Beating the odds

Collaboration strategies will bring success in a competitive environment

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Arthur D Little

Content

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Executive summary

The world is undergoing unprecedented changes. As competitive landscapes are being transformed and unprecedented chunks of value are being redistributed from former leaders to web-scale platform players, the importance of understanding, learning from and adapting to the new environment becomes critical.

We identified five main trends we believe are currently shaping the business environment, and will continue to do so in the future:

- Growth is shifting from developed to emerging markets
- Technology is changing consumption behavior and sending ripple effects across sectors and value chains
- Borders between traditional markets are blurring, creating a level playing field for successful new competitors
- The Industry 4.0 opportunity will be game-changing across value creation chains
- Ethical and sustainability-related pressures on business are intensifying

The urgency to act in the face of the described converging trends is growing, and executives would do well to prepare their businesses for what lies ahead. We believe there are three critical imperatives for companies to tackle the challenge:

1. **Define – or redefine – your company´s long-term vision**. Have a clearly articulated view of where the business is going and, equally fundamental, why.
2. **Build the right competencies and capabilities**. Identify the critical competencies and capabilities needed, as well as the best way to fill the gap by not only developing your strengths but by leveraging the strengths of the appropriate partners.
3. **Build the right organization**. Ensure that the organization can effectively develop and manage the required competencies and capabilities.

The successful implementation of the steps depends on some critical factors. First, an alignment between vision, strategy and organization (in terms of structure, talent and processes). Second, the choice of the right partners to undertake the journey, and even more critical the ability to steer and adapt dynamic collaboration arrangements beneficial to all parties. Third, an organization that is able to experiment, learn and incorporate new knowledge in the face of volatile environments.

1. A brave new world

New, innovative companies are spiraling upwards on a wave of success. While former leaders struggle to survive and web-scale platform players disrupt industries capturing unprecedented chunks of value. As this progresses, the importance of understanding, learning from and adapting to the new environment becomes critical.

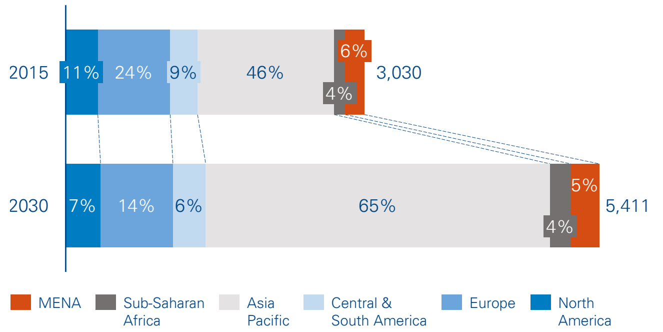
Below, we highlight some of the main trends currently shaping the business environment, and that we believe will continue to do so in the foreseeable future.

Growth is shifting from developed to emerging markets

The global middle class had reached 3.2 billion people at the end of 2016, according to Brooking Institution, up from 2 billion 10 years before. At the same time, it is currently at its peak historic growth rate. This implies that in just a few years a significant milestone will be reached, at which more than half of the 7.5 billion world population will live in middle-class or rich households.

The growth is expected to be far from even at a global level, however. The middle-class population in Europe and North America is expected to stagnate, while most of the growth to 2030 will come from the Asia-Pacific region. (See Figure 1.)

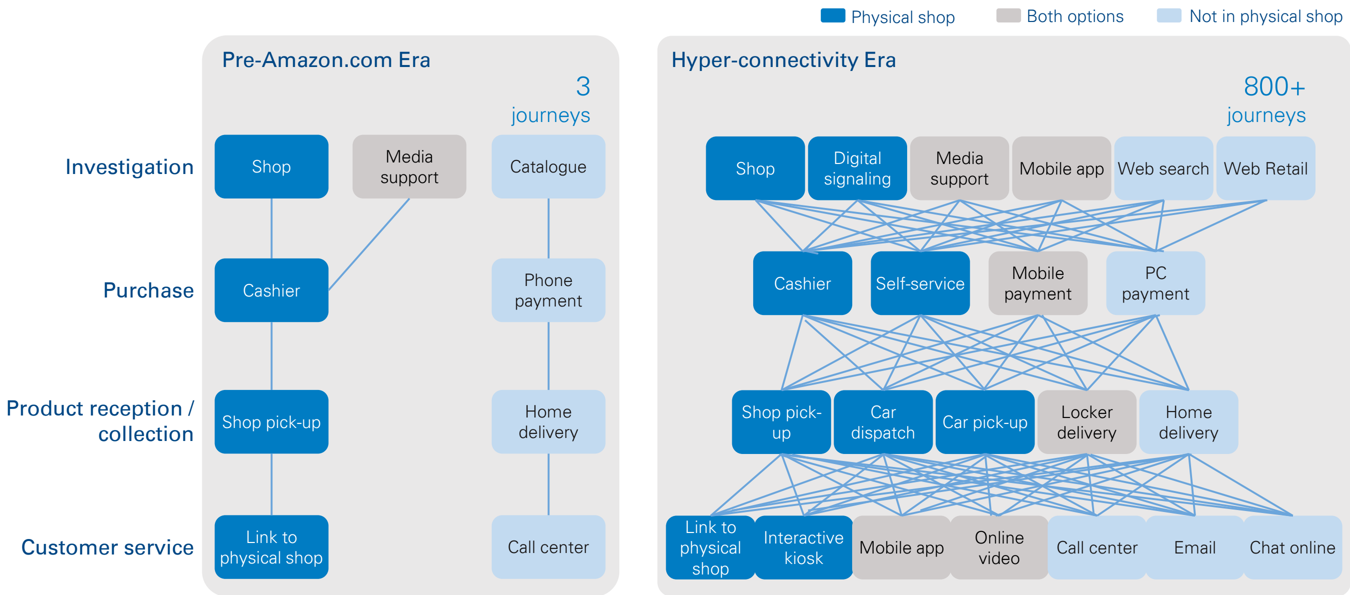
Figure 1: Geographical distribution of the world's middle-class population



Source: Brookings Institution, Arthur D. Little analysis

We expect the business landscape to change accordingly. On the 2016 Fortune Global 500 list, 197 companies originated from the Asia-Pacific region, up from 116 in 2001. As growth shifts toward the region, we expect a tremendous advance of local large corporations from Asia-Pacific. The additional spending associated with this growth holds the promise of high-gain opportunities. An important caveat, however, is that for most companies the strategy and positioning of today will probably not do the trick. This is the case whether a company is just to survive, or become one of the up-and-coming leading global businesses of the future.

Figure 2: Customer journey evolution



Source: Cisco, Arthur D. Little analysis

Technology is changing consumption behavior and sending ripple effects across sectors and value chains

The digital transformation has changed the rules of the game across sectors, significantly altering the customer journey. In an era of hyper-connectivity, the customer now has myriad options to research and buy the products and services he or she needs, 24/7.

As the customer becomes more sophisticated, better informed and more demanding, companies face increasing challenges to deliver compelling and competitive value propositions in a seamlessly integrated way across touch points.

The new paradigm has a ripple effect in value chains, as consumer-facing businesses are adopting the same mind-set in the dealings with their business partners. To be able to sustain innovative offerings, competitiveness in features, and agile processes throughout, they require the same from their providers and allies.

Following this new paradigm, one example is Amazon and its customer-oriented strategies. Amazon is implementing a new refunds policy for all its merchants that ship products themselves, so they are now subject to the same rules applied to items shipped by Amazon.

This new returns policy will make it easier for consumers to send back items at the merchant's expense, and require that merchants adapt their customer-oriented strategies to the one defined by Amazon.

Borders between traditional markets are blurring, creating a level playing field for successful new competitors

While the degree of interconnectedness of the global economy is reaching unseen levels, the globalization mantra has long been at the back of everyone´s mind. Companies are well aware that their long-established presence in their home markets may come under attack at any moment from international peers looking for attractive new regions. Own local markets have not been safe harbors for a while.

What comes as a surprise, however, is that competition can now arise from sectors and businesses once considered unrelated. As companies such as Google, Apple and Tesla breach industry boundaries and compete in advertising and travel, technology and watchmaking, and automotive and renewable energy at the same time, traditional lines between industry verticals are being blurred.

The common denominator is usually technology, and as more of the action moves to the digital arena, opportunities – or threats, depending on the perspective – are flourishing. By now, classical examples are Uber and AirBnb. Both entered established, traditional markets and revolutionized existing business models. They achieved this by transferring the sharing and collaboration culture flourishing in the online world of YouTube and Facebook to the physical world of hotel stays and taxi rides, and by creating a service offering that was simple, convenient and compelling at the same time.

As Uber and AirBnB disrupt the traditional industries of hospitality and transportation, two things become clearer: I) non-traditional competitors that can deliver the experience and value the customer is looking for can now aspire to displace incumbents in a matter of years; and II) no sector is immune.

The Industry 4.0 opportunity will be game-changing across value creation chains

The term "Industry 4.0" is used extensively, as is the promise – and, at the same time, the threat – of radical improvements in operations across the board. It englobes a long list of concepts and technologies, including, among others: big data and advanced analytics, self-learning systems, collaborative robots, virtual modeling/simulation, augmented reality, collective intelligence/crowd sourcing, the Internet of Things, and so on.

Applications are numerous in all areas of operations. We include some examples below:

- R&D: virtual plant manufacturing, 4D printing, self assembly materials
- Manufacturing: predictive analytics detecting manufacturing irregularities, collaborative robotics and simulation of robot motion
- Logistics: cloud-based, end-to-end and real-time material tracking, autonomous intraplant transport systems
- Marketing & sales: augmented-reality showrooms, connected customer devices
- Support functions: virtual-reality training simulator, mixed-reality solutions for video conversations

The benefits that technologies associated with Industry 4.0 could bring are not merely theoretical. While some companies are already beginning to revamp their operations, those left behind risk remaining at a significant disadvantage.

For example, as presented in our "Future of operations in the digital world" viewpoint, we modeled the cost advantage an early adopter could achieve compared to followers. We found that on average, the early adopter could almost double its EBIT margin over a 10-year period compared to followers, and that a significant gap was visible in the first two years (10 percent).

Moreover, cost is not the only dimension to be considered. Industry 4.0 will be enabled and powered by platforms. These allow meaningful exchanges of value between players, leveraging resources of participants and enabling game-changing shifts across the entire business model and value creation chains.

However, distinct capabilities are required in order to take advantage of the opportunities. New technologies with potential for the business must be identified, understood and analyzed. Subsequently, relevant applications must be developed and implemented for all affected areas of operations. And, more importantly, the right platforms to be integrated in must be identified.

Once again, early adopters stand to gain, as the sooner the benefits of streamlined operations and increased collaboration can be translated to better customer value, the higher the chance of being able to sustain the value generation. Conversely, companies that are not able to keep up are under threat to see their value propositions erode against more agile competitors.

Ethical and sustainability-related pressures on business are intensifying

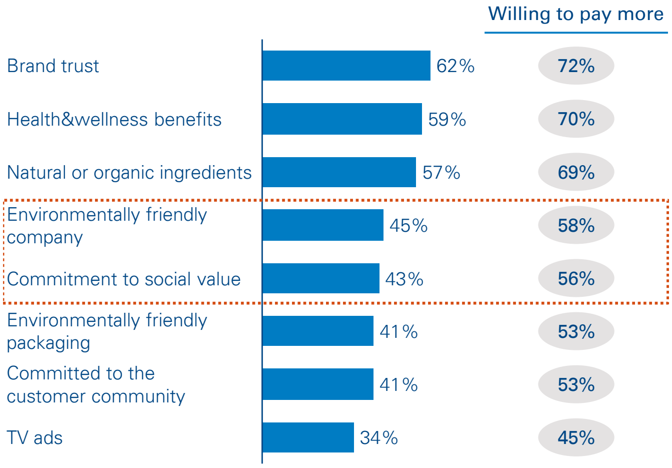
While not new, sustainability concerns are resulting in increased pressure on businesses, driven by consumer demands, governmental initiatives and societal/non-governmental organization pressure.

According to Nielsen's global survey on corporate social responsibility[2], 66 percent of global online consumers are willing to pay more for products and services from companies that are committed to positive social and environmental impact – up from 55 percent in 2014 and 50 percent in 2013.

The same study shows that consumer brands that demonstrate commitment to sustainability outperform those that do not. In 2015, the first category of companies experienced a growth rate of more than 4 percent globally, while those without social or environmental commitment grew less than 1 percent.

There are numerous examples of companies across all sectors that have incorporated sustainable practices into their business models, pressuring competitors. Ikea, for example, is following through on its commitment to produce more energy from renewable sources than the total it uses by 2020, and is already at almost half its target. In addition, it is working to promote a circular business model, with its stores in Belgium offering clients options to sell back or have Ikea furniture repaired, as well as to learn to renew or donate furniture bought anywhere.

Figure 3: Key purchasing drivers analysis (as weighted by all survey respondents)



Source: Nielsen - Global Survey on Corporate Social Responsibility 2015

As another example, Inditex has invested more than €7 billion in the past five years to support its sustainability program. The program includes reuse and recycling initiatives, investment in better and more streamlined logistics, and the upgrading of stores to make them more eco-efficient.

To compete in this scenario, companies must keep abreast of innovations, engage in dialog with stakeholders in order to address their concerns, and be ready to rethink their entire business models.

The good news is that while challenging, successfully standing up to the challenge may not only have social and environmental benefits, but also boost performance. The key is to be able to adapt the offering according to customers' purchasing decision drivers and communicate it effectively. Yet again, this is not only true for consumer-facing businesses, but for the entire value-producing network.

Summing up, the picture painted by the trends described above is that of an environment where disruptive forces are altering the status quo, where the distinction between allies and competitors is being blurred, and where consumer demands and concerns are driving the entire value network. While the different trends emerged at different points in time and developed at distinct paces, they are now converging to shape an utterly different reality. It is a brave new world filled with opportunities for the ones that manage to adapt and take advantage, and with threats of rapid extinction for those that don't.

2. How to respond effectively

The urgency to act in the face of the described converging trends is growing, and hesitation could mean a drastic loss in competitiveness. Even if we do not see yet broad evidence in every industry, we can be sure that somewhere, start-ups and corporations are developing radical new products, challenging established ways of working and revolutionizing entire business models. Collaboration across companies in different industries will disrupt competitive landscapes as we see them today, and thriving in this new environment poses challenges even for the fittest. Executives would do well to prepare their businesses for what lies ahead.

We believe there are three critical imperatives for companies to tackle the challenge:

1) Define – or redefine – your company's long-term vision

Before engaging in any battles, companies must have clearly articulated views of where their businesses are going and why.

The definition of the "where" requires an understanding of the environment, the different trends and their evolution. In times of disruption, this is not merely the classical analysis and prediction of basic industry indicators, but a scenario-building exercise of how emerging trends, as well as the different actors, including your business, may shape the future. While flexible enough to incorporate future changes, the result must provide the basic pillars on which to base your future strategy.

The "why" is as fundamental. As argued in Arthur D. Little's viewpoint, "The WHY strategy: There is no strategy without meaning", the definition of a clear, long-lasting and resilient strategic purpose is key to enhancing differentiation and increasing customer and employee loyalty.

The resulting vision will need to inspire the organization and energize all employees around a common purpose. To this end, it needs to be:

- **Aspirational** – it needs to provide enough stretch compared to the existing situation in order to motivate.
- **Achievable** – while inspiring, it must not seem unrealistic.
- **Simple** – the vision must be shared, understood and adopted at all levels of the organization.

A shared view of the fundamental purpose of the company and where it is going is key to maintaining consistency and focus, and diminishing the risk of being derailed by transitory currents.

2) Build the right competencies and capabilities by developing your strengths and leveraging the strengths of the appropriate partners

Based on the defined ambition, the company must identify the competencies and capabilities required to fulfill it. Traditionally included within a strategy-setting context, we believe this is an exercise that must be performed on an almost-ongoing basis.

Trends play a key role, as while they may open windows of opportunity not previously available, they normally dictate requirements to stay in the game. For example, in a setting where customers research, compare and engage across multiple interaction channels, the lack of an integrated commercial approach may prove to be fatal.

In a fast-changing, hyper-competitive environment, a key success factor is for the business to realize that it cannot and must not develop internally all the competencies and capabilities required. On the contrary, its success will rely on its ability to leverage the differential competencies/capabilities of partners alongside its own.

To this end, the company must undertake the following steps:

- Define which critical competencies and capabilities must be held internally, and which not. In our work supporting clients through this process, we employ two basic principles:

  What matters is the confluence of various competencies and capabilities, much more than individual ones. The key is to find the right combination of competencies and capabilities that will allow the business to maximize its value share and build a sustainable competitive position.

  The internally held key capabilities must be truly differential, and what is more important must be kept that way. They need to allow the company not only to gain its target share of the generated value, but also defend it.

- Analyze the current situation and identify the gap in terms of required competencies and capabilities, now and in the foreseeable future, versus the current and expected situation with current plans.

- Determine the best way to fill the gaps (in accordance with the decisions taken in the first step), with a mix of:
  - Internal development, through evolution and/or disruption (breakthrough innovation)
  - Acquisition from third parties, or
  - External collaboration, which englobes a wide array of potential arrangements, ranging from strategic alliances through to joint ventures or participation in start-ups.

3) Build an organization that can effectively develop and manage the competencies/capabilities

The management of competencies and capabilities in a context of changing conditions, hyper-competition and hyper-collaboration calls primarily for an adaptative organization. Rigid, hierarchical structures must be revisited and replaced by flexible configurations that encourage innovation, free flow of information, engagement and self-organization.

Additionally, the most efficient end-to-end management of processes (especially the critical ones) must become the norm. This means assigning clear objectives and empowering the organization to change underperforming links.

Finally, the organization should be both efficient and effective, through the best mix of technology and talent. Technological tools must be fully leveraged in order to improve data dissemination and decision-making, automating processes as much as possible. People, in this new context, become of even more strategic importance as they can manage an unprecedented amount of data and harness the increasing power of machine learning and artificial intelligence.

An important caveat is that the imperatives described above do not constitute a closed-end, static process, but rather need to be seen as continuous improvements to be incorporated into the running of the business.

3. What drives success?

From observing and learning from different businesses and industries shaping and adapting to the current environment, we have identified three basic factors to do so successfully.

1) Alignment between vision, strategy and organization

A business that has an approach based on a clear, shared sense of long-term purpose will navigate better through volatile environments than businesses that simply react to outside forces. Without shared goals, employees optimize their respective areas with a short-term view. This results in friction, waste of effort, and strategic missteps. Moreover, an aligned organization (in terms of structure, talent and processes) provides the tools for effective implementation.

2) The right partners for the journey

Be it for the incorporation of competencies or capabilities, or for collaboration, it is critical to choose adequate partners. While natural options may easily appear, one must take into account that at times "non-obvious" companions from seemingly unrelated businesses might better fill the gap.

What is even more critical, however, is the ability to steer the partnerships in the right direction. To this end, companies must establish, maintain and continuously adapt dynamic collaboration arrangements beneficial to all parties as required. This is especially challenging, as volatility in the business environment implies that individual benefits and interests can easily vary over time. If the collaboration is to be a success, all parties must stand to gain, and only in this way can their individual competitive capabilities be multiplied.

3) Learning and flexible organizations fueled by the best talent

The abilities to adapt to changing conditions, and to incorporate and update skills as required, are key. Organizations that experiment, learn and incorporate new knowledge into the day-to-day running of the business are most likely to succeed in the face of volatile environments. These traits are directly related to the company vision, values, culture and level of empowerment, as if decisions are made at the lowest feasible level, the entire organization will be faster, more effective and more aligned.

We believe succeeding in the new environment depends on taking the first step of acknowledging the challenges and adopting the right mind-set to confront them. No business is immune, and the sooner you prepare, the higher your chances of not only surviving, but also thriving in the new setting.

Ultimately, it comes down to three basic imperatives, all equally important:

- Defining your vision and executing the strategy to deliver it.
- Identifying and building the required competencies and capacities, leveraging your business ecosystem in your surroundings.
- Ensuring that your organization can deliver, fueled by the best talent.

Case 1: Tag Heuer Connected – first smartwatch by a high-end traditional watch manufacturer

In 2015, Tag Heuer, Google and Intel created an alliance to launch to market the Tag Heuer Connected – the first luxury smartwatch designed by a Swiss watchmaker. The collaboration involved all three companies contributing their own core capabilities: Google provided the operating system software and Intel the processor, while Tag Heuer focused on the watchcase and design.

As Tag Heuer's CEO, Jean-Claude Biver, stated, it would have proven to be impossible – and both financially and technically catastrophic – to try and design and/or make their own operating systems or processor chips. Instead, the company leveraged its brand image and expertise in watch design and production, adding state-of-the-art technology at the hands of recognized partners.

Google and Intel, on the other hand, achieved entrance into the high-end segment of wearable technology.

Case 2: Unilever and Dollar Shave Club – Incorporation of a key capability through acquisition

In 2016, Unilever acquired five-year-old business Dollar Shave Club in what seemed to be a strategic bet on the disruption of the consumer-goods industry by digital models.

Founded in 2011 and financed by several venture capitalists, Dollar Shave Club offers razor blades and other personal-grooming products by mail, on a monthly subscription basis. Its markets include the US, Canada and Australia. Still in negative numbers at the time of the acquisition, the business had reached 3.2 million subscribers.

Dollar Shave Club debuted with its blades-by-subscription service in the beginning of 2012. The launch was announced through an innovative YouTube video featuring CEO Michael Dubin, which won the "Best Out-of-Nowhere Video Campaign" at the 2012 AdAge Viral Video Awards and had over 24 million views to date.

While helping diversify Unilever´s personal-care business and compete against P&G top brand Gillette, the acquisition mainly offered a valuable capability: digital expertise. Unilever bought a native digital start-up with the corresponding technical know-how, organizational set-up and business model. According to Unilever´s CEO, Paul Polman, Dollar Shave Club brings "expertise and technology in direct-to-consumer sales we can use internationally and in other parts of our business."

Unilever recognized a key capability it needed in the face of changing market conditions, decided that it needed to own it, and used M&A to obtain it.

Case 3: McDonald´s and Glovo – delivery partnership in Spain

With the advent of numerous on-demand meal-delivery apps, traditional fast-food chains see themselves forced to adapt to the trend. Spain is no exception, with competitors McDonald's and Burger King respectively having launched delivery services. The main difference was the chosen models: while Burger King developed the service in-house, McDonald's chose to implement it at the hand of a partnership with local start-up Glovo.

Founded in Barcelona in 2015, Glovo offers an on-demand service, with independent couriers that purchase, pick up and deliver anything that is ordered through the application (food, pharmacy, groceries, courier, etc.). Currently, its service is available in Spain (Barcelona, Madrid, Valencia, Zaragoza, Seville and Málaga), France (Paris) and Italy (Milan and Rome).

McDonald's declared that the alliance was a strategic bet, responding to customer demands. Having recognized a missing capability, McDonald´s saw an opportunity to fill the gap in an accelerated way through an alliance with a seemingly unrelated partner.

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Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. Arthur D. Little is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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