

BUILDING THE CORE OF THE COMPANY

CORE COMPETENCIES: PART I

INTRODUCTION

This newsletter, the first of a two part series, discusses the very real problems of figuring out what the core competencies of a company are, particularly a technology company, and the relevance of these competencies to the corporate strategy. We also want to force the discussion of the cost of maintaining these competencies, so that the economics of the core competencies and the overall business model are considered in parallel.

Part II will discuss the issues of competency rationalization following a merger, communication challenges that happen when difficult decisions are made about core competencies and methods useful for non-technologists to employ when making decisions about the merits and value of different technical competencies. These issues are very tough in practice. This is where the fireworks really happen.

The phrase “core competency” is a buzz word. It is thrown around quite easily, typically being located after the social small talk that begins a business dinner and right before the actual deal discussion. A lot of business literature exists on the topic. [The original article that coined the term “core competency”](#), authored by C.K. Prahalad and Gary Hamel, is an excellent overview of the concept of strategy and competencies. The MindTools website contains a shorter article that has a [pragmatic method of discussing personal core competencies](#).

MAGIC

For our example, we consider a company that was a medium-sized start-up that made small semiconductor lasers. With them we did all kinds of crazy things, including making atomic clocks, helium magnetometers, laser pointers, and pumps for experimental fusion reactors, light sources for projectors, and on and on. From one standpoint, this multitude of products created confusion, and many projects became nothing more than science projects.

However, this diversity of research enabled us to learn a tremendous amount about semiconductor lasers, and we truly were the best in the world at making high power semiconductor lasers. When the optical amplifier came along, we had a great competency to serve that market, and we grew incredibly quickly. In 2000, the company, SDL, Inc., was sold for about \$42B.

Is it that the management of SDL had a strategy that focused all of our efforts upon pumps for optical amplifiers? No, the company was dedicated to high power lasers as a competency, and like many laser companies, it served many smaller laser markets, as opposed to having a highly sophisticated and predictive marketing group guiding R&D investment dollars.

Perhaps the success of SDL was flawless execution? Here, we'd like to take some credit for working both hard and smart in that time of incredible growth, and we did put good systems in place as the company grew, but it would be very difficult to argue that SDL ever became a true manufacturing powerhouse.

No, rather the point is that the marriage of a very unique core competency, in this case a strong and unique ability to make high-power semiconductor lasers, with a rapidly growing customer need provided a company with a great growth opportunity.

The alignment of significant customer need with strong and unique core competencies provides a path to very rapid and profitable growth.

STRATEGY AND COMPETENCIES

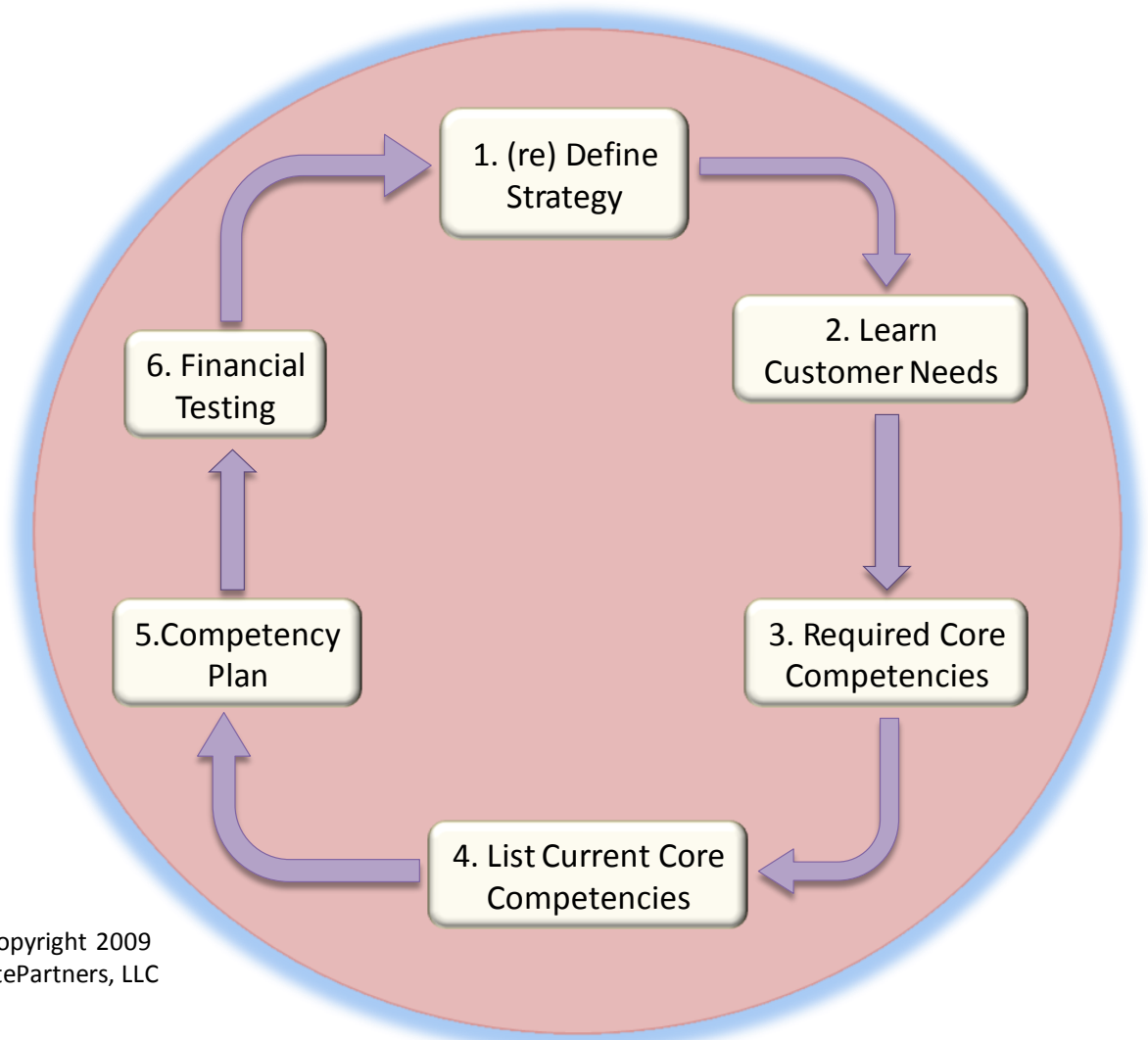
For the purpose of this discussion, we offer a very specific definition of strategy.

Strategy is the identification of current, and development of future, customer needs that allow for profitable growth given the current, and reasonable future, corporate core competencies.

Let's break that thought into smaller pieces. We start with the working statement of strategy, which encompasses both the current state of the company and where management aspires to take the company in the future. Next, we'll develop an understanding of what core competencies are required for the strategy to be successful. Then, we work through an analysis of the current and needed competencies of the company, developing a plan to add missing competencies. Finally, we'll circle back and run financial modeling to make sure that the current and future competencies are affordable within the Company's business strategy.

Figure 1 illustrates this methodology visually, with the starting point always being the working strategy of the company. Each step is described in greater detail in the discussion following the figure.

CURRENT STATE COMPETENCY PLANNING



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FIGURE 1: THE FLOWCHART FOR CURRENT STATE COMPETENCY PLANNING.

1. Develop and state your working strategy for the business, both current and future states.
2. Analyze the current needs of the customer, and what competencies are required to satisfy them. This part of the exercise is very straightforward-- you hop on the bus and go talk with customers. Develop a full range of questions about what they value; what they desire. Make sure that the discussion covers technical and non-technical topics. Recognize that many functions have customer contact, including engineering, operations, sales, finance and customer service. Use the different perspectives of each of the functions that interact with customers to develop the best set of customer needs for this analysis.

3. Develop a list of competencies that are required to meet these customer needs in a differentiated way. Then test these activities in a couple of ways: Is the competency something that is difficult to replicate? Does the competency have importance in the future markets/products that your strategy contemplates? Ideal competencies are important to your customer needs, are difficult for your competitors to replicate, and have broad future applicability. Bear in mind that competencies are not always technical. Non-technical competencies can include customer interfaces and relationships, brand, corporate information and analysis capabilities, product tracking and delivery speed, etc.
4. List the activities currently being done within your company that exemplify a core competency. The activities that are listed as core competencies in the prior step must be preserved and grown. The other activities done within your company are not essential to your current business. They may be required for your business to operate, but are not creating value for your business. In general, activities that are not strategic core competencies must be performed at the lowest price point for the company.
5. You will likely find that you are missing some of the core competencies identified in Step 2. Develop a plan, with an approximate financial cost and timeline, to bring these core competencies into your company.
6. Run a simple economic test on your plan. The focus of this financial test is to verify that your current business supports the core competencies that you have identified. Remember, you must continually invest in existing core competencies and pay for the development or acquisition of those competencies that your company does not have. If your current state business strategy works, move onto the competency analysis of the future of your company. If, however, the cost of the competencies makes the business unprofitable, then the current strategy of the company must be redefined, or a smaller (more affordable) set of core competencies must be found capable of supporting the strategy.

Let's be just super clear here on two critical points.

Many, if not most, technology companies are both underfunding core competencies and overfunding non-essential activities. Many technology companies fund non-essential technical work, and tend to poorly understand non-technical capabilities that can truly add value. While it is tough work, you have to fix that.

Many businesses, and a few industries, have business models where appropriately funding the core competencies needed by the customers leads to little hope of profitability. If the test of step 6 says that you can't easily make money, it is important to embrace that reality and change your business strategy.

FUTURE STATE COMPETENCY PLANNING

The next step in competency planning is to consider what core competencies will be needed for the future of your company. Much of this is very similar to what we've already discussed.

However, understand future customer needs requires much more than simply asking your customer what they will want in the future, i.e., Step 2 of the process is different. We wish to stress the importance of not just understanding, but actually creating future customer needs. A company,

particularly a technology company, with a linear vision of the future, where the coming years are basically slight modifications of the present, is almost certainly destined for mediocre performance. Developing a truly visionary strategy is quite difficult; it demands the understanding of the underlying market drivers and, by extension, the unrealized future needs of market itself. A future newsletter will discuss marketing techniques to develop and understand the future needs of your customers. With respect to core competencies, the most effective strategies have these traits:

1. They anticipate, and in the best case, develop the future needs of customers. [The concept of iTunes and iPods](#) simply didn't exist before Apple introduced the products and underlying software.
2. They leverage existing competencies to create new product categories and enter new markets. By contrast, a strategy that relies entirely upon new core competencies, which must be developed or acquired, has very significant risk and added cost.
3. Core competencies acquired/developed to enable future products and markets serve to reinforce the competitive position of the company in current products/markets.

SUMMARY

[InSite Partners](#) employs a six-step process for linking core competencies to strategy, and then uses economics tests to validate the appropriateness of the resultant business model. InSite Partners brings the process, tools and focus on execution to help businesses quickly work through this exercise, allowing the company to achieve both better profitability and growth potentials.

Our next newsletter will focus upon issues that naturally arise when implementing a core competency analysis. Those topics will include issues of competency analysis prior to the consideration of M&A activity, competency rationalization following a merger, management of the communication challenges that happen when tough actions are taken concerning choosing and funding core competencies and useful methods for non-technologists when faced with the task of evaluating the economic value of technical activities and competencies.