A stitch in time saves nine: behind every major business failure lies an untold story

Shiladitya Dasgupta and Debashish Sanyal

Shiladitya Dasgupta is an Assistant Professor at the Asia Pacific Institute of Management, New Delhi, India. Debashish Sanyal is Professor at the S.P. Jain Center of Management, Singapore.

Small mistakes in strategic planning lead to big business failures

Drops make an ocean. A series of small successes always lead to a big success, the type that gets attention from the press. The converse is equally true. A big failure does not occur out of the blue, it is always the consequence of a series of small failures. These small failures go unnoticed, until one day they gather critical mass and lead to a big failure with catastrophic consequences (Bazerman and Watkins, 2004).

The big failures, such as the subprime crisis, the subsequent global financial meltdown and failure of some iconic American corporations got a lot of media attention and induced academics and managers alike to don their thinking caps. The *Harvard Business Review* published a special section in its October 2009 issue titled, "Spotlight on risk". While the big failures deservedly get a lot of attention from intellectuals and press, the unnoticed small failures extract a bigger price from society, inform of closure of numerous small businesses, which is never reported or analysed and small mistakes committed by MNC firms, which costs them in thousands, if not in millions. Ultimately these thousands add up to a billion one day! The bulk of the employment in any economy is provided by thousands of small firms, even more so in emerging nations like India and China, where small business provides employment to rural folk. In absence of proper guidance, many of these small firms close down, leading to a rise in unemployment and migration to big cities, which in turn compounds problems for city planners.

At this juncture, it is important to distinguish between mistakes committed in the process of innovation and mistakes committed in the process of strategic planning. Mistakes committed in the innovation process are necessary steps, without which big innovations that change the society and lead to scientific and economic progress will never materialize. These mistakes then are voluntary in nature, they are committed consciously as a matter of choice, with the knowledge that they can change the course of human civilization one day.

On the other hand, mistakes committed in strategic planning are usually involuntary in nature; they are not committed as a matter of conscious choice. Appropriate analogies can be drawn from the field of sport. In grand slam tennis, there exists a term called "unforced errors". These unforced errors occur, when a player serves and misses the line or wrongly places the ball, which fails to clear the net. These unforced errors finally separate a champion like Roger Federer from an also ran player. In international soccer unforced errors occur, when the striker comes tantalizingly close to scoring the goal, with only the goalkeeper between him and the goal post and misses the mark or erringly pass the ball to a player from opposing team. Champion teams like Brazil, Italy or Germany usually convert such chances and their ball passing skills are impeccable. Similar chances are converted by top notch hockey teams from penalty corners. The legendary basketball player, Michael Jordan would have never missed the net from close quarters. The champion players or champion teams then focus on getting their basics right and never commit such basic errors on field.

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Errors in strategic planning are usually such basic errors, committed unknowingly and stems from lack of appropriate due diligence. It is this kind of error, which accumulates over a period of time and gathers a critical mass with catastrophic consequences, and finally gets reported in the press as black swan events (Taleb Nassim, 2007). While a lot of ink then gets spilled on analysing what went wrong and special issues are published by premier journals on business failure, what goes unnoticed and untold are the series of small mistakes, committed over a period of time that finally led to that big failure. This paper aims to focus on such small failures, committed during the process of planning or revising strategy.

For example while launching a new brand; there is no excuse in not knowing one's target customer profile and their choices and preferences. A breakfast cereal maker, who is a global leader in its field, launched a new brand of breakfast cereal in India in early 2000s. The product received a lukewarm response. The firm then did a deeper research on its target customer profile and realised that owing to increasing incidence of cardio-vascular diseases in India, the average Indian office-goer has become health conscious. It repositioned its brand as a healthy breakfast and success followed. It was a case of once again getting one's basics right!

Examples of such failures abound in small business. Faridabad is a satellite town within the national capital region (NCR) of New Delhi in India, situated just 20 miles away from the capital. It is situated within the state of Haryana, which adjoins NCR and surrounds NCR in south and west. Gurgaon, the northern hub of Indian IT and BPO industry is also in Haryana. Numerous shopping malls have been built in Gurgaon since 2005. The professional middle class of Gurgaon city, who have money to spare due to high salaries drawn from IT/BPO sector, indulge in shopping sprees on weekends. This led many construction firms to believe that a similar success story can be repeated in Faridabad as well. One mall commenced business in 2006 and was an immediate success. Twenty other mall constructions followed! The national highway no. 2 from Delhi to Agra runs through Faridabad for a good 15 mile stretch and this stretch became dotted with numerous shopping malls by 2009 on both sides.

Presently, most of the new malls lie deserted, there are very few shops in them and the number of customers is few and far between. Millions of dollars have been sunk into the construction of these malls, with elaborate designs and systems. The construction firms, who built these malls, overlooked one simple fact. The shoppers of Gurgaon are fundamentally different from that of Faridabad. Gurgaon being a major IT/BPO hub boasts educated middle class shoppers, who have money to spend on expensive brands on weekends. On the other hand, Faridabad happens to be one of the most industrialised towns in India with a number of heavy and small engineering firms. The educated middle class shopping crowd of Gurgaon is absent here! The majority of the Faridabad residents are blue collar workers or small scale entrepreneurs, working in various manufacturing units and their outlook on life are radically different from that of the educated middle class shoppers of Gurgaon. They visit a mall only on special occasions to buy gifts for loved ones. This simple fact was overlooked by many construction firms, who rushed to sink the millions in an El-Dorado, which never existed! A due diligence exercise done in terms of customer demographics would have saved the millions and channelled them for better purposes, generating much needed employment in an emerging economy.

Such mistakes are committed not only by small and medium sized firms, but also by big business boasting of personnel from premier technical and management institutes. One of the best-known automobile manufacturers, operating in India for a long time now, tasted initial success with a relatively higher priced model. Car buyers were willing to pay the extra premium for this model, as it still delivered excellent value for money along with a snob appeal the brand carried. This led the manufacturer to believe that buyers will always buy its brand and are willing to pay the extra premium for the brand appeal. It launched another model aimed at the value conscious family car buyer, at a price, substantially higher than competing models in that segment. The model received a lukewarm response. The firm targeted a value conscious segment of the Indian car buying population, which actually comprises the mass market and believed that its brand appeal will carry the day, it did not! This error was committed despite the firm being in the Indian auto market for more than a decade and can boast of possessing some of the finest managerial talent available in the country. The adverse reactions to the model's price and features it offered in return, came flying thick and fast in product rating web sites, blog forums and networking social sites. The firm committed two small mistakes here. The first was not gauging the impact of the internet discussion forums and not understanding a simple fact that almost 80 percent of the Indian car buying public today are networked over the web in large and small towns. The second, not learning quickly enough from the adverse reactions that came swiftly in web sites like www.carwale.com, where thousands of users write their own reviews on cars and thousand others buy cars, after reading these reviews.

Such small mistakes go unreported and unpublicised, big firms usually never admit making such errors, as it leads to a major loss of face for them (until it blows up on their faces!). On the other hand, big firms have enough financial cushions to absorb the impact of small errors made in strategic planning and carry on, while numerous small and medium businesses usually go down under, creating unemployment and social unrest.

The big impact of small mistakes

The ensuing case study demonstrates, how a MNC engineering firm which set up shop in India, committed a series of small mistakes in planning its strategy, that finally led to sustained losses over a five-year period. The study covers a period between 2000 and 2005.

Facts of the case

The firm is a component supplier to consumer white goods industry and is a global leader in its field. It arrived in India in 1999 and immediately took over an existing component manufacturer's plant. The firm then focused on the job of scaling up capacity quickly, by installing new machines with the clinical efficiency and speed large multinationals are usually known for. In early 2000, its marketing team reported that cheaper products launched by overseas competitors have just started arriving in the market, which incorporated changes as specified by Government of India since 2000. These new regulations came into effect from early 2000 as India was part of the Kyoto protocol on global warming. The acquired plant manufactured products which did not meet the new environmental emission norms and therefore the plant had to be modified substantially and a new product meeting the new emission norms had to be designed and launched.

The firm's top management dismissed the concerns raised by such reports, being confident that it was the best in business and its brand strength will allow it to dominate the Indian market. It then went on to seal raw material supply agreements with a few reputed Indian firms, who were known in their field of business. This was done to ensure a continuous supply of quality raw materials. Since the firm operates in a B2B mode, it went on to ink selling agreements with three original equipment (OEM) manufacturers in the field of consumer durables. The capacity of the plant was 2 million units per annum. The projected production and sales volume in 2001 was estimated to be a million units, going up to 2 million units by 2005. The year 2000 was a year of planned loss, as the new product had to be designed and tested and the usual teething problems associated with new machines had to be overcome.

Starting from 2001, the sales never reached projected volumes. For five years starting from 2001, the sales volumes were 0.7 million, 0.9 million, 0.8 million, 0.7 million and 0.8 million respectively. The capacity utilisation was less than 50 percent, the volumes remained stagnant and there was a steady erosion of selling price since 2001. In 2001 the average selling price realised for the new component meeting new emission norms was $ 24 per unit from the three OEM customers, which dropped to $ 21/unit in 2002, and to $ 20 by 2004, finally to $ 18 by 2005. Thus there was 33 percent erosion in selling price over a period of five years. Meanwhile some of the major suppliers of the firm started demanding a higher procurement price and threatened to disrupt supplies. The firm managed to source alternate suppliers from overseas but this resulted in lost production and market share. By 2003, two more competitors decided to set up shop in India, significantly adding to the overall industry capacity. To add to the firm's woes the new model failed to meet quality norms set by OEM customers and the quality issues could be sorted out only by 2002. Cheaper imports from overseas also started reaching the OEM customers, which was of comparable quality. The overall growth of the industry was constrained by two factors, related to Indian economy and consuming habits of the Indian customer. The first was lack of adequate power supply in many of the small towns and villages of India, which stunted the growth of consumer white goods industry. The second factor was related to purchasing power of Indian customers, who are usually value conscious and operate on a small budget.

The firm being a big MNC, had the financial cushion to absorb the impact of sustained losses and finally figured a way to outmanoeuvre the competition, in terms of product price-feature positioning and was back in the black by 2008 with almost 90 percent capacity utilisation. However thousands of dollars were lost in the intervening period. Apart from the financial losses, the firm also lost some of its key personnel, which led to erosion of intellectual capital.

Analysis of the case

The firm made a series of small mistakes in 2000, while crafting its long term strategic plan and business plan projections to its shareholders from 2000 to 2005. These small mistakes later gathered critical mass and engulfed the firm in crisis, splashing red ink on its financial statements for a length of time.

The first was to underestimate abilities of overseas competitors to come up with a comparable product in terms of features at a lower price. This was made possible by easier access to technology and resources. The barriers to access to physical resources, by virtue of which, big business created a unique competitive advantage for itself have virtually crumbled down and today hardly any physical resource remains unique. This was already expressed by numerous strategy scholars in late 1990s (Lowendahl and Revang, 1998) and was a hard reality, by the time the firm had set up shop in India. The second mistake was overestimating its brand prowess in a value conscious Indian market. The third mistake lay in not reading the customer's mind, which by then had considerable media exposure in India, in terms of the mobile, internet and television. Internet penetration was strong in metro cities by then and was spreading fast to small towns and social networking and rating sites such as Facebook, Twitter or Linked-in had already made their way. This made the final retail customer more demanding and hype resistant, which affected the fortunes of the firm's OEM customers, which in turn affected the firm's fortunes. The fourth mistake was over-reliance on select few OEM customers, who played truant right from year 2001, as they were challenged by cheaper imports. The fifth was relying on a few big and powerful suppliers, who started dictating terms later on, the importance of developing alternate vendors were overlooked and resulted in lost production and sales. The sixth mistake lay in not studying the industry characteristics clearly, the fact that many other competitors also viewed the Indian consumer white goods industry as a promising market was overlooked and the industry was saddled with overcapacity by 2003/2004. The seventh lay in establishing a large plant right at the outset, whose capacity was never utilised for a long period of time due to volume stagnation. The volume stagnation stemmed from environmental constraints and economic constraints, which were never accounted for in the strategic planning process. The eighth mistake lay in not taking into account the cost innovations by competitors, which made a substantial dent in sales volumes and price and resulted in 33 percent price erosion in five years. The ninth and the last mistake lay in not working out the cost-feature trade off equation of the new product, which met the new emission norms and assuming that the old equation will work as well! The market had changed substantially by end of 2000, due to fast changing customer tastes and arrival of cheaper imports. It took the firm more than five years to figure out the right cost-feature equation and it could finally hit the sweet spot in terms of brand positioning much later in 2007 and 2008.

Thus a series of small and unwitting mistakes committed in the process of strategic planning led to a big impact over a long period of time and resulted in sustained losses. The firm offered a congenial work atmosphere, where mistakes were tolerated and experimentation encouraged. It commenced business with the best available managerial talent in the industry, therefore it will be wrong to assume that these competent managers made mistakes knowingly in a callous manner. On the other hand they worked with best intentions to keep the company afloat and fought the price erosion with a series of cost cutting measures, by employing well known strategic cost management techniques like target and *kaizen* costing and activity based costing. Efficient cost management helped the firm to stay put during this difficult period, until it figured a way out to counter competition.

The influence of key drivers

In order to develop a better understanding of strategic risks and avoid committing the small and basic mistakes while crafting strategy, a deeper understanding is required about key social and technological forces that has shaped our society since advent of industrial revolution and continue to shape and influence our behaviour and habits.

As in the late twentieth century, emergence of the first global system in late nineteenth century was based on interaction between technology and economic institutions. Long distance transport and communications achieved breakthroughs similar to those today. The Suez Canal and the Panama Canal drastically cut down international shipping times, as did the progressive development of faster and larger steamships from 1840s. New railways in India, Russia, and the United States and in Latin America opened vast and fertile territories of economic development and settlement. The spread of telegraph lines and transoceanic cables linked up the world, medical innovation such as quinine, which offered protection against the dreaded tropical disease: Malaria facilitated European investments, settlements, and colonization. These technological breakthroughs were revolutionary in underpinning the then global system. On the economic level, key institutions similarly spread on a global scale. International gold and silver standards became universal after 1870s (Sachs *et al.*, 1995).

The railways, telegraph and steamship shrunk distances in nineteenth century, this coupled with advent of social institutions like the joint stock company and audit firms allowed international business to expand and flourish. A similar expansion was witnessed in early twentieth century, when two major social innovations, advent of multi divisional organizations and management accounting allowed US corporations to expand their foot print outside USA (Hamel, 2006).

The key drivers are then a set of technological and social innovations (Beinhocker, 2006) that are dynamic and ever changing. As they evolve, they continue to reshape society. They influence government policies, customer preferences, supplier behaviour. They facilitate emergence of unique competitors, disruptive business models, and new products. Therefore there is a strong relationship between key drivers such as technological progress, changing demographics and increasing access to resources and causal factors such as industry overcapacity, brand value erosion, commoditization, emergence of new competitors, disruptive business models and so on.

We now state the key contention of this paper:

> The social and technological drivers are continuously evolving and their evolution gives rise to the causal factors which eventually results in strategic risks.

As these drivers are continuously evolving, the causal factors are also evolving along with them, resulting in an ever-shifting business landscape which resembles a shifting sand dune. While planning strategy, certain assumptions always get embedded in it; these assumptions may hold true at a point of time. However due to ever changing dynamics, these assumptions may not hold true after a short period, this then gives rise to a series of small mistakes which eventually has a big impact. Therefore during the process of strategic planning, the dynamic nature of key drivers will have to be taken into account.

Key drivers → Causal factors → Strategic risks

For example in the case study, the firm pinned its hopes on its brand strength while setting up a large plant. It overlooked two basic factors; the first was emergence of new and unknown competitors, who were capable of offering a product comparable to its own, in terms of cost and features. The second was that in a value conscious market, customers have little or no respect for a brand and powered by internet, their perceptions are changing very fast. This was affecting the OEM customer's fortunes, which in turn was affecting the firm's fortunes.

Capturing the ever changing nature of strategic risks

Selecting the key drivers

The first step is to select a set of key drivers that are influencing the behaviour of causal factors, related to the firm's business and industry. We have selected a set of ten key drivers that significantly influence the causal factors in today's business. However these drivers are not static in nature. A year down another set of key drivers may significantly influence the firm's business environment. Therefore the key lies in recognising the fact that these drivers themselves are not static in nature. Some of the ten key drivers selected by us may become irrelevant for a firm a few years down. Yet some of them may remain influential over a passage of time, such as technological change. Technology has been termed as the "great growling engine" of change (Dicken, 2007) and has shaped our society for more than 200 years now since advent of industrial revolution and will continue to remain an influential driver, as long as human society exists. Increasing access to resources, as pointed out by many strategy scholars is another influential driver that facilitates emergence of new competitors and products, causes over capacity and commoditization and continues to be another influential driver. Outsourcing of key business processes is another influential driver that continues to facilitate the process of globalization since early 1980s. Open innovation is significantly reducing the R&D costs and accelerating development of new products and processes (Chesbrough, 2007), exposure to media and internet continues to influence and significantly alter customer perceptions, making them demanding and hype resistant (Li and Bernoff, 2008). Mobility of key personnel, increasing scarcity of natural resources, changing customer demographics, emergence of new markets are some of the major trends today that continues to shape and influence strategic planning (Beinhocker *et al.*, 2009). Last but not the least the consolidation process of some of the older industries such as steel inform of mega mergers such as the Tata-Corus, takeover of Arcelor by Ispat group, or forging of alliances in automobile industry such as Tata-Fiat in India to share logistics and distribution costs continues to be a major driver. These ten key drivers are shaping and reshaping the business landscape today and broadly covers all the major causal factors that give rise to various strategic risks. However this is not an inclusive list. Drivers can be industry specific as well. Instead of selecting ten drivers, managers may choose ten or more drivers instead. The key lies in understanding what drivers at a point of time are influencing his firm's business environment.

Analysing the causal factors

The next step is to understand what factors are accelerating a particular strategic risk. Here the strategic risk map advocated by Slywotzky and Drzik (2005) is a useful guide to commence the process. But due to the dynamic nature of drivers, a deeper understanding is required to understand how each of the key drivers gives rise to a particular causal factor, which in turn accelerates a particular strategic risk.

For example industry risk can be caused by factors such as overcapacity, changing government regulations, commoditisation and demand saturation. However these causal factors may be have their roots in increasing access to resources, open source innovation, which may accelerate new product development, while significantly bringing down the cost of new product development. Customer risk is another key strategic risk; a causal factor here is hype resistant and aggressive customers, demanding more features at a lesser price. These casual factors may have their roots in increasing media exposure and exposure to social networking and product rating sites. Raw material scarcity may result in accentuating supplier risk. However the root cause of raw material scarcity may lie elsewhere, such as increasing access to physical and financial resources. Brand risk is another key strategic risk caused by causal factors such as appearance of new products, shorter product life cycles, and cheaper substitutes. However these causal factors may have their roots in open innovation or proliferation of knowledge over the internet, making product manufacturing and assembling knowledge open to all. In this era of free access to information, knowledge may render itself obsolete very quickly.

Therefore a deeper understanding of causal factors and where their roots lie will help the strategic planner understand the dynamic nature of risks involved in the process.

Benefits and limitations of performing the key driver-causal factor analysis

The most significant benefit of adapting such an evolutionary approach lies in improving a firm's strategic agility. Strategic agility is reconciling the ever increasingly difficult task of committing one's resources to a particular strategic option while retaining enough flexibility to change direction if necessary (Doz and Kosonen, 2008). The bigger the firm, the bigger the .price it pays to remain agile while maintaining efficiency. Before a firm commits its resources in one direction, a key driver-causal factor analysis will help the managers of the firm develop a deeper and more comprehensive understanding of the dynamic nature of strategic risks with a historical perspective. The unwitting mistakes that creep in the process of strategic planning can be avoided to a good extent (if not altogether).

The limitations of such an approach lie in the element of subjectivity that creeps in estimating the relationship between the key driver and causal factor and in gauging the intensity of the causal factor, so as to determine to what extent it an accentuate a strategic risk. Peering into the future is always a subjective exercise; one can at best make an intelligent guess about the future and take his/her chances. However there is a difference between calculated risk and blind risks. A comprehensive driver-factor analysis does help one to take a calculated risk, with a better understanding of the consequences involved and its limitations notwithstanding, such an analysis will significantly improve a firm's understanding of strategic risks and prevent a major business failure. A stitch in time can indeed save nine, nine hundred, nine thousand or nine million jobs!

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Corresponding author

Shiladitya Dasgupta can be contacted at: dasgupta@asiapacific.edu

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