capital commitments manageable by not having to build new factories but investing to upgrade its partners' existing factories. Further, SAB realised that rather than offering global brands at premium prices, the market at that point would best support local brands at local prices, and that a China-wide expansion strategy would be much less realistic than a phased geographic expansion based on regional strongholds. Therefore, SAB entered the China market with a cost leadership/localisation strategy, which was aligned with the environment, rather than a differentiation/globalisation strategy, which was not.

Organisation and Competencies Fail to Support Strategy

This form of misalignment occurs when operational configurations and the competencies they exhibit do not support or operationalise strategy adequately, and they even create contradictions or tensions between strategy and operations. For example, a European firm in a service-oriented industry has over the last few years exhibited double-digit growth, but its customer service capability lagged behind, causing tensions with its customers, and creating the danger of distorting the firm's differentiated market positioning and jeopardising further growth. The firm identified this misalignment and dealt with it by increasing investment in its customer care function.

Further, a successful professional services firm with exceptional annual revenue growth rates (in the mid-20s) had a traditional functionally-based organisation design and a reward system that did not distinguish between levels of performance, both of which created difficulties in supporting this growth, in particular the efficient delivery of bigger and more complex projects. This firm took steps to review its organisation design, adopting a matrix design and changing some of its processes such as aligning reward to individual performance and instituting a more robust governance system. These steps enabled the organisation to support the strategy of rapid growth.

Incompatibilities and Tensions Within the Organisation Level

This form of misalignment occurs when operational configurations and processes are mutually inconsistent in their orientations and goals. This can occur at both the functional or departmental level as well as at the corporate or cross-divisional level. Examples at the functional level are the classic conflicts between internally-oriented functions such as production or operations and externally-oriented ones such as marketing or sales. At the corporate level, there may be conflicts among divisions that have to compete for funding from head office, or between the head office and divisions when there are differing views about the appropriate degree of centralisation/decentralisation. At the corporate level, tensions across divisions arise especially when corporate budgets get allocated across divisions largely based on financial performance without sufficient attention to cross-divisional synergies or longer term potential; or for cultural, historical and organisational design reasons, which could be harmful to competitive advantage.

When Carlos Ghosn took over the reins at Nissan in 1999, and was trying to diagnose the key issues that needed to be addressed to reverse the company's decade-long decline and imminent bankruptcy, he referred to a 'culture of blame' where various departments and regions blamed each other for the company's woes instead of taking responsibility and acknowledging their own contribution to the problems. The engineering department had been all powerful, leading to cars that were over-engineered and not necessarily aligned to what the market wanted.

The historical difficulties of achieving rapid development and global roll-out of innovations in multi-national giants such as Procter & Gamble (P&G) indicate less than ideal levels of cross-divisional alignment. P&G's mode of global expansion after the setting up of the overseas division in 1948 involved extensive duplication of operations and processes in several new markets, in effect creating a smaller P&G clone in each market, which enjoyed high levels of operational independence. This allowed and even fostered insufficient levels of cross-national coordination on processes such as new product development, lower levels of efficiency, development of a 'not invented here' syndrome and fierce independence of international operations. In the 1980s concerted efforts begun to address these issues through increasing cross-national integration and coordination of key functions. By the 1990s the international division was replaced by four regional organisations structured through a matrix organisation (regions/product categories), and global category executives were appointed, but innovation and diffusion were still too slow. This prompted a change programme initiated in 1998 labelled 'O2005', which was seen as the most fundamental and dramatic organisational change in P&G's history. The historically decentralised corporate design of P&G and associated culture of independence therefore led to low levels of cross-divisional and cross-national alignment, among other things impacting the innovation and global roll-out of new products, and efforts to address these issues took decades.

Rewarding One Thing but Expecting Another

One classic and widespread form of misalignment is 'the folly of rewarding A while hoping for B'.[3] In academia, for example, one receives the rewards that matter such as tenure or a full professorship in a world-class university mainly for one thing (research quality and productivity as evidenced in quality journal publications), yet great teaching, student mentoring and earnest performance in administrative duties are also hoped for. Further, we have seen service organisations rewarding employees based on strict quantifiable measures of individual performance (for example, sales figures), yet hoping for teamwork and sharing of culture; or rewarding managers purely based on specific measures of the firm's financial performance, yet hoping that these same managers work to create a climate where customers receive a great experience in their use of the service and in their interactions with the company. Of course great customer experience and financial performance ideally go together and are part of a desirable virtuous circle, but exclusive emphasis on just one element of a desirable gestalt can lead to distortions in emphasis and behaviours that undermine the other elements. This is why, for example, if a manager at General Electric hits the numbers but does not exhibit the company's desired values through their behaviours, they would still be in trouble.

Failure to Realign Strategy and Organisation with Environmental Changes

This form of misalignment occurs when a company has a highly aligned model across the four ESCO elements of operations, core competencies, strategy and environment (thus having high alignment both internally and externally), but it does not keep in touch with external changes, or does not appreciate their implications and impact. For a variety of reasons, such companies are too inertial to adapt their strategy and internal operations, and as a result do not realign effectively when the environment changes. Inertia can arise from organisational cultures that do not value rigorous debate or constructive dissent, are hostile to diversity, encourage groupthink, dwell on history and past successes, tolerate unproductive politics, or are characterised by a sense of invincibility that leads to complacency.

One example of failing to adapt to environmental change is Wang Laboratories, founded in 1951, and once the leader in network enterprise computing. One problem was that Wang failed to appreciate the extent to which the arrival of the personal computer (PC) would encroach on its market, and that it would in fact be cheaper for companies to buy several PCs for their employees rather than Wang's expensive mainframe-based system that tied companies to the provider in terms of regular maintenance costs. Mainframes would still be needed by the market, but to a much smaller extent than before. Other issues included lack of compatibility of Wang's systems with other available software because of their proprietary standards, and questionable senior appointments in the company that led to several senior managers leaving in protest. During its last couple of years the company undertook significant restructuring and started focusing more on software than hardware, but the effort to realign was too late; it filed for bankruptcy in 1992.

The situation of Eastman Kodak is also instructive. For the last five years the company has been remaking itself into a digital giant through a process that many believe has started too late. This has been a massive process of realignment of operations, core competencies and strategy prompted by an environment where digital technologies have not only cannibalised Kodak's traditional film business but also offer high returns for companies that can compete effectively in it. The realignment process has cost Kodak over $2.5 billion in restructuring costs, and a further loss of 27,000 jobs (to about 50,000 employees, down from 145,000 in 1988).

A company that managed to realign successfully is IBM. Under Gerstner's leadership, the company realised that most segments involving hardware were gradually becoming commodified and unattractive in terms of current and future profitability. IBM then gradually reduced its investments and operations in mass-market, commoditised hardware manufacturing and increased its capabilities in high-end servers, software, services and consulting, realigning itself with market trends and re-focusing on high-growth and high-return segments.

Lou Gerstner took over in 1993, after IBM had lost US$16 billion between 1991 and 1993. He had initially refused the job of IBM CEO, concerned that he lacked the technological background to lead IBM, but what is noteworthy is that his decisions about the future of the company were based not on technology but on the customers' perspective. This is what led him, for example, to make a U-turn on a momentous plan to break up IBM into smaller businesses, since from the customer's point of view it is more efficient and desirable to buy technology from an integrator rather than to buy from several different suppliers. He strived to change IBM's culture from an inward-directed, politically charged one where divisions were behaving like fiefdoms, to a customer-focused, integrated one, committed IBM to open technology standards and led the focus on services rather than hardware.

Misguided Strategic Actions Leading to Even Greater Misalignments

This final form of misalignment is the most regrettable one. It occurs when managers mistakenly take actions believing that the result would be greater alignment with a new strategy or a new environmental imperative. Their actions however destroy a company's capabilities and create even greater misalignments. One example is how the managers of Schlitz beer, once the second largest selling beer in the US, tried to reduce costs by using cheaper, synthetic ingredients in the production process and shortening the production cycle. This was promptly leaked to the market, and its market share started to fall. Even after the company decided to reinstate all production processes to their former mode, it was too late – the brand had already been tarnished and the company went bankrupt. A further common example of inadvertent destruction of competencies is re-engineering or re-structuring efforts handled poorly, where morale is destroyed, and productivity and profitability are only temporarily enhanced. Longer term problems occur since the company's capability base is depleted when the most capable employees feel unsure about their future in the company and are snapped up by competitors.

Why Do Misalignments Persist and What Can Be Done About It?

Why then do misalignments persist, despite so many tools to help managers achieve alignment, and despite the time and energy spent on this issue?

Organisational Inertia

One reason is the inertial pressures brought about by the influence of dominant ways of thinking and cultures that discourage debate and reward blind conformity. In BMW, inertia and groupthink are fought by a culture where vigorous debate and constructive conflict are encouraged by the company's leaders, particularly in new product development processes, with the assumption that once a decision is taken everyone commits to it even if they had previously held different views. On the other hand, inertia due to the dominance of accepted ways of thinking was a factor that arguably delayed Kodak's investment in digital technologies to the point where its very survival was at stake. Performance management systems that are fully focused on the numbers without taking into consideration issues such as what values are exhibited by executives, do not tolerate mistakes as learning opportunities and do not allow a reasonable timeframe for investments to pay off, tend to exacerbate the level of organisational inertia by fostering a culture of risk aversion and potential massaging of performance-related figures.

Flawed Strategic Planning and Unbalanced Resource Allocation

Linked to the disease of inertia is flawed strategic planning. This was a significant factor leading to the demise of foreign competitors in the Chinese beer industry, since it led to a misalignment between global brewers' strategy and environmental conditions. The impact and implications of the salient features of the environment such as the price sensitivity and patriotism of consumers, likely response of incumbents, weak infrastructure and red tape in each region were not fully appreciated. Further, Kodak's woes could be seen as resulting from less than fully effective environmental monitoring and assessment of the implications and impact of environmental/technological trends. A related issue is the unbalanced resource allocation that results from flawed planning, especially from lack of attention to issues of alignment, for example, a misalignment between growth in demand and the required investment in customer support capabilities.

Organisational Politics

Politics is another significant factor that leads to the creation or persistence of misalignments. A strategic re-orientation is often held back by a culture of fiefdoms rather than an overall corporate outlook, populated by individuals who believe they would lose out in a new order of things because of a lower level of resources allocated to their empire, a reduction in the numbers of their subjects, or new roles and responsibilities for themselves that they would feel uncomfortable with. As a result they either actively sabotage or passively resist any changes, making any organisational realignment harder. Such political issues were key among the factors that fostered performance problems that necessitated P&G's efforts to increase global integration and the speed of new product roll-out from the early 1980s onwards, IBM's turnaround in the mid-1990s, and Nissan's turnaround in the late 1990s.

What Can Be Done about Strategic Misalignments?

In terms of immediate action, cross-functional teams can conduct a review to identify the main misalignments and debate potential solutions. This should be adequately resourced in terms of time, perhaps the presence of an effective facilitator or organisation development practitioner, as well as the involvement of the right people. The six kinds of misalignments mentioned above could be used to help managers evaluate the extent of misalignments in their own organisation.

For each kind of misalignment, a rating can be given (1 for low, meaning that there is high alignment, to 5 for high, which would indicate the need for swift action). There may be a few relevant aspects for each broad type of misalignment, as well as a few potential solutions that may become obvious only after extended debate. These are simple questions but if taken seriously, they can foster meaningful conversations that address important strategic issues.

Type of misalignments	**Rating (1 to 5)**	**Comments**	**Potential solution**
1. Is there alignment between strategy and environment?			
2. Do the organisation and competencies support strategy?			
3. Are there any misalignments within the organisational level?			
4. Is the reward system consistent with expected behaviours?			
5. Is there adaptability to environmental change?			
6. Are any actions taken that may create greater misalignments?			

Leaders and senior teams must be vigilant since misalignments can creep up unnoticed. The boiling frog syndrome is a reality in many organisations. Small, incremental changes in the environment are often either not perceived or their collective implications remain un-appreciated, until crisis conditions develop when it may be too late to react effectively. An active strategic thinking, planning and operationalisation process that challenges managers' mindsets and helps them ask the right questions can minimise the chance that environmental changes and their implications go unnoticed. Diversity of thinking and questioning of the status quo can also minimise the influence of inertial and dominant strategic paradigms at the very times when fresh thinking is needed. Creative, out-of-the-box ways of strategising may be useful here.[4] Finally, leaders must make sure that politics are kept to a manageable, constructive level and swiftly address any destructive politicking.

In this chapter, we suggested that tight strategic alignment is a precondition to achieving sustainable competitive advantage, and offered examples of highly aligned firms such as SIA, Ryanair and IKEA. We then examined the main types of misalignments that can be found in companies, as well as the reasons for which misalignments persist and finally what leaders can do to identify misalignments and debate corrective actions. Achieving and maintaining alignment requires clear thinking, discipline, seamless execution and constant vigilance in monitoring external changes, fine-tuning and, if necessary, realigning to maintain a winning position.

END NOTES

1. See the ICAO and IATA figures cited in Chapters 1 and 2.
2. For a detailed discussion see Heracleous, L., The Demise of Foreign Competitors in the Chinese Beer Industry, in Singh, Pangarkar & Heracleous (2004) *Business Strategy in Asia*, 2nd edition, Thomson Learning.
3. Kerr, S. (1995) On the Folly of Rewarding A while Hoping for B, *Academy of Management Executive*, 9(1), pp. 7–14.
4. Heracleous, L. & Jacobs, C. (2005) The Serious Business of Play, *MIT Sloan Management Review*, Fall, pp. 19–20.