11 Sustainability

Sustainability relates to the degree to which an enterprise business incrementally and in an ongoing basis creates value to its customers and shareholders, captures value from its diverse assets (tangible and intangible), and attracts investors. Enterprise businesses that do not create value, by definition, destroy it; and unprofitable enterprise businesses are wasting both the money of their shareholders and the enterprise resources and assets.

In today's era of unprecedented change, complexity, volatility, and risk – where everything seems to be moving at extremely fast speed, there is very little room for error. The business imperative is not anymore just to perform excellently, but to perform excellently consistently. Sustaining success in today's hyper-competitive marketplace is an ultimate challenge for any enterprise business.

11.1 What Is Value Creation?

Nothing is more important today than the concept of "value creation and value capture," which it has become the benchmark criterion for success. Ultimately, the most successful enterprise businesses understand that the purpose of any business is to create value their customers, employees, and shareholders, and that the interests of these three groups are inextricably linked. Therefore, sustainable value cannot be created for one group unless it is created for all of them.

As illustrated in Fig. 11.1, the first focus of an enterprise business should be on creating value for its customers, but this cannot be achieved unless the right employees are selected, developed, and rewarded, and unless shareholders receive consistently attractive returns of their investments. An enterprise business creates value when the benefits provided to its stakeholders, customers, and employees exceed all the costs incurred.

For the customers, it entails making products and providing services that customers find consistently useful. In today's economy, such value creation is based typically on innovation and on understanding unique customer needs with ever-increasing speed and precision.

A. Van Aartsengel and S. Kurtoglu, *A Guide to Continuous Improvement Transformation*, Management for Professionals, DOI 10.1007/978-3-642-35904-0_11,

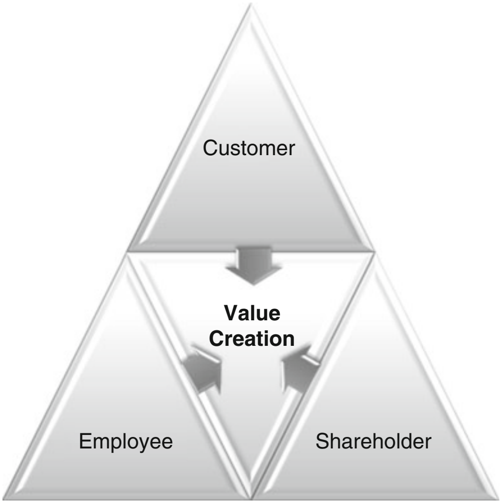

Fig. 11.1 Customer-employee-shareholder value triangle

But enterprise businesses can innovate and deliver outstanding services and products only if they tap the commitment, energy, and imagination of their employees. Value must therefore be created for those employees in order to gain their commitment and enable them. Value for employees includes being treated respectfully and being involved in decision-making. Employees also value meaningful work; excellent compensation opportunities; and continued training and development.

11.2 How Value Is Created and Destroyed

Within enterprise businesses, value is created when the right actions are taken and the right investments are made. Value is destroyed when the wrong actions are taken and the wrong investments are made. Value leaks or evaporates when nothing is done.

The right actions, within any enterprise business, are defined by the balance between two needs:

1. The need to look backward in order to maintain the existing business and its current customers, and
2. The need to look forward in order to explore and achieve performance breakthroughs and to identify and attract new customers and new sources of value.

Achieving this balance, as we indicated throughout the previous sections of this chapter, requires extraordinary capabilities and specific and intensive actions along eight determining factors of strategic management:

1. Leadership
2. Culture and Values
3. Strategic Planning and Management
4. Performance Measurement

5. Performance Management
6. Alignment and Commitment
7. Process Improvement and Management
8. Sustainability of Initiatives

When the right actions are taken within an enterprise business, value creation (and the avoidance of value destruction) occurs through the synergy that diverse critical resources and capabilities provide in achieving a balance of the eight determining factors. The larger the enterprise business is, the more important the synergy that diverse resources and capabilities provide within the enterprise business. Moreover, anybody in an enterprise business, at any organizational level, can contribute to creating value or destroying it. Employees who waste time or are otherwise unproductive, for example, destroy value.

The success of an enterprise business at the "Continuous Improvement" stage of maturity is based on doing the right things right and the enterprise business progressively becoming more expert. It learns successful ways of doing things. It finds out what its customers and shareholders like and gets good at delivering those things. It develops its technological expertise. It uses recipes which work and it becomes efficient. And it becomes effective. All this is by no means automatic, but happens as a result of deliberate management initiatives along the eight determining factors discussed throughout the previous chapters.

Failure in one of these eight determining factors results in unbalance and eventually value destruction. Value destruction, which results from taking the wrong actions, is often driven by poor decision-making, individual advocacy and self-interest, and not by what creates measurable long term value. Thus enterprise business executives and managers should, first and foremost, capture "the story" of value creation for their particular business.

Creating value for shareholders means delivering consistently high total returns on their investment capital. This generally requires both strong revenue growth and attractive profit margins. These, in turn, can be achieved only if the enterprise business delivers sustained value for its customers.

In business practices, value creation is typically measured by profitability in the short-term and long term growth. In order to achieve these goals, an enterprise business must establish, as a result of long-term oriented analyses, a process for continually developing and delivering a steady stream of products and services that offer unique and differentiated benefits to a chosen set of customers.

One example of a long-term oriented method of analysis which is based on the extrapolation of performance trends is the gap analysis. This form of analysis looks at performance already in existence and at products/services in development and predicts the rate of turnover or contribution margin they will achieve. Because of the product/service life cycle, turnover or contribution margin tend to reduce over time. By comparing projected future figures with what would be necessary to ensure the survival of the enterprise, a crucial performance gap can be identified.

Figure 11.2 shows how this is done. Just because an enterprise business has created value for its shareholders in the past does not mean that it will be able to continue to create value in the future. Long-term value creation is a challenge that

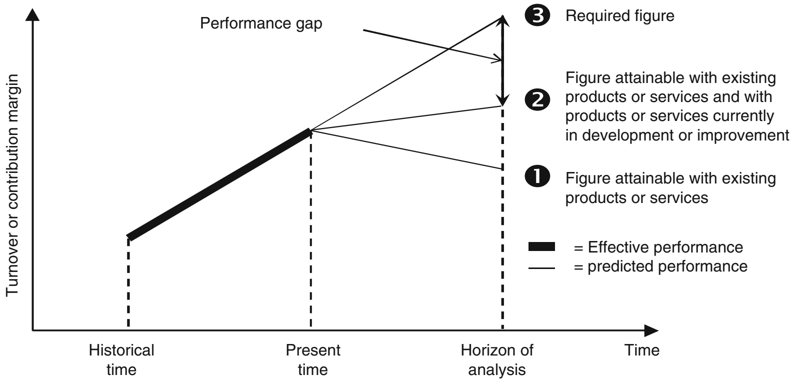

Fig. 11.2 Performance gap analysis

requires extraordinary and focused capabilities on the enterprise primary value-adding activities.

While gap analysis identifies the performance gap which needs to be bridged, it offers no clues as to how this can be done. Ansolff's analysis approach provides a practical framework for bridging this performance gap.

Ansolff's analysis simplifies the competitive position of an enterprise by defining two dimensions: The enterprise products/services and its markets. If we consider Ansoff's matrix shown in Table 11.1 we see that the gap in turnover or contribution margin can be closed with an improved market penetration, with new customers for existing products/services, with new products/services for existing customers, or with new products/services for new customers.

However, Ansoff's matrix cannot help an enterprise to decide which of these alternatives is to be preferred and to be attempted (Ansoff, 1965, 1976).

Improved Market Penetration – It occurs when an enterprise business chooses to enter an existing market with its current lines of products or services. It starts with the existing customers of the enterprise. This approach is used by enterprise businesses in order to increase sales without drifting from the original product-market intended strategy. Enterprise businesses often penetrate markets in one of three ways:

1. By gaining competitors customers;
2. By improving the product quality or level of service;
3. By attracting non-customers of the products or convincing current customers to use more of the enterprise product or service, with the use of marketing communications tools like advertising etc.

The market penetration approach to closing the performance gap is important for enterprise businesses because retaining existing customers, especially high lifetime value customers, is cheaper than attracting new ones. It is also used when the enterprise business' average cost of producing and distributing products or providing services decreases as the size of its operations increases. To proceed with a market

Table 11.1 Ansoff matrix

	Existing products/services	New products/services
Existing markets	Improved market penetration	Product/services diversification
New markets	Market diversification	Lateral diversification

penetration approach the enterprise business must hold a defendable competitive position to avoid likely counter-action from its competitors.

Market Diversification – It occurs when an enterprise business chooses to move beyond its immediate customer base towards attracting new customers for its existing products or services. Its numerous implementations often involve:

1. Development of new geographical markets;
2. Addition of new distribution channels;
3. Adoption of different pricing policies to attract different customers;
4. Creation of new market segments.

Products/service diversification – It occurs when an enterprise business chooses to introduce new products to existing customers. With this approach, the enterprise business chooses to develop modified products that appeal to existing customers in order to encourage them to spend more on these products. Note that product/service diversification refers to significant new product/service developments and not minor changes in an existing product/service of the enterprise business. The reasons that justify the use of this approach to closing performance gap include one or more of the following:

1. To use the enterprise business excess production capacity;
2. To counter competitive entry;
3. To exploit new technology;
4. To protect overall market share;
5. To maintain the enterprise business reputation as a product/service innovator.

Lateral diversification occurs when an enterprise business chooses to introduce new products to new customers. This approach to closing the performance gap is distinct in the sense that when an enterprise business diversifies, it essentially moves out of its current lines of products or services and markets into new areas different from its core businesses. It is important to note that lateral diversification may be into related and unrelated areas. Related diversification may be in the form of backward, forward, and horizontal integration. Backward integration takes place when the enterprise business extends its activities towards its inputs such as suppliers of raw materials etc. in the same business. Forward integration differs from backward integration, in that the enterprise business extends its activities towards its outputs such as distribution etc. in the same business. Horizontal integration takes place when an enterprise business moves into businesses that are related to its existing activities.

When the right investments are made, value creation (and the avoidance of value destruction) occurs through the processes of innovation, improved market penetration, product/services diversification, market diversification, or lateral diversification.

11.3 Value Creation Through Sustaining and Disruptive Innovation

Successful enterprise businesses, no matter what the source of their capabilities, are pretty good at responding to evolutionary changes in their markets – what in "The Innovator's Dilemma" (Christensen, 1997, 2003), Clayton Christensen referred to as sustaining innovation. Where they run into trouble is in handling or initiating revolutionary changes in their markets, or dealing with disruptive innovation.

Disruptive innovations create an entirely new market through the introduction of a new kind of product or service, one that is actually worse, initially, as judged by the performance metrics that mainstream customers' value. Early personal computers, for example, were a disruptive innovation relative to mainframes and minicomputers. Personal computers were not powerful enough to run the computing applications that existed at the time they were introduced. These innovations were disruptive in that they did not address the next-generation needs of leading customers in existing markets. They had other attributes, of course, that enabled new market applications to emerge – and the disruptive innovations improved so rapidly that they ultimately could address the needs of customers in the mainstream of the market as well.

Disruptive innovations occur so intermittently that no enterprise business has a routine process for handling them. Furthermore, because disruptive products nearly always promise lower profit margins per unit sold and are not attractive to the enterprise business' best customers', they are inconsistent with the established enterprise business values.

Sustaining technologies are innovations that make an enterprise business product or service perform better in ways that customers in the mainstream market already value. These are breakthrough innovations that sustained the best customers of these companies by providing something better than had previously been available.

Sustaining innovations are nearly always developed and introduced by established industry leaders. But those same enterprise businesses never introduce – or cope well with – disruptive innovations. Why? The resources-processes-values framework introduced earlier in the "Enterprise Culture & Values" section holds the answer. Industry leaders are organized to develop and introduce sustaining technologies. Month after month, year after year, they launch new and improved products to gain an edge over the competition. They do so by developing processes for evaluating the technological potential of sustaining innovations and for assessing their customers' needs for alternatives. Investment in sustaining technology also fits in with the values of leading companies in that they promise higher margins from better products sold to leading-edge customers.

Innovation in enterprise businesses is not only about product development. Innovation (sustaining or disruptive) is ultimately about finding ways to deliver new value to the marketplace from existing enterprise resources, whether this value is in the form of products, new work practices, improved processes, new management techniques or new business models. Innovation is an important partner to change. It is the wellspring of social and economic progress, and both a product and a facilitator of the free exchange of ideas that is the lifeblood of progress. It is reflected in new products, work practice, and work/production processes, advances in communications technology, etc.

As the systems model suggests, a successful enterprise businesses at the "Continuous Improvement" stage of maturity is likely to generate substantial surplus funds which are not required in order to maintain its leading position. How these funds get invested to continuously create value to its shareholders, customers, and employees, and captures value from its diverse resources and assets depends very much on the circumstances of the individual enterprise business.

In terms of goal orientation, the mature enterprise business, like many other systems, seeks to control its environment in order to ensure its own future well-being. The one thing the mature enterprise business, with all its heavy investments sunk in the status quo, seeks to avoid is change and instability. It will find it advantageous to invest heavily in preserving its current leader position within the current state of affairs.

Indeed, at the "Continuous Improvement" stage of maturity, it is difficult, however, for a successful enterprise business to make a fundamental change in what has established its leading position. This is especially the case with product and technology when a successful mature business is likely to have major investments sunk in the old product and technology. Getting into something fundamentally new may mean writing off huge capital assets which will weaken the balance sheet and in the short term wreak havoc with profitability. Also, there are non negligible psychological investments in the old product and technology used or developed by the enterprise business.

Furthermore, one of the fruits of maturity is the ability to pay top salaries and thus to attract highly qualified professionals. Many of these highly qualified professionals may have built their entire careers on the old product and technology and their very natural response to such a fundamental change is likely to be defensive and reactive. Nor is it at all certain that leadership in the new product and technology will necessarily follow being a leader in the old; giving up a leading position should certainly not be done lightly. Enterprise business executives and managers must consider the business risk exposure to the full range of macroeconomic and industry trends that will shape business performance.

While there are different types of risk that an enterprise business should consider (Duckert, 2010; Hampton, 2009; Hiles, 2004; Lam, 2003; Monahan, 2008), three overarching themes are especially important today:

1. *Macroeconomic risk* – It relates to the risk associated with uncertainties and turbulent in the macroeconomic environment. What would happen if a major growth market, say China, India or Brazil, enters a period of extended inflation or even stagnation? What would happen if the enterprise local currency weakens (or strengthens) significantly relative to the currencies of served markets or key sourcing regions?
2. *Capital-Market risk* – It relates to the risk associated with the current state of the capital markets. For example, many enterprise businesses are trading at high valuation multiples because, although their post downturn profits remain abnormally low, investors have already priced economic recovery into their

stock price. What would happen if those high multiples cannot be sustained? What would happen if the enterprise multiple relative to its peers starts to decline?

3. *Regulatory risk* – It relates to the risk associated with the growing role of regulatory governments. What is the possibility that new, more stringent, government regulations will constrain the enterprise ability to create value? Will new regulations or higher taxes seriously erode the enterprise ability to fund growth and innovation or continue its current level of payouts to investors?

Once the relevant uncertainties and turbulence in the macro-economy, the capital-market, and the regulatory environment have been identified, and once the potential risk has been quantified, successful enterprise businesses innovate through appropriate and relatively small incremental changes, as their businesses are able to focus, with the least inhibition and interruption, on the achievement of the enterprise intended strategy.

11.3.1 Creating Capabilities to Cope with Disruptive Innovation

Despite beliefs spawned by popular change-management and reengineering programs, processes – within the resources-processes-values framework introduced earlier in the "Enterprise Culture & Values" section – are not nearly as flexible or adaptable as resources are – and values are even less so. So whether addressing sustaining or disruptive innovations, when an enterprise business needs new processes and values – because it needs new capabilities – enterprise business executives must create a new organizational space where those capabilities can be developed. There are three possible ways to do that (Christensen & Overdorf, 2010). Enterprise business executives can:

1. Create new organizational structures within corporate boundaries in which new processes can be developed;
2. Spin out an independent organization from the existing organization and develop within it the new processes and values required to solve the new problem;
3. Acquire a different organization whose processes and values closely match the requirements of the new task.

11.3.2 Creating New Capabilities Internally

When an enterprise business' capabilities reside in its processes, and when new challenges require new processes – that is, when they require different people or groups in the enterprise business to interact differently and at a different pace than they habitually have done – managers need to pull the relevant people out of the existing enterprise business and draw a new boundary around a new group. Often, organizational boundaries were first drawn to facilitate the operation of existing processes, and they impede the creation of new processes. New team boundaries facilitate new patterns of working together that ultimately can coalesce as new processes. These structures are often referred to as "heavyweight teams."

These teams are entirely dedicated to the new challenge introduced by the disruptive change, team members are physically located together, and each member is charged with assuming personal responsibility for the success of the entire project. At Opel, for example, the boundaries of the groups within its product development organization historically had been defined by components – power train, electrical systems, and so on. But to accelerate auto development, Opel needed to focus not on components but on automobile platforms – small car for example – so it created heavyweight teams. Although these organizational units are not as good at focusing on component design, they facilitated the definition of new processes that were much faster and more efficient in integrating various subsystems into new car designs.

11.3.3 Creating Capabilities Through a Spinout Organization

When the mainstream enterprise business' values would render it incapable of allocating resources to an innovation project, the enterprise business should spin it out as a new venture. Large enterprise businesses cannot be expected to allocate the critical financial and human resources needed to build a strong position in small, emerging markets. And it is very difficult for an enterprise business whose cost structure is tailored to compete in high-end markets to be profitable in low-end markets as well. Spinouts are very much in vogue among managers in old-line enterprise businesses struggling with the question of how to address the Internet. But that is not always appropriate. When a disruptive innovation requires a different cost structure in order to be profitable and competitive, or when the current size of the opportunity is insignificant relative to the growth needs of the mainstream enterprise business, then – and only then – is a spinout organization required.

How separate does such an effort need to be? Clayton M. Christensen shows that a new physical location is not always necessary (Christensen & Overdorf, 2010). The primary requirement is that the project not be forced to compete for resources with projects in the mainstream enterprise business. Projects that are inconsistent with an enterprise business' mainstream values will naturally be accorded lowest priority. Whether the independent organization is physically separate is less important than its independence from the normal decision-making criteria in the resource allocation process.

Enterprise business executives often think that developing a new operation necessarily means abandoning the old one, and they are despise to do that since it works perfectly well for what it was designed to do. But when disruptive innovation appears on the horizon, enterprise business executives need to assemble the capabilities to confront that change before it affects the mainstream business. They actually need to run two businesses in tandem – one whose processes are tuned to the existing business model and another that is geared toward the new model.

11.4 Value Creation Through Diversification

In terms of goal orientation, the mature enterprise business, like many other systems, seeks to control its environment in order to ensure its own future well-being. The one thing the mature enterprise business, with all its heavy investments sunk in the status quo, seeks to avoid is change and instability. It will find it advantageous to invest heavily in preserving its current leader position within the current state of affairs.

First of all, it will seek to control its own industry, if possible through the achievement of a monopolistic position. In this way, it can hope to control the level of business to set limits on the competitive activity which would be profitable for any other business to embark on.

For similar reasons it may well seek to achieve control over its inputs whether sources of raw material or possibly core technologies, if they are in any way insecure. It may seek to achieve this through the exercise of its purchasing muscle in tying up long-term arrangements or by acquiring key suppliers.

In today's economy, however, successful enterprise businesses are constrained by anti-trust legislations which limit their ability to dominate their markets, prevent competition-reducing acquisitions and sometimes result in enterprise businesses being broken up if they became too dominant by organic growth. Growing enterprise businesses are therefore forced to diversify into new markets and new activities.

Under the diversification practice, the enterprise seeks to increase profitability through greater sales volume obtained from new products or services and new markets, as indicated in the previous section.

Diversification not only adds complexity and confuses strategic direction, but it also creates an alternative focus for future development and an ongoing demand for investment which may in the end result in the starvation of the once successful mature business. Thus diversification leads naturally to the mature business which has lost its direction and failed to keep up investment in its key businesses.