

# Strategic Chronicle™

*A Newsletter for Clients and Associates of KLM, Inc.*

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## Competitive Strategy

Competitive advantage is that toward which strategic thinking aspires. Yet, ultimately, all competitive advantages are transitory.

What strategic thinkers are after is a strategy that will remain in vogue for a substantial period of time, and that will change and evolve to remain sustainable in the future.

This is not to say one can never arrive at a strategy, but rather that the development of competitive strategy is an ongoing process. Engaging in this ongoing process is what it means to be “competitive” – to be always assessing the situation, always analyzing, always adjusting and changing.

The identification of good competitive advantage requires deep thought and innate intelligence. Strategists need to possess both an understanding of cause and effect within specific business situations, and knowledge of the history of modern strategy. Brilliant strategy emerges from understanding what works, what doesn't, why, and how to deliver the necessary performance.

**The only  
“sustainable competitive advantage”  
is the commitment to keep evolving  
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to stay current with the times.**

Every successful competitive advantage is predicated on some particular set of conditions that exist for a period of time and for a set of reasons. When the underlying factors change or are disrupted by new knowledge, science, technology, or creative insight, the power of the then winning competitive strategy is undermined and eventually unseated by new strategic thinking.

How do we achieve and sustain competitive advan-

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tage? First, by understanding what competitive advantage can provide, whether it be market position, business model, economy of scale or scope, vertical integration, acquisition, or brand position which leverages brand equity and core competencies. Then second, by understanding, through scenario planning, what could unseat competitive advantage, and where we will find competitive advantage tomorrow.

Strategists need to be able to unpack plans and activities in order to model, anticipate cause and effect, and predict where sustainable competitive advantage lies in the future.

What about “sustainable” competitive advantage? It is one thing to have a competitive strategy, and it is another for it to yield “sustainable” competitive advantage.

If all strategies eventually become obsolete, how can anything be sustainable? “Sustainable” doesn't mean a strategy never changes and is always the same. “Sustainability” refers to the ability of strategy to change, and to leverage the changing situation. Most importantly, such strategy must possess foresight and prescience regarding its next form. In this sense, the only “sustainable competitive advantage” is the commitment to keep evolving one's strategy to stay current with the times.

Time was when industries like the American automobile industry thought their barriers to entry, based on capital-intensive fixed assets and their economies of scale in manufacturing, would always confer dominance upon their enterprises. Then, the import automobile manufacturers arrived with new technologies, different approaches to management, superior design, and modular manufacturing to level the competitive advantage of the American, set-in-stone manufacturing processes.

“Sustainable” competitive advantage is only achievable for those who understand that the development of strategy is an unending process, and who recognize the need to have identified their next competitive advantage while the present advantage is still competitive.

## Brand Faceting and Marketing Strategy

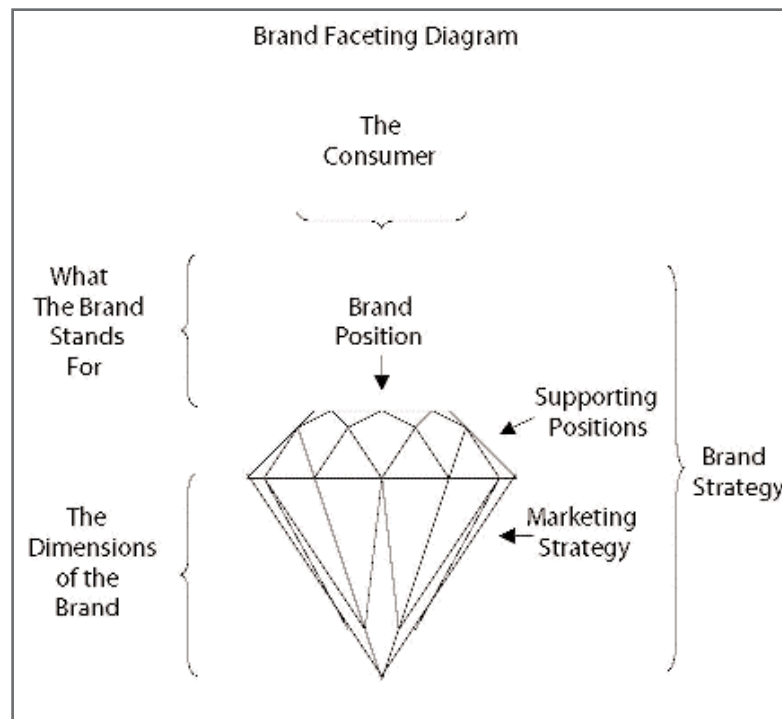
Despite the fact that the number of Brands in the marketplace has increased by hundreds of thousands since 1990<sup>1</sup>, the Brand still remains one of the most valuable and singular assets an enterprise can possess - thus the importance of managing it with wisdom.

The proliferation of Brands has, however, made the management of a Brand even more challenging and more critical to the success of an overall enterprise. Remember that, fundamentally, customers choose a Brand because of what it stands

for, often even more so than for the benefits of a specific product or service.

In the past, Brand Management paradigms stressed the unchanging quality of the Brand. Today, this perspective can seriously interfere with the organic development of the Brand. Wise Brand managers now realize that it is natural for a Brand to change over time, and that it is in the best interest of the Brand to do so, lest it should lose its relevance to its target audience.

There is much confusion about how to manage a Brand. Many believe that change should be minimized to present a consistent identity, and that the Brand should not change, at the risk of losing its loyal franchise. But then, often after a period of incrementally increasing irrelevance, such a static approach ends in the need to reposition the Brand to catch up with its market.



This need for repositioning demonstrates that there needs to be a more organic, more natural way to develop the Brand without suffering recurring periods of declining relevance.

One way to think about natural Brand development is in terms of *faceting* the expressions of a Brand. We can liken this approach to creating a brilliantly cut diamond.

A Brand with history and dimensionality

has various facets which have been de facto developed and of which the consumer has Brand Awareness. Marketing against such facets, dimensions, or aspects can be compared to allowing your customer to see the cut of the Brand much as one would view a well-cut diamond by allowing the light to shine through it from various angles.

1. The United States Patent and Trademark Office has issued 1,058,828 trademarks since 1990, and this is only a partial number of how many Brands there are across the total economy.

While there is a very visible, primary main face to the diamond, secondary and tertiary facets can also be cut from the stone to provide light and brilliance, shape and symmetry, and contribute value. A Brand with depth is no different from a well-cut stone. Such a faceted approach makes obsolete the days when a Brand was a one-dimensional entity.

The primary facet of the stone is the Brand Position, for it is only through the Brand Position that the facets can be focused and leveraged. Once the Brand is positioned, leveraging the various dimensions of the Brand creates different relationships and allows the natural evolution of the Brand to occur. By displaying its varied dimensions to communicate the depth of the Brand, the Brand secures the space it needs to grow, change and evolve through new expressions of itself. By strategically considering which facets should be shown in a particular situation, we show the Brand at its most appropriate, without losing track of its unity – which, by definition, can almost never be shown in its entirety.

All Brands possessing a history have a dimensionality upon which the Brand Strategy can draw to present the complexity and richness of the Brand.

Like light reflected through a brilliantly cut diamond, the Marketing Strategy should devise ways to portray the Brand in all its richness.

Brand Faceting, as a Marketing Strategy, works in the area of subtle and incremental change to produce an evolutionary effect, and to reduce the risk of losing your existing franchise by making an uncharacteristic shift that your customer, present or pursued, doesn't follow.

Managing the growth and change of a Brand has always been difficult, requiring both art and wisdom. Most Brands are either over-managed and not allowed to change, or not managed at all and allowed to drift or even languish without strategic guidance or direction. The real art is to manage your Brand in such a way as to respect its natural expression. There is an art to it.

Where the Brand use to be a tool of Marketing, now Marketing is in service to the Brand.

## What Is Intellectual Capital?

Intellectual Capital, which during 2000 accounted for over one-tenth of the U.S. GDP, or one trillion dollars, is usually divided into seven areas:

- 1) **The Brand**, an on-going identity conveying the values of the enterprise, its products and services, and ultimately its role in the customer or consumer's lifestyle.
- 2) **Intellectual Property** and Goodwill, to include trademarks, patents, licenses, trade secrets, and Intellectual Property Strategies.
- 3) The **active intelligence**, energy, and creativity of an organization, including knowledge, know-how, trade secrets, information, data, and the ability to innovate and to take products and services to the marketplace.
- 4) **Corporate Culture**, with its ways of doing business, its rituals, and its practices.
- 5) The **people**, with their abilities, talents, and relationships.
- 6) The **experience and history** of the organization and its "Corporate Memory."
- 7) Intellectual materials, or **the work product** of the day, which is the new capital used to create new wealth.

## Intellectual Capital and Intellectual Property

How does traditional “Intellectual Property” fit into the modern discussion surrounding the value and practicality of “Intangible Assets,” “Knowledge Assets,” or what has come to be known as “Intellectual Capital?”

During the early 1990s, with the emergence of corporate growth through mergers and acquisitions, the term “Intangible Assets” gained currency to refer to all the “non-physical assets” within an organization, such as its Brand or its Intellectual Property (IP).

This distinction between physical and “Intangible Assets” allowed Brands and IP to be recognized as valuable despite their intangibility, and to receive both dollar valuations in business negotiations and new strategic significance in corporate strategy. Just as physical assets, such as plant, property, and equipment, possess both dollar value and strategic meaning, so the patents, trademarks and copyrights of Intellectual Property possess specific value and strategic opportunity.

### Actionable Assets

Often the biggest assets an organization holds are its less tangible Intellectual Capital assets. During 2000, the market-to-book ratios of Fortune 500 companies increased to 6.3:1, suggesting that for every \$1.00 of physical assets on the balance sheet, the market recognized \$6.30 worth of other Intangible Assets. On average, in successful organizations Brands, Intellectual Property, and other Intangible Assets are two to three times the value of physical assets.

While many organizations have become aware of the tremendous dollar value and strategic opportunity resident within their Brands in the form of Brand Equity and Brand Awareness, few enterprises realize or utilize the wealth located within their Intellectual Property holdings per se.

While Intellectual Property is now valued and assigned a specific dollar value, many otherwise savvy corporate executives who know well how to leverage traditional physical assets for marketplace gain, still find themselves unable to grasp how to put their Intellectual Capital Assets to work, not the least of which is their Intellectual Property

Portfolios. Such holdings, consisting of patents, trademarks, copyrights, licenses, and trade secrets, are still frequently overlooked in daily practice as sources of net worth, monetary value, financial gain, and as important strategic tools vis-à-vis competitive advantage.

### Leveraging Intellectual Property Assets

Intellectual Property, while possessing

value in and of itself, can also be leveraged to provide improved financial performance and enhanced competitiveness. Organizations that learn how to manage their Intellectual Property with strategic vision discover new sources of income and competitive advantage in the marketplace.

During the decade from 1990 to 1999, IBM leveraged its patent portfolio through licensing activities, increasing its annual royalty income by an astounding 3,300%, from \$30 million in 1990 to nearly \$1 billion at the end of 1999!

Additionally, because such income is free of manufacturing expense or significant operating costs, the majority of IBM’s \$1 billion per year is free cash

**“...The new economy is about the growing value of knowledge as an input and output, making it the most important ingredient of what people buy and sell; it is about the rise in the relative weight of intellectual capital vis-à-vis real estate, plant and equipment, and financial capital; and it is about the development of new techniques and technologies to manage and measure knowledge materials and assets more effectively.”**

**-Thomas Stewart**

Fortune Magazine, 10/12/98, Copyright 2002, Time, Inc. All rights reserved.

flow which falls straight to the bottom line as profit.

To match such a level of net profitability, IBM would have to have sold an additional \$20 billion worth of its manufactured products per year. In other words, the company would have had to have grown its worldwide business by 25% - which would have been a rather Herculean and rather unlikely task.

How could an enterprise leverage its patents so dramatically? Through the simple realization that patents are assets, and that just like physical assets, it is the responsibility of management to exploit the Intellectual Asset base of the organization for monetary and strategic gain.

How can this legally protectable Intellectual Capital, known as Intellectual Property, be leveraged? Here are a few of many ways:

- 1) Map patents, and build patent walls (called “clustering”) around successful products, services, and methods to prevent encroachment and ensure competitive advantage.
- 2) Position patents to potential licensees to tap the earnings potential of Intellectual Property Assets and create royalty streams.
- 3) Engage in cross-licensing to obtain income from under-utilized holdings, and to gain needed Intellectual Property in return.
- 4) Obtain patents around a dangerous competitor’s holdings to prevent its further market access (called “bracketing”).

Simply put, protect that which is most vital and adds the greatest value to your enterprise, and then, as with any other business asset, turn around and require these Intellectual Property Assets to generate business-building returns.

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is available online  
in both PDF and HTML formats  
at  
**www.klminc.com**

## The Challenge Today

The new challenge today before our CEOs and executives is to realize that patents, trademarks, and copyrights are no longer merely legal matters. Today, they are the assets of enhanced corporate net worth, and the stuff of strategic thinking and new competitive advantage.

Learning to exploit Intellectual Property Assets for strategic and financial gain is essential in today’s knowledge-driven enterprises. Those who turn this ability into a core competency and a competitive advantage are likely to experience the greatest success.

## **Branding Diamonds**

De Beers Consolidated Mines, Ltd. has essentially owned the diamond market for over 100 years, supplying over 85% of the world’s diamonds. It is known throughout the world for both mining diamonds and for acquiring the diamonds mined by its few competitors, thus positioning itself to control the world’s supply and set pricing much as it wished to. Its supremacy has been unprecedented.

During the 1990s, De Beers began the then seemingly unusual practice of “Branding” its diamonds. Despite the fact of its near-total monopoly of the diamond market, it began inscribing a small Brand Mark on its stones to differentiate its products within the commodity marketplace, and to ensure their worth against the inexorable declining value of non-oil commodities<sup>1</sup>.

At the same time, De Beers embarked upon its now famous consumer advertising campaign, “A Diamond Is Forever,” despite the fact that the company does not even sell diamonds directly to the consumer.

The growing success of Brands, Branding and the strategies of Consumer Packaged Goods (CPG) Marketing are widely recognized within the global business community. Today many non-packaged goods

1) The International Monetary Fund (IMF) has calculated the trend of non-oil commodity prices across the 20th century, and reports that such prices have declined on average 0.6% a year since 1900. Such numbers support the broadly accepted wisdom, that over time all commodities decline in price.

enterprises have adopted these approaches, some as an escape from the infamous “commodity trap.”

During the 19th century and much of the 20th century, as the industrial era heated up, wealth was found in commodities. Today, with the dawn of the era of Intellectual Capital, wealth resides in knowledge-based assets such as Brands. Coke and Pepsi have successfully demonstrated this fact with their new bottled water businesses. Today “branded bottled city water” products like Coke’s Dasani and Pepsi’s Aquafina costs more per gallon than gasoline – oil crisis or not.

De Beers, wisely taking a page from Intel’s “Intel Inside” playbook, embarked upon its Branding and CPG activities to reposition its diamonds from commodities into “Branded goods.” As commodities, diamonds were viewed as merely interchangeable items in a vast global trade which rarely differentiated the source of goods. Now, as Branded goods are supported by CPG marketing, De Beers diamonds are differentiated from commodities and freed from a supply-driven market.

Recently De Beers began encouraging new and emerging players in the diamond marketplace at the raw materials level to develop their own Brands and marketing programs to vie for the attention of consumers, all with the goal of lifting diamonds out of the commodity market by creating a consumer market where Brands and Brand Awareness matters.

De Beers can only leverage its own Branding and Marketing activities by driving the creation of a multi-player non-commodity marketplace around diamonds per se. Branded goods carry greater margins and create end-user demand. Raw materials and commodities can’t drive margins because their prices keep falling in the commodity marketplace. Studies accomplished for the IMF indicate that there is no correlation between world commodity prices, which keep falling, and the retail prices of value-added products, which keep delivering often increasing margins.

De Beers has recently teamed with LVMH Moët Hennessy Louis Vuitton, the well-known European luxury goods giant, to form De Beers LV. The purpose of the joint-venture is to unlock the value in the De Beers name, and to turn it into a global luxury Brand.

While originally motivated by market and financial considerations, the De Beers Branding and Marketing initiatives are also allowing customers an unexpected benefit: the ability to differentiate legitimate “ethical” diamonds from diamonds produced by terrorist organizations – the so-called “conflict” or “blood diamonds,” thus providing consumers a guaranteed ethical choice.

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Editor: Diane Dvorin

Contributing Editors: Dr. Lindsay Moore

Creative and Design: Maela Moore, Carolyn Oakley

Editorial Board: Diane Dvorin, Dr. Lindsay Moore

### **KLM, Inc., Management Consultation**

1919 14th Street, Suite 515

Boulder, Colorado 80302

U.S.A.

Telephone (303) 444-7239

Telefax (303) 444-7235

### **KLM, Inc., Management Consultation**

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