Competing for the Future

by Gary Hamel and C.K. Prahalad

Included with this full-text *Harvard Business Review* article:

Competing for the Future

The Idea in Brief

Will your company survive the changes that may strike your industry in the next five to ten years? The answer depends on whose **view of the future** is driving your agenda: yours or your competitors'.

Consider these questions:

- Which customers does your company serve today—and which will it serve in the future?

- Who are your competitors today—and who will they be in the future?

- Which capabilities make your firm unique today—and which will make it unique in the future?

If you don't have detailed answers to the "future" part of these questions, or if your "future" and "today" answers are similar, your company can't expect to remain a market leader.

Yet most senior managers devote less than 3% of their time to developing a corporate view of the future that's distinctive, well tested, and deeply shared by colleagues. Why? The task requires enormous commitment and intellectual energy. Difficult questions about the future also challenge the belief that top managers possess a clear, compelling view of the opportunities and risks awaiting their company.

Results? The urgent drives out the truly important. Managers spend too much time catching up to competitors by cutting costs and improving quality and productivity. Such actions are prerequisites for survival, but they don't provide enduring competitive advantages. To stay *ahead* of industry change, managers must focus on creating a future in which their company will lead, not follow.

The Idea in Practice

Improving Efficiency and Productivity

Stagnant growth, declining margins, and failing market share often force executives to slash payrolls, R&D budgets, and underperforming businesses—making their companies "lean and mean." But such moves have more to do with shoring up current businesses than building tomorrow's industries. They boost share price only temporarily and create a distorted picture of productivity. For example, when an industry halves it workforce but increases output only marginally, the resulting ROI ratio may *look* impressive—but it disguises the industry's failure to create new markets.

Creating the Future

Real organizational transformation stems from a shared point of view about your industry's future. It answers questions such as:

- How do we want our industry to be shaped in five to ten years?

- What capabilities must we start building now if we want to occupy the industry high ground later?

- How should we organize for opportunities that may not fit within current business units' boundaries?

- Creative companies answer these questions by gathering insights from people at all levels in the organization.

▶ Example:
Electronic Data Systems' industry position seemed unassailable in 1992, but some executives foresaw problems—new competitors and fewer new customers among leading IT users. One hundred and fifty managers convened to create EDS's future. They analyzed threats and opportunities created by the digital revolution. They benchmarked their competencies against competitors' and considered how to build additional capabilities to develop new opportunities.

With the participation of 2,000+ people, managers formulated a new strategy cen-

tered on *globalizing* (spanning geographical, cultural, and organizational boundaries), *informationalizing* (helping customers convert data into information, knowledge, and action), and *individualizing* (mass-customizing services and products).

Though this process consumed nearly 30,000 person hours, EDS now had a broader, more prescient view of its industry and its role—and a view shared by *every* senior manager.

What drives your company's agenda: your competitors' view of the future or your own?

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Look around your company. Look at the high-profile initiatives that have recently been launched, the issues preoccupying senior management, the criteria and benchmarks by which progress is measured, your track record of new-business creation. Look into the faces of your colleagues, and consider their ambitions and fears. Look toward the future, and ponder your company's ability to shape that future in the years and decades to come.

Now ask yourself: Do senior managers in my company have a clear and shared understanding of how the industry may be different ten years from now? Is my company's point of view about the future unique among competitors?

These are not rhetorical questions. Get a pencil and score your company.

How does senior management's point of view about the future compare with that of your competitors?

Conventional . . . . Distinctive and
and reactive   farsighted

Which business issue absorbs more senior-management attention?

Reengineering . . . . Regenerating
core processes   core strategies

How do competitors view your company?

Mostly as a . . . . Mostly as a
rule follower   rule maker

What is your company's strength?

Operational . . . . Innovation and
efficiency   growth

What is the focus of your company's advantage-building efforts?

Mostly . . . . Mostly getting
catching up   out in front

What has set your transformation agenda?

Our competitors . . . . Our foresight

Do you spend the bulk of your time as a maintenance engineer preserving the status quo or as an architect designing the future?

Mostly as an . . . . Mostly as an
engineer   architect

If your scores fall somewhere in the middle

or off to the left, your company may be devoting too much energy to preserving the past and not enough to creating the future.

When we talk to senior managers about competing for the future, we ask them three questions. First, what percentage of your time is spent on external rather than internal issues—on understanding, for example, the implications of a particular new technology instead of debating corporate overhead allocations? Second, of this time spent looking outward, how much do you spend considering how the world may change in five or ten years rather than worrying about winning the next big contract or responding to a competitor's pricing move? Third, of the time devoted to looking outward *and* forward, how much do you spend working with colleagues to build a deeply shared, well-tested perspective on the future as opposed to a personal and idiosyncratic view?

The answers to these questions typically conform to what we call the "40/30/20 Rule." In our experience, about 40% of a senior executive's time is devoted to looking outward and, of this time, about 30% is spent peering three, four, five, or more years into the future. Of that time spent looking forward, no more than 20% is devoted to building a collective view of the future (the other 80% is spent considering the future of the manager's particular business). Thus, on average, senior managers devote less than 3% (40% x 30% x 20%) of their time to building a *corporate* perspective on the future. In some companies, the figure is less than 1%. Our experience suggests that to develop a distinctive point of view about the future, senior managers must be willing to devote considerably more of their time. And after the initial burst of energy that they must expend to develop a distinct view of the future, managers must be willing to adjust that perspective as the future unfolds.

Such commitment as well as substantial and sustained intellectual energy is required to answer such questions as: What new core competencies will we need to build? What new product concepts should we pioneer? What alliances will we need to form? What nascent development programs should we protect? What long-term regulatory initiatives should we pursue?

We believe such questions have received far too little attention in many companies, not be-

cause senior managers are lazy—most are working harder than ever—but because they won't admit, to themselves or to their employees, that they are less than fully in control of their companies' future. Difficult questions go unanswered because they challenge the assumption that top management really is in control, really does have more accurate foresight than anyone else in the corporation, and already has a clear and compelling view of the company's future. Senior managers are often unwilling to confront these illusions. So the urgent drives out the important; the future is left largely unexplored; and the capacity to act, rather than to think and imagine, becomes the sole measure of leadership.

Beyond Restructuring

The painful upheavals in so many companies in recent years reflect the failure of one-time industry leaders to keep up with the accelerating pace of industry change. For decades, the changes undertaken at Sears, General Motors, IBM, Westinghouse, Volkswagen, and other incumbents were, if not exactly glacial in speed, more or less linear extrapolations of the past. Those companies were run by managers, not leaders, by maintenance engineers, not architects.

If the future is not occupying senior managers, what is? Restructuring and reengineering. While both are legitimate and important tasks, they have more to do with shoring up today's businesses than with building tomorrow's industries. Any company that is a bystander on the road to the future will watch its structure, values, and skills become progressively less attuned to industry realities. Such a discrepancy between the pace of industrial change and the pace of company change gives rise to the need for organizational transformation.

A company's organizational transformation agenda typically includes downsizing, overhead reduction, employee empowerment, process redesign, and portfolio rationalization. When a competitiveness problem (stagnant growth, declining margins, and falling market share, for example) can no longer be ignored, most executives pick up a knife and begin the painful work of restructuring. The goal is to carve away layers of corporate fat and amputate underperforming businesses. Executives who don't have the stomach for emergency-room surgery, like John Akers at IBM or Robert

Gary Hamel is a professor of strategic and international management at the London Business School in London, England. **C.K. Prahalad** is the Harvey C. Fruehauf Professor of Business Administration at the University of Michigan in Ann Arbor, Michigan. Two of the authors' six previous HBR articles have won McKinsey Awards for excellence. This article is adapted from their book *Competing for the Future,* which was published by the Harvard Business School Press in September 1994.

Stempel at GM, soon find themselves out of a job.

Masquerading behind terms like refocusing, delayering, decluttering, and right-sizing (Why is the "right" size always smaller?), restructuring always results in fewer employees. In 1993, large U.S. companies announced nearly 600,000 layoffs—25% more than were announced in 1992 and nearly 10% more than in 1991, the year in which the U.S. recession hit its lowest point. While European companies have long tried to put off their own day of reckoning, bloated payrolls and out-of-control employment costs have made downsizing as inevitable in the old world as it is in the new. Despite excuses about global competition and the impact of productivity-enhancing technology, most layoffs at large U.S. companies have been the fault of senior managers who fell asleep at the wheel and missed the turnoff for the future.

With no growth or slow growth, companies soon find it impossible to support their burgeoning employment rosters and traditional R&D budgets and investment programs. The problems of low growth are often compounded by inattentiveness to ballooning overheads (IBM's problem), diversification into unrelated businesses (Xerox's foray into financial services), and the paralysis imposed by an unfailingly conservative staff. It is not surprising that shareholders are giving moribund companies unequivocal marching orders: "Make this company lean and mean;" "Make the assets sweat;" "Get back to basics." In most companies, return on capital employed, shareholder value, and revenue per employee have become the primary arbiters of top-management performance.

Although perhaps inescapable and in many cases commendable, restructuring has destroyed lives, homes, and communities in the name of efficiency and productivity. While it is impossible to argue with such objectives, pursuing them single-mindedly does the cause of competitiveness as much harm as good. Let us explain.

Imagine a CEO who is fully aware that if he or she doesn't make effective use of corporate resources, someone else will be given the chance. So the chief executive launches a tough program to improve return on investment. Now, ROI (or return on net assets or return on capital employed) has two components: a numerator—net income—and a denominator—

investment, net assets, or capital employed. (In a service industry, a more appropriate denominator may be head count.) Managers know that raising net income is likely to be harder than cutting assets and head count. To increase the numerator, top management must have a sense of where new opportunities lie, must be able to anticipate changing customer needs, must have invested in building new competencies, and so on. So under intense pressure for a quick ROI improvement, executives reach for the lever that will bring the fastest, surest result: the denominator.

The United States and Britain have produced an entire generation of managers obsessed with denominators. They can downsize, declutter, delayer, and divest better than any other managers. Even before the current wave of downsizing, U.S. and British companies had, on average, the highest asset-productivity ratios of any companies in the world. Denominator management is an accountant's shortcut to asset productivity.

Don't misunderstand. A company must get to the future not only first but also for less. But there is more than one route to productivity improvement. Just as any company that cuts the denominator and maintains revenues will reap productivity gains, so too will any company that succeeds in increasing its revenue stream atop a slower-growing or constant capital and employment base. Although the first approach may be necessary, we believe the second is usually more desirable.

In a world in which competitors are capable of achieving 5%, 10%, or 15% real growth in revenues, aggressive denominator reduction under a flat revenue stream is simply a way to sell market share and the future of the company. Marketing strategists term this a *harvest strategy* and consider it a no-brainer. Between 1969 and 1991, for example, Britain's manufacturing output (the numerator) went up by only 10% in real terms. Yet over this same period, the number of people employed in British manufacturing (the denominator) was nearly halved. The result was that during the early and mid-1980s, the Thatcher years, British manufacturing productivity increased faster than that of any other major industrialized country except Japan. Though Britain's financial press and Conservative ministers trumpeted this as a "success," it was, of course, bittersweet. While new legislation limited the

power of trade unions, and the liberalization of statutory impediments to workforce reduction enabled management to excise inefficient and outmoded work practices, British companies demonstrated scant ability to create new markets at home and abroad. In effect, British companies surrendered global market share. One almost expected to pick up the *Financial Times* and find that Britain had finally matched Japan's manufacturing productivity—and that the last remaining person at work in British manufacturing was the most productive son of a gun on the planet.

The social costs of such denominator-driven job losses are high. Although an individual company may be able to avoid some of those costs, society cannot. In Britain, the service sector could not absorb all the displaced manufacturing workers and underwent its own vicious downsizing in the recession that began in 1989. Downsizing also causes employee morale to plummet. What employees hear is that "people are our most important asset." What they see is that people are the most expendable asset.

Moreover, restructuring seldom results in fundamental business improvements. At best, it buys time. One study of 16 large U.S. companies with at least three years of restructuring experience found that while restructuring usually did raise a company's share price, such improvement was almost always temporary. Three years into restructuring, the share prices of the companies surveyed were, on average, lagging even further behind index growth rates than they had been when the restructuring effort began.

Beyond Reengineering

Downsizing attempts to correct the mistakes of the past, not to create the markets of the future. But getting smaller is not enough. Recognizing that restructuring is a dead end, smart companies move on to reengineering. The difference between restructuring and reengineering is that the latter offers at least the hope, if not always the reality, of getting better as well as getting leaner. Yet in many companies, reengineering is more about catching up than getting out in front.

For example, Detroit automakers are catching up with Japanese rivals on quality and cost. Supplier networks have been reconstituted, product-development processes redesigned, and manufacturing processes reengineered.

However, the cheerful headlines heralding Detroit's comeback miss the deeper story—among the losses have been hundreds of thousands of jobs, 20-some percentage points of market share in the United States, and any hope of U.S. automakers beating Japanese rivals in the booming Asian markets anytime soon.

Catching up is not enough. In a survey taken at the end of the 1980s, nearly 80% of U.S. managers polled believed that quality would be a fundamental source of competitive advantage in the year 2000, but barely half of Japanese managers agreed. Their primary goal was to create new products and businesses.[1] Does this mean that Japanese managers will turn their backs on quality? Of course not. It merely indicates that by the year 2000, quality will be the price of market entry, not a competitive differentiator. Japanese managers realize that tomorrow's competitive advantages will be different from today's. It remains to be seen whether Detroit will set the pace in the next round of competition and produce vehicles as exciting as they are fuel efficient and reliable or will once again rest on its laurels.

We come across far too many top managers whose advantage-building agenda is still dominated by quality, time-to-market, and customer responsiveness. While such advantages are prerequisites for survival, they are hardly a testimony to management foresight. Though managers often try to make a virtue out of imitation, dressing it up in the fashionable colors of "adaptiveness," what they are adapting to all too often are the preemptive strategies of more imaginative competitors.

Consider Xerox. During the 1970s and 1980s, Xerox surrendered a substantial amount of market share to Japanese competitors, such as Canon and Sharp. Recognizing that the company was on the slippery slope to oblivion, Xerox benchmarked its competitors and fundamentally reengineered its processes. By the early 1990s, the company had become a textbook example of how to reduce costs, improve quality, and satisfy customers. But amid all the talk of the new "American Samurai," two issues were overlooked. First, although Xerox halted the erosion of its market share, it has not fully recaptured share lost to its Japanese competitors: Canon remains one of the largest copier manufacturers in the world. Second, despite pioneering research in laser printing, network-

ing, icon-based computing, and the laptop computer, Xerox has not created any substantial new businesses outside its copier core. Although Xerox may have invented the office as we know it today and as it's likely to be, the company has actually profited very little from its creation.

In fact, Xerox has probably left more money on the table, in the form of underexploited innovation, than any other company in history. Why? Because to create new businesses, Xerox would have had to regenerate its core strategy: the way it defined its market, its distribution channels, its customers, its competitors, the criteria for promoting managers, the metrics used to measure success, and so on. A company surrenders today's businesses when it gets smaller faster than it gets better. A company surrenders tomorrow's businesses when it gets better without changing.

We meet many managers who describe their companies as "market leaders." (With enough creativity in delimiting market boundaries, almost any company can claim to be a market leader.) But market leadership today certainly doesn't equal market leadership tomorrow. Think about two sets of questions:

Today	In the Future
Which customers do you serve today?	Which customers will you serve in the future?
Through what channels do you reach customers today?	Through what channels will you reach customers in the future?
Who are your competitors today?	Who will your competitors be in the future?
What is the basis for your competitive advantage today?	What will be the basis for your competitive advantage in the future?
Where do your margins come from today?	Where will your margins come from in the future?
What skills or capabilities make you unique today?	What skills or capabilities will make you unique in the future?

If senior executives don't have reasonably detailed answers to the "future" questions, and if the answers they have are not significantly different from the "today" answers, there is little chance that their companies will remain market leaders. The market a company dominates today is likely to change substantially over the next ten years. There's no such thing

If managers don't have detailed answers to questions about the future, their companies can't expect to be market leaders.

as "sustaining" leadership; it must be regenerated again and again.

Creating the Future

Organizational transformation must be driven by a point of view about the future of the industry: How do we want this industry to be shaped in five or ten years? What must we do to ensure that the industry evolves in a way that is maximally advantageous for us? What skills and capabilities must we begin building now if we are to occupy the industry high ground in the future? How should we organize for opportunities that may not fit neatly within the boundaries of current business units and divisions? Since most companies don't start with a shared view of the future, seniors managers' first task is to develop a process for pulling together the collective wisdom within an organization. Concern for the future, a sense of where opportunities lie, and an understanding of organizational change are not the province of any group; people from all levels of a company can help define the future.

One company that developed a process for establishing a point of view about the future is Electronic Data Systems (EDS), based in Plano, Texas. In 1992, EDS's position seemed unassailable. With $8.2 billion in sales, EDS had recorded its thirtieth consecutive year of record earnings and looked forward to the ever-growing demand for computer-services outsourcing. EDS expected to become at least a $25 billion company by the year 2000.

But some top executives, including Chairman Lester Alberthal, foresaw problems. Margins were under intense pressure from new competitors, such as Andersen Consulting. Customers were demanding hefty discounts in their long-term service contracts. Fewer new customers could be found among leading-edge IT users in the United States. And future business needs would involve desktop computers, not the mainframes EDS specialized in, while the most exciting new information-network services would focus on the home, not the office.

The company's top officers, known as the Leadership Council, concluded that EDS was no more immune from "great company disease" than any other successful enterprise. Council members committed themselves to rebuilding industry leadership for the 1990s and

beyond.

As it happened, others in the company were already thinking along similar lines. Back in 1990, a small band of EDS managers, none of them yet corporate officers, had created a Corporate Change Team. Despite their lack of an official charter, team members believed EDS needed to rethink its direction and its deepest assumptions. They soon realized this would require far more resources, both temporal and intellectual, than could be mustered by one small team.

After talking with the Leadership Council about its goals, the Corporate Change Team developed a unique approach to company renewal. From across the company and around the world, 150 EDS managers—key resource holders as well as less-senior managers who were known to be challenging, bright, and unconventional—gathered in Dallas, 30 at a time, to begin creating the future. Each of the five "waves" considered in detail the economic threats to EDS and the opportunities afforded by the digital revolution. Each wave was given an assignment. The first wave studied the discontinuities that EDS could use to change the shape of the industry. The second and third waves tried to develop a view of the company's competencies that was substantially independent from current definitions of EDS's served markets. They then benchmarked those competencies against EDS's strongest competitors. Drawing on the work of the previous waves, wave four explored opportunities on the horizon. And wave five considered how to devote more company resources to building competencies and developing opportunities.

Each wave's output was thoroughly debated by the other waves and with the Leadership Council. Finally, a team composed of members from all the waves produced a draft corporate strategy, which, again, was debated throughout the company.

EDS's new strategy is captured in three words: globalize, informationalize, and individualize. The strategy is based on the company's ability to use information technology to span geographical, cultural, and organizational boundaries; to help customers convert data into information, information into knowledge, and knowledge into action; and to mass-customize and enable individuals to mass-customize information services and products.

The process of developing this strategy for the future was full of frustrations, surprises, unexpected insights, and missed deadlines. More than 2,000 people participated in the creation of EDS's new strategy, and nearly 30,000 person-hours were devoted to the exercise. (More than one-third of the time investment was made outside the company's normal business hours.)

EDS emerged from the process with a view of its industry and its role that was substantially broader, more creative, and more prescient than it had been 12 months earlier. This view was held not only by a few technical gurus or corporate visionaries but by every senior EDS manager. Indeed, those who participated in the process thought it contributed as much to leadership development as it did to strategy development.

The Quest for Foresight

To create the future as EDS has done requires industry foresight. Why do we talk of foresight rather than vision? Vision connotes a dream or an apparition, and there is more to industry foresight than a blinding flash of insight. Industry foresight is based on deep insights into trends in technology, demographics, regulations, and lifestyles, which can be harnessed to rewrite industry rules and create new competitive space. While understanding the potential implications of such trends requires creativity and imagination, any "vision" that is not based on a solid foundation is likely to be fantastical.

For this reason, industry foresight is a synthesis of many people's visions. Often, journalists or sycophantic employees have described foresight as the "vision" of one person. Much of the credit for NEC's visionary concept of "computers and communication" may have gone to Akira Kobayashi, but the idea of exploiting the convergence between the two industries synthesized the thinking of many in the company. Senior executives are not the only ones with industry foresight. In fact, their primary role is to capture and exploit the foresight that exists throughout the organization.

Given that change is inevitable, the real issue for managers is whether that change will happen belatedly, in a crisis atmosphere, or with foresight, in a calm and considered manner; whether the transformation agenda will be set by a company's more prescient competitors or by its own point of view; whether transfor-

mation will be spasmodic and brutal or continuous and peaceful. Palace coups make great press copy, but the real objective is a transformation that is revolutionary in result and evolutionary in execution.

Developing a point of view about the future should be an ongoing project sustained by continuous debate within a company, not a massive one-time effort. Unfortunately, most companies consider the need to regenerate their strategies and reinvent their industries only when restructuring and reengineering fail to halt the process of corporate decline. To get ahead of the industry change curve, to have the chance of conducting a bloodless revolution, top managers must recognize that the real

focus for their companies is the opportunity to compete for the future.

This article is adapted from Competing for the Future, *published by Harvard Business School Press in September 1994.*

1. Donald Hambrick, *Reinventing the CEO: 21st Century Report* (New York: Korn Ferry International and the Columbia University Graduate School of Business, 1989).

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Further Reading

ARTICLES

Bringing Silicon Valley Inside
by Gary Hamel
Harvard Business Review
September–October 1999
Product no. 3464

To create your company's future rather than merely improving efficiency and productivity, you need an organizational climate that encourages **resource attraction**: enabling good business ideas to attract the necessary capital and the best talent—and run for all they're worth. By contrast, **resource allocation** (providing resources based on estimates of where the profit margins are highest and most immediate) tends to smother ideas that have the most potential to create new markets and businesses.

Use the following guidelines to cultivate a climate of resource attraction: 1) A good idea can come from anyone. 2) No one person can kill a great idea. Power is diffuse, and there are many sources of capital. 3) Innovators get rewarded handsomely for ideas that succeed commercially.

How to Identify Your Enemies Before They Destroy You
by Farshad Rafii and Paul J. Kampas
Harvard Business Review
November 2002
Product no. 2136

How to harness your company's collective wisdom to arrive at a shared view of the future? This article's assessment tool enables managers to think *systematically* about potential threats and either formulate preventive measures or turn threats into new business opportunities.

Managers collectively analyze how likely an innovation is to move through six stages of the "disruption process": from foothold market entry to incumbent displacement. After identifying potential disruptions, managers form cross-functional teams to explore competitive dynamics and evolving customer needs. They individually rate and weigh contributing factors for each of the six stages from *highly unlikely* to disrupt to *highly likely* to disrupt. After resolving disagreements, they interpret their agreed-upon results and present suggested actions to senior managers.

Why Good Companies Go Bad
by Donald N. Sull
Harvard Business Review
July–August 1999
Product no. 4320

Sull affirms the danger of getting stuck in tried-and-true activities when industry transformation looms. Through **active inertia**, managers engage in too much of the wrong kind of activity—clinging to what worked well for their organizations in the past but is no longer appropriate.

Active inertia poses several threats: 1) Strategic frames become blinders to new opportunities. 2) Processes harden into routines, becoming ends in themselves. 3) Relationships among customers, suppliers, and employees become shackles, restricting response to market changes. 4) Values harden into dogmas, becoming self-defeating rules rather than unifying, inspiring beacons.

To combat active inertia, managers need to inspect assumptions they've made about their business and industry, and ask "What hinders us?" before rushing into inappropriate action.

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