naked**innovation**

uncovering a shared approach for creating value

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DANIEL CHEONG/FLICKR

6 Business

Strategic Design

It is not necessary to change.
Survival is not mandatory.

W. EDWARDS DEMING

AT THIS POINT, YOU MAY BE ASKING YOURSELF, "This is all quite interesting, but how does this impact my business, strategy, and bottom line?" This is a very good question and not one to be taken lightly. We do not presume to be experts in all realms of strategy. Starting with Sun Tzu's classic, *The Art of War*, many important works have been written on how to organize oneself to succeed in a competitive environment. Understanding the work by thought leaders of strategy such as Michael Porter, Gary Hamel, and the late C.K. Prahalad, is an undertaking all serious strategists should embrace. That said, we will not dwell at length on the two basic strategies currently employed by business today: cost leadership and "me too" competitiveness—everyone knows these. Instead, we are interested in a new logic for business: ***Distinctive Value***. Yes, the logic of delivering on the unmet needs and unarticulated desires of people.

Traditional business logic is fundamentally inside out in nature and starts within a company and a product team: create an idea (similar to competitors), produce the product, and sell the product (in known channels). This chain of value creation is straightforward because it minimizes internal variables and lowers short-term risk. It is inherently deterministic, rational, and allows companies to optimize around fixed organizational structures and development processes. You see the top of the hill to be climbed and you climb it. This is what business is and has been for most firms and the people who work within them for a century or more.

Unfortunately, this traditional business logic climbs known hills—many times, at the expense of organic growth and an increase in long-term risk. Whole industries fall into ruts as players are willing to split up a known pie and compete directly with each other. Global competition or small firms seemingly come from nowhere to unseat great companies and decades long market leaders with some simple yet unrecognized vision and supporting invention. Take vacuum manufacturer Dyson for example. Dyson created an offering that changed the dynamics of home cleaning—men across the world became desperate to vacuum! There is simply no real reason Hoover or other previous market leaders in floor care could not have beat Dyson to the punch in delivering an exceptionally better product. It's just that their intent was squarely focused on maximizing their position in the current

TRADITIONAL LOGIC OF STRATEGY AND VALUE CREATION

NEW LOGIC OF STRATEGY AND VALUE CREATION

competitive space rather than compellingly transforming people's lives.

Jeremy Alexis, a professor at the Institute of Design with a particular interest in exploring emerging relationships between design and business practice, defines "a business" simply yet elegantly as "a value delivery system." When thought of in this way, the essence of strategy is not about beating your competitors nor creating products. Instead, as Alexis and some predecessors suggest, it is the act of creating distinctive value for people—and ultimately doing it in a way that it can be profitably sustained. The question then, is not how to most efficiently climb the hill you see before you (and have climbed many times), but which hill should be climbed? We would suggest it isn't the same hill your competitor is climbing. It is indeed as Sun Tzu said, "[success] without fighting is the true pinnacle of excellence."

Firms must identify what people value, communicate that value internally and externally, and provide it in meaningful and profitable ways. This seemingly simple change in perspective has dramatic ramifications for how firms organize and operate. While most are built around optimizing *existing* products, around *existing* operations, around *existing* channels of sale to reach customers, we suggest that the entire relationship be turned around. By first identifying what specific needs and desires are most highly regarded by customers, firms have

[1] Sun Tzu, *The Art of War*, translated by Ralph D. Sawyer (Boulder, Colo.: Westview Press, 1994), 177.

remarkable and actionable starting point with which to first communicate Vision and then Invent. It is essentially "outside in" to recognize that the needs of current and, more importantly, future customers define who you are and what you do. This is empowering in terms of successfully creating value for people, but problematic in terms of operating as an ongoing concern. It forces firms to be more agile and flexible than ever before. It forces them to be willing to regularly redefine what their business actually is and how to do it.

While this may sound extreme, Peter Drucker suggested a notion decades ago that was remarkably similar when viewed through a contemporary lens. He said there are three fundamental questions business managers and strategists must ask themselves. Inserting Alexis' definition for a business within Drucker's questions makes them powerful:

› What is the distinctive value we deliver?

› What distinctive value should we be delivering?

› What distinctive value will we deliver?

These questions represent the new strategic logic of distinctive value and underlie a larger shift from a focus around a century of optimization to our current era of Continuous Innovation. We want to produce truly compelling experiences and build our organizations flexibly to create them. This attitude is heavily dependent on perspective, so before we get into some tools to help do it, let's tell a story.

In late January 2007, a fascinating conversation about Apple's recently announced iPhone played out openly and dramatically online between blogger and Jump Associate Pete Mortensen and Wharton Graduate School of Business Professor Peter Fader. In an interview on the Wharton website, Fader made a few basic (and classically marketing focused) propositions. In

essence, he said the iPhone was entering a much more mature and well developed market than the iPod did at its introduction; he said users will expect hardware keypads and Outlook integration because they were getting them already on their current smart phone devices; finally, he questioned the $500 introductory price point. We think Fader convincingly argued that iPhone would have had a hard time conquering the existing mobile phone and smart phone market.

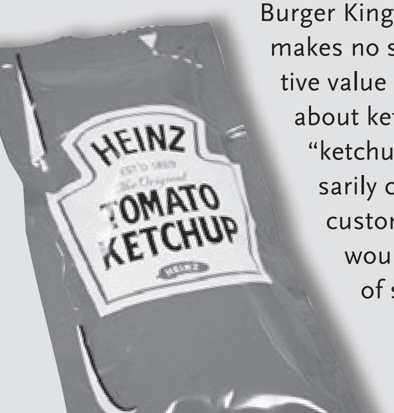
But what he didn't understand was that *it wasn't supposed to*. Fader's description ultimately didn't represent Apple's strategic or innovation intent, as was recognized by Pete Mortensen in his blog on Wired.com. Responding specifically to Fader's analysis, Mortensen wrote that a "me too" response, as Fader suggested, "is one that classically occurs to marketers. Take the industry-standard feature set and add an innovative feature or form on top to set it apart from the current players.... Marketers tend to live (and die) by this strategy. And it definitely has its benefits. It pays attention to what already exists and works to meet the explicit demands of the market." But, it is also clear that developed markets tend to fall into deeply-dug ruts focused on direct competition and maximizing the current shared pie. Focusing entirely on your competition and market as it stands sets you up to lose sight of the bigger picture.

Enter iPhone. Mortensen appropriately recognized that Apple's strategy was different when he wrote, "So what game is Apple playing, you might be asking yourself? A strategic design play, naturally. Design isn't just about styling—it's about creating something great that meets the real needs of people." This basic premise is correct, but we disagree with the language used to describe it. While Apple is clearly a design-obsessed firm, it is not "Design" per se that defined their intent in this case. Instead, it was their focus on creating something great that would meet the real needs of people. The needs of Treo and Blackberry users were being met quite well, so trying to compete with these products would just have further split the existing (albeit growing) smart phone pie. In this way, it was not only Apple's strategy that was different but, more importantly, their strategic logic. This is the logic of distinctive value.

So what was this unique value that iPhone was created to deliver? Let's consider your co-authors for a moment. We both had slightly better than commodity mobile phones and iPods. We carried them everywhere. The cost of these two devices together was approximately $500. Did we demand a hardware keyboard for texting for our first "smart phone"–like device? Not necessarily, because we had never had anything as robust as Blackberry or Treo before. Would we demand Outlook integration? No, because we didn't have it then on the phones we were using. Was

What Not to Do as a User-centered Innovator.

Jeremy Alexis has a rule for this issue we think every innovator should memorize: **Don't design ketchup packets.** The basic premise is that ketchup packets are both frustrating to use and easy to improve through design. At first glance, it seems like it would make sense to act as a user advocate in this case. But, the problem isn't that McDonald's, Burger King, or Wendy's can't do it, but that it makes no sense financially to do it. The distinctive value offered by these restaurants isn't about ketchup packets. Creating a better "ketchup delivery vehicle" wouldn't necessarily cause an increase in the number of customers or the volume of sales while it would, most certainly, increase the cost of serving ketchup.



LOUNGEFROG/SXC.HU

$500 too much to pay? Certainly not, if it provided the functions of both—and so much more—with the convenience of only carrying one device. Talk about distinctive value! Apple was banking on the fact that there were probably ten million other people in nearly the same situation.

Regardless of whether or not iPhone would be as commercially successful as the iPod, it still illustrates a markedly different logic of how a business decides to compete. Would you and your firm rather produce commodity products or would you like to create experiences that transform people's lives? We would argue you *can* do it with mobile phones, enterprise software, or energy. While the process of how to do it is less clear than delivering low cost or "me too" products, the reward for transforming lives is tremendous if successful. Is it really so crazy to have this as a goal?

So all we have to do is figure out what our future customers value and we can guarantee our company's success. We wish it were that easy—but unfortunately, viably delivering distinctive value may be the hardest part. We've come to the point in developed society where we can build almost anything. However, we can't necessarily do it in a way which will provide the resources for our firms to continue. This is what many "user-centered" designers seem not to understand—and that can cause intense friction on interdisciplinary teams.

We witnessed this first hand while doing some work at a major Internet portal. Invited to a design review with an entire product team, we sat in shock and awe as the design manager stated within the first minute of the presentation that, "The new designs would be a lot better for users if they didn't have to have the advertisements on them." This is at a company whose nearly entire revenue was advertising based! Within that first minute, this design manager (who was a fantastic designer, by the way) had demonstrated little understanding of how his own company made money. That is, he had no real knowledge of their *business model*, and had, in the process, completely ruined his group's credibility. At that point, it didn't really matter how good the designs were because few people in the presentation were even listening.

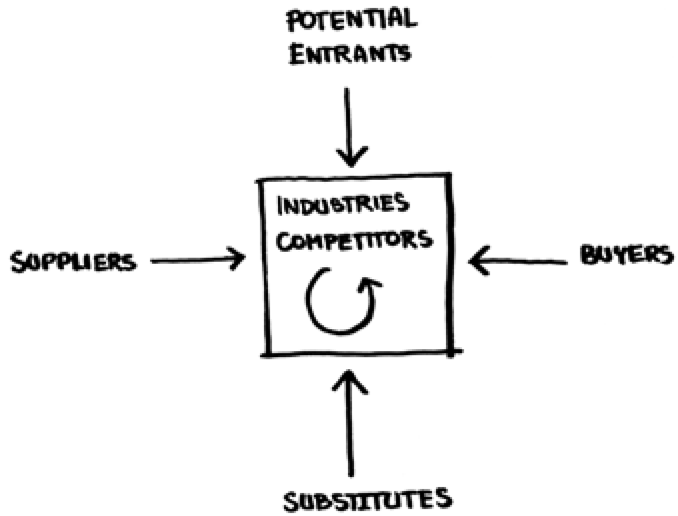
So we've got to create distinctive value for people but do it in a way that an organization can be sustained and grow. The very notion of creating an innovation chain by walking through parts of the Balanced Breakthroughs Model provides us a high-level model and process for creating offerings that fulfill the desire of potential customers, are feasible within our firm's capabilities, and viable financially. It is something of a scorecard that allows us to judge whether our project, and company, capitalizes on emerging and converging trends.

Previous chapters have focused on understanding desirability and feasibility but this, up to now, has been more about offering a new perspective rather than providing any specific means to answer the questions we posed in Chapter 2. This is partly because, as we noted at the beginning of this chapter, so much work has been written about how to understand and win in a competitive environment. Many of the analysis methods and frameworks presented by Porter, McKinsey & Company, and *Harvard Business Review* can provide new perspectives when your intent is to deliver distinctive value. We regularly use the well-known SWOT, McKinsey's 7 S's and 3 C's, Porter's Generic Strategies, Blue Ocean Strategies' value curves, and position maps to understand our company, competitors, the industry in which we are working, and offerings. You should use them too. That said, there are a number which we would like to share: Porter's Five Forces, scenario planning, Doblin's Ten Types of Innovation, and the value web. First let's consider the venerable Five Forces.

Porter's Five Forces

If there is a Sun Tzu of modern business strategy, it would have to be Michael Porter. A leading professor at the Harvard School of Business, Porter's ideas on competitiveness represent the foundation for strategy courses taught today throughout the world. His first book, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (1980) is a landmark study of how firms understand the dynamics of their industries. In it, Porter introduced a series of tools for understanding various parts a company's ecosystem. His ***Five Forces*** represent a unified generic framework that every MBA uses and is applicable to entire companies or, more granularly, to new product or service ideas. It is good practice to quickly complete a Five Forces evaluation whenever seriously considering some concept to bring to market.

PORTER'S FIVE FORCES



The Five Forces driving industry competition and a new offerings success include:

Suppliers | *What is the bargaining power of suppliers?*
Suppliers can enable or strangle your business so it is essential to understand them well. Embedded within this larger question of bargaining power are sub-issues to consider like what are a supplier's switching costs? What is supplier concentration compared to firms concentration? What is the threat of forward integration—could they take your place with a few moves?

Potential Entrants | *What is the threat of new entrants?*
Industries are more or less likely to allow for new competition. For example, the travel agents industry is highly deregulated, has virtually zero start-up costs, and has exploded in the last decade while the oil industry is incredibly difficult to enter and has gone through a slow march to consolidation. A few of the finer points to consider with potential entrants include barriers to entry, switching costs, capital requirements, access to sales channels and distribution, and brand equity.

Buyers | *What is the bargaining power of customers?*
Some markets allow for extreme power over buyers while in others, buyers have considerable power. A few keys issues to consider when examining buyer position include the firm to buyer ratio, buyer access to information, volume, switching costs, the ability to integrate backwards and replace you as a supplier, and most importantly, buyer price sensitivity. Again, knowing these issues or, at least knowing what you don't know, sets you and your team up for good recommendations on research and execution plans.

Substitutes | *What is the threat of substitute products?*
Honestly, this is one of the most difficult questions to answer. If you know of substitutes you assume you would consider them in your product and strategic planning. Unfortunately, all too regularly firms are caught off guard by new entrants to their markets either because of new capability developed by a competitor, entrants from other markets, or a simple new elegant solution that more appropriately meets the needs of customers. We suggest innovators regularly examine problems and solutions in terms of their specific form, larger category, generic benefits, and budgetary level. Remember to address the benefit, not just continue to crank out products because that's what you has always been done. As a former CEO of Black & Decker once proclaimed, "People want holes, not drills."

Industry Competitors | *How intense is the rivalry between existing firms?*
Anyone who has worked both in growing and flat markets can attest to the difference. Competition, while intense in growing markets, just do not reach the same level as in flat markets. Growth greases the wheels, allows for less optimized and exploratory workflows, and nice paychecks. As markets mature, the number of competitors, lower rates of growth, control of channels, exit barriers, focus on brand, and large marketing budgets generally create rivalries between firms that shed a lot of red on balance sheets. Be prepared to spend a lot—or have a fantastically elegant solution—if you're entering an intensely competitive market.

The Porter's Five, like most of the tools in *Naked Innovation*, forces individuals within organizations to look outside in the world. It doesn't provide specific answers but better informs the more basic questions we have to ask ourselves about what distinctive value we are, we should, and we will deliver in our industries. While the Five Forces model is largely focused on the here and now, another tool we use is more focused on the many potential futures *which could be*.

Scenario Planning

Scenario planning was first formally developed by the U.S. military and then put into famous application in the corporate world by Pierre Wack at Royal Dutch Shell. While it sounds mysterious, humans are pretty much always doing some level of scenario planning. Think about this morning before you left your house or hotel room. As you were getting ready, you were playing out what may or may not happen that day in your head. If the traffic was bad, maybe you should leave a bit earlier. If a meeting went well this afternoon, you may have to work extra hours this weekend. The basic gist is that you consider the fact that external forces impact your actions and thus could create any number of possible futures.

Scenario planning as executed in a corporation or an innovation project is similar but far more organized. It is also focused on the extreme, especially negative ones which would drastically change the landscape. Using scenario planning in the early 1970s, Royal Dutch Shell considered the story of a world in which oil supplies were at issue and prices skyrocketed. While their competitors focused on optimizing their own operations around the known, Shell pushed forward with an array of expensive investments and long term pricing contracts. These paid off when an extreme in one of the big trends they were considering, the instability of the Middle East, reared its ugly head and caused the oil crisis of that decade. While the rest of the leading petroleum companies, the so-called Seven Sisters, were scrambling, Shell profited handsomely. Scenario planning can be used to mitigate risk and prepare for the future but also as a generative tool on innovation projects. Telling stories of the future and then imagining how your client or firm could

succeed in them is an untapped method for new ideas and strategic planning. The point is not to try to discover the one "true" future but to realize there are many ways the future can end up and being actively prepared to deal with a combination of them. We might not be able to define the future but we can, indeed, use our resources to shape it. The basic steps of scenario planning are these:

- Identify a focal issue or decision
- Research and list key trends related to it—make sure to cover trends in Politics, Economics, Society, and Technology (PEST)
- Score trends based on significance to the problem and uncertainty—more significant trends that are less certain should get more weight and come up on top
- Select the top two trends from your scoring
- Create a position map with the two trends which illustrate extremes in their possible outcome
- Define the quadrants with relevant names
- Make scenarios, or stories of the future, which pertain to the quadrants
- Use these stories to spot opportunities and risks for your innovation project
- Incorporate these insights into your solution or road map

Frankly, scenario planning is a method which really requires a bit more explanation than we can provide in Naked Innovation. We would strongly suggest you check out one of the several excellent books on the topic; personally, we like Peter Schwartz' *Art of the Long View*.

So now (if you didn't know it already) you know Porter's Five Forces and a bit about scenario planning. We've promised to outline Doblin's Ten Types of Innovation but the power of the Ten Types is so great that we'll spend the entire next chapter doing it. We'll also cover Value Webs in Chapter 9: Using Frameworks.

Before You Go On...

Let's review the keys to strategy in Naked Innovation.

- The focus of strategy as it pertains to innovation is not on competitors but on delivering *Distinctive Value* to people.
- The new logic of value creation in this increasingly competitive environment is *outside-in* in nature by *identifying value, communicating value,* and then *delivering value.*
- This new focus of strategy and logic of value creation does not invalidate the traditional tools for strategy but forces us to use them in new ways. Use Porter's Five Forces, SWOT, etc. In addition, new tools like Value Webs and the Ten Types of Innovation need to be created to address the new dynamic—more on these in coming chapters.

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