Spinning the wheel of strategic innovation

This century wealth will be created through strategic, rather than product, innovation. But how can truly innovative strategies be developed when firms see themselves as operating in a mature market and adopt almost identical strategies to competitors? Chris Styles and Jules Goddard suggest the “Strategy Wheel” – an eight-step model – as a solution.

The aeroplane, TV, mobile phone and PC were all significant, discontinuous product innovations that created new markets, industries and wealth in the 20th century. Whatever their origins, major product breakthroughs are difficult to achieve and sometimes out of reach of firms with limited resources. As suggested by leading authors such as Gary Hamel and Costas Markides, there is, however, another kind of innovation – strategic innovation – that will be critical for survival and growth in the 21st century and is only limited by a firm’s creativity and courage.

In the last 20 years a new type of business hero emerged – not the product inventor but the inventor of strategy. Michael Dell, Anita Roddick and Richard Branson didn’t invent the product categories they sold (computers, soap and airlines had been around for sometime before they arrived). Rather, they invented new business models – or strategies – for selling them. As markets globalise, competition intensifies, and both consumers and investors become more demanding, strategic innovation will not just be
left to a handful of insightful entrepreneurs but will become a necessary weapon for corporate survival and growth.

In the next section we outline the problem of the “maturity trap” – how and why strategic convergence happens in most industries, leading to them being labelled mature. We then show how using strategic innovation – through a heuristic (“aid for discovery”), or model, we call the “Strategy Wheel” – can help firms get out of this trap.

The power of the Strategy Wheel is that it forces its users to be explicit about the assumptions underlying a firm’s and an industry’s dominant business models, challenge them, look into the future and devise radically new strategies. Rather than another strategy “product”, the Strategy Wheel is a framework that brings together existing strategic ideas into a structured, coherent whole.

The maturity trap

We often hear managers and CEOs refer to their industry’s maturity as the reason for declining margins and slowing growth. This tendency is perhaps at its most extreme in the automobile, telecoms, financial services and airline markets. With such a large number of players, excess capacity and limited product innovation – classic signs of industry maturity – what should we expect?

But in each of these industries we can find standout examples. Southwest Airlines, for example, has had an average operating margin over the past decade of close to 12 per cent compared with other US airlines that have struggled at around a quarter of that level. And revenue growth has been about three times the industry average.

More often than not, these standouts are firms that have broken out of their industry’s strategic convergence and are doing something genuinely different that customers like and reward. Investors reward this with higher valuations.

How do firms fall into the maturity trap? Most compete in industries with a set of players that essentially follow the same strategy. They compete by trying to outperform each other in areas of implementation, by being better at the same game. These firms see the world the same way and make the same assumptions about how to compete.

The pressures on competing firms to imitate each other – and thereby deny themselves their wealth-creating potential – are powerful and pervasive:
The myth of a single standard of excellence, the one right way to compete (“world class”)  
The practice of benchmarking in pursuit of this standard (“shoal effect”)  
The power of habit and the instinct for herding (“safety in numbers”)  
The faddish quality of managerial panaceas (and their shrinking half-life)  
The aversion to risk that is built into managerial capitalism (“the agency problem”)  

This is a game of operational effectiveness rather than real strategy. Customers see little difference and therefore their choices are largely based on price. The impact is a self-fulfilling prophecy: margins spiral downwards, customers have limited choice and are dissatisfied, and workers are increasingly stressed because they are constantly asked to do more with less as cost cutting appears to be the only way out. The mature industry becomes even more mature. And because managers tend to move around in the same industry (everyone is looking for “industry experience”), existing thinking is reinforced and new ideas are scarce.

In contrast, firms that outperform the market challenge and overturn some accepted assumptions of the industry. These firms have a different “theory” on how to compete and construct a different business model – they invent a new game and are genuinely different from industry rivals. This comes from innovation, entrepreneurship, leadership and real strategy. In these firms, managers recognise the importance of identifying and building internal resources and capabilities that are scarce and valued by customers, and then leveraging them in innovative ways.

The innovative aspect of their strategy may be the product or service offering or it may be some other part of the business model, such as pricing, distribution methods, customer service, the way the firm communicates with its customers or some combination of these. These strategies usually address a customer insight or deep customer dissatisfaction that rivals have missed or ignored. Customers are therefore more willing to pay a price premium and reward the firm with healthier margins. In these situations strategy takes the firm, the industry and its customers into the future, rather than keeping them anchored in the past.

In recent history many industry radicals have been newcomers and not incumbents (Dell and Compaq, Body Shop and L’Oreal; category killers such as Toys R Us and Home Depot versus traditional department stores). But it need not be the case. The difference between maturity and innovation is mind-set – the way managers think. In an age of busy, over worked managers endlessly “doing things”, it’s time to once again recognise that management is an intellectual discipline as much as a behavioural one. To be different, you have to think different.

In summary, the key elements of strategic innovation are:

- The firm is seen as a pool of scarce and valued resources and capabilities that are leveraged via a particular business model or strategy  
- High returns come from challenging industry-wide assumptions, not adopting the same “sensible” policies as everyone else  
- Inspiration should come from customer dissatisfaction, boredom and a feeling on their part that there is no choice  
- Radical, discontinuous change creates more value than incremental improvement in operational effectiveness  
- Strategy focuses on shaping some aspect of the future environment

The argument for strategic innovation is a strong one and voiced by a number of academics and consultants. However, the problem strategists face is how to create these innovative strategies from a blank piece of paper. That is, how to find a rational way to, in effect, think irrationally (from the industry’s point of view).

There are, of course, already a number of concepts, tools and techniques which relate to some aspect or other of the ideas behind strategic innovation. For example, business model analysis and design, contrarian and lateral thinking, scenario planning, competitive analysis...
of current and future rivals, various customer research techniques, brainstorming, performance measurement and direction setting to name a few. The problem is how to fit them all together in such a way that a coherent and truly innovative strategy can emerge.

The Strategy Wheel framework

Our suggested Strategy Wheel aggregates and structures the strategic tools available into a coherent “process of discovery” that aids the development of innovative strategies. It also leaves way for new tools to be added as better ways to address each part of the process are found. The Wheel is derived from a 2 x 2 matrix (no points for innovation there!) with the two dimensions being internal, or “in here” (firm and its resources), versus external, or “out there”, (market place); and today (current operating environment) versus tomorrow (environment approximately five years out into the future, reflecting the average time taken to fully implement a new strategy and see its results).

Each cell is then further split into two segments consisting of the key strategic questions that need to be addressed at each stage. Here we add Socrates to the list of strategy gurus with his approach of asking the right questions. Often managers focus on getting their answers correct – usually to multiple decimal places – rather than thinking about which are the right questions to ask. It is surely better to be vaguely right in answering the right questions than precisely right answering the wrong ones.

![Strategy Wheel Diagram](image_url)

Figure 1: Strategy Wheel

How well is the business performing?

What is the winning formula?

Who do we see as the competition?

Which beliefs unite the industry?

How will the new world impact customer priorities and industry landscape?

How might the world change over the next five years?

What strategic business design is needed to realise this opportunity?

What strategic opportunity has the greatest potential for value creation over the next 5 years?
The set of questions suggested by the eight segments are graphically presented as the Strategy Wheel in Figure 1, with the shape of the framework suggesting the active process — giving the Wheel one complete “spin” represents one pass at developing a strategy for a firm or brand.

**Step 1: performance measurement**

The importance of performance measurement has made it a billion-dollar business and there is no shortage of methodologies and checklists. Many are robust and useful for this first part of the Wheel. Whatever techniques are used, however, the focus should be on value created – for customers on one hand and shareholders on the other – with explicit links being made between the two.

**Customers:** Despite the last 10 years of emphasis on market orientation and customer focus, many firms still focus more on their financials than their customers. The irony is, of course, that the route to healthy financials is happy customers. As John Kay has pointed out, business is like John Stuart Mill’s Oblique Principal, explained elegantly in relation to one’s personal happiness: “Those only are happy who have their minds tried on some object other than their own happiness…”

Great businesses seek innovative ways to create value for the customers they serve and in doing so create value for their shareholders. There are, of course, numerous customer-based measures available. But care is needed before blindly adopting a standard customer satisfaction measure (an attitudinal measure). There may be others (for example, behavioural measures such as retention or repeat buying) that are more powerful and reflective of the value being created for the customer. Also, be sure to make measures relative where possible, for example, relative satisfaction, relative price, and reflect the firm’s/brand’s market positioning strategy.

**Shareholders:** Shareholder value is simply the estimate of future cash flow a firm will generate. It is directly related to the customer measures (which drive inflows) as well as the relative scarcity, utility and sustainability of the firm’s internal resources and capabilities (which drive price premiums and operating margin). It should also reflect the firm’s ability to seize and create new opportunities into the future, rather than relying only on current sources of revenue.

**Step 2: current business model**

Influenced by the work of Day and Slywotzky, we suggest analysing the business model according to the 5 As Star (see Figure 2): audience (choice of served market); appeal (unique value proposition); access (channels of communication and distribution); activities (what the firm chooses to “make” or do internally and “buy” or outsource); antagonists (rivals targeting the same audience). Each point of the star reflects a strategic choice – who to serve, what to offer. It is at this point that a number of questions start to be asked. How different is the firm’s star from its rivals’ – or has strategic convergence set in? Does everyone in the organisation have a clear and shared idea of what these choices have been or is there some confusion and debate? Have we made focused choices or tried to be all things to all people?

For example, in the automobile industry it would be hard to separate the business models of General Motors and Ford – both serve a multitude of segments, compete essentially on “value for money”, use mass advertising to communicate and dealers to sell, create massive scale to drive down costs and compete, essentially, with each other.

BMW, on the other hand, focuses on one segment (status conscious, quality seekers), appeals to them through a promise of the ultimate driving experience (combining sport and luxury), communicates with their customers through well-targeted events, sponsorships and Formula 1 involvement and targeted media exposure, concentrates on brand management and design, and competes against a range of up-market car brands and other prestige products (for example, boats).

While some components are similar (for example, the use of exclusive dealers – a regulatory requirement in many cases), the GM/Ford versus BMW models are quite different. Mercedes Benz was in a similar race as BMW — although targeting a more conservative market with a different appeal – but it, too, seems to have adopted the “one right model” of massive scale through its merger with Chrysler. It is now trying to fill every niche and advertises how “affordable” ownership of a Mercedes is. At one point, its web site focused on communicating information on cost savings, volume and its performance under difficult market conditions. BMW’s site talked about innovation.

**Step 3: competitor analysis**

It is important in this step to look beyond obvious competitors. The strategist needs to separate form (product) from function (benefits), consider the whole value chain and think laterally about who has the resources and capabilities to move into the firm’s space on their own or in combination with others.

We suggest assessing competitors at three levels: immediate rivals with similar business models; firms occupying other parts of the value chain...
that could potentially move further upstream or downstream; and “oblique” competitors – firms currently outside the value chain that have the potential to satisfy the firm’s target audience through some new, innovative business model that leverages existing resources.

Collectively, these competitors are can be represented on a “radar screen”, similar to that suggested by Slywotzky, with some posing a stronger threat than others.

Again using BMW as an example, we would cluster the other auto-makers around the centre, with some being more “dangerous” than others. Then upstream we would look at designers, component manufacturers and so on. Downstream, we would include dealers, finance providers, insurers and so on.

For the oblique competitors, we could consider those with strong, prestige European brands: Gucci, for example (BMW has already leveraged its brand into “lifestyle” products so why couldn’t the reverse happen?); new retail models (AutoBytel); other branded modes of transport (British Airways); car rental firms; and even producers of alternative energy sources. These all have the potential to impact the appeal and viability of the BMW business model.

An interesting exercise is to construct the most dangerous combination one can think of. For BMW one could imagine a global financial services firm (HSBC) combining with a global rental car firm (Hertz), a comparable auto brand (Alfa Romeo) and an alternative energy source provider (Shell) to produce a powerful competitor that combines a strong, up-market automobile brand running on clean fuel purchased through lease finance and providing customers with access to a number of models as part of one purchase through a global swap mechanism (SUV during weekends; sports saloon during weekdays). This analysis also starts to suggest where some interesting opportunities may lie for the firm itself.

Step 4: challenging industry assumptions

This step identifies the core assumptions held by current industry players. The task is to understand the “dominant logic” of the industry and the current “rules” of the game. This would include assumptions about:

![Business model](image)
Some of the assumptions made about these aspects of the business may well be correct. But others may have once been correct but are now false or were never correct and never tested. These then become the object of contrarian thinking, whereby each underlying assumption is systematically challenged.

Business definition is a good place to start.

Was (is) Apple Computer in the computer business with rivals such as IBM (originally) or was it in the computing (interface) business with rivals such as Microsoft? If this question had been asked in 1987 might Apple have become a software firm that leveraged its icon-driven operating system before Microsoft? A chemical firm recently rethought its business from being a supplier of a surfactant, a cleaning agent (product definition) to being in the “clean clothes” business (customer solution definition) with dramatic scope for business redefinition.

When financial planners and advisors emerged in the 1980s, the conventional wisdom among investment houses was that they were competitors. Charles Schwab saw them as customers and set up back office services for these intermediaries. Stockbrokers have traditionally charged commissions for each transaction but the real value they provide their customers is not conducting the transaction itself (as online broking has revealed) but in the advice they give. The old pricing model can be challenged.

Many of the assumptions made relate to customers or what suppliers believe customers value. Until Lexus, the assumption by prestige car makers was that “prestige” came from leading-edge German engineering. Lexus believed that in addition to engines, prestige comes from having a luxurious interior.

A useful input into this stage is the result of studying customer dissatisfactions. These often reveal shortcomings of current industry practice and opportunities for new business models. For example, in the mobile phone market, customers are becoming increasingly confused and frustrated by the complex pricing and tariff plans
<table>
<thead>
<tr>
<th>Wish list</th>
<th>Revealed dissatisfaction</th>
<th>Opportunity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Options given are simple to understand</td>
<td>Financial matters are complicated</td>
<td>Simplify/demystify financial matters</td>
</tr>
<tr>
<td>I understand what they are talking about</td>
<td></td>
<td></td>
</tr>
<tr>
<td>They made it easy to understand</td>
<td></td>
<td></td>
</tr>
<tr>
<td>They showed me simple comparisons</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I enjoy talking about my financial matters with them</td>
<td>Financial management can’t be enjoyable (and is therefore to be avoided)</td>
<td>Financial management is exciting, fun and enjoyable (and is therefore to be sought out)</td>
</tr>
<tr>
<td>I feel comfortable with them</td>
<td></td>
<td></td>
</tr>
<tr>
<td>They were pro-active and contacted me about exciting products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It was a pleasure doing business with them</td>
<td></td>
<td></td>
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<tr>
<td>I am so happy my broker treats me with respect</td>
<td></td>
<td></td>
</tr>
<tr>
<td>They take their commission when we make money</td>
<td>Financial services firms are more interested in making money for themselves than their customers</td>
<td>Customer focus through performance-based fees</td>
</tr>
<tr>
<td>Investments advised are accurate in performance</td>
<td></td>
<td></td>
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<tr>
<td>The service I receive is good value for money</td>
<td></td>
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<tr>
<td>They rang me to tell me about a new investment option that went really well</td>
<td></td>
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<tr>
<td>They do all my stock-broking for free</td>
<td></td>
<td></td>
</tr>
<tr>
<td>They doubled my money in only one year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I would trust them to manage my investments blindly</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 1  Dissatisfaction in financial services
they must choose between. A solution whereby the plan a customer is on is automatically adjusted periodically depending on actual usage would be a truly customer-centric form of customer relationship management.

To illustrate the usefulness of dissatisfaction research, Table 1 shows some outcomes of research among customers of financial services (personal investment advisors). The study probed customers’ wish lists – what they really want but can’t get. This revealed a number of underlying industry-wide dissatisfactions that represented possible opportunities for existing or new providers.

**Step 5: understanding the future (macro view)**

This step looks into the future at a macro level and techniques such as scenario planning are therefore useful. It involves understanding trends (those parts of the environment that you are reasonably certain about (such as an ageing population in Western countries) and identifying uncertainties such as cities continuing to be residential and working hubs compared with a new breed of knowledge workers choosing to live in less crowded and polluted semi-rural areas and telecommuting. Trends are played out under different conditions of uncertainty and scenarios emerge.

Once various scenarios are developed, strategists can assess which are most likely, which are more advantageous to a firm or brand and which pose the biggest threat. Then, rather than just be prepared to face whichever scenario develops, strategists should identify actions that the firm could take in the short-term that may move the environment more towards their favoured scenario.

This draws on some of the principles of complexity theory and “the butterfly effect”, whereby a small change in the “initial conditions” of a system (such as an industry, country or region) can have substantial impact on the end state. The future is not predetermined and we should not look at the environment as fixed. However, understanding the system, and the interaction between the key variables that shape the system, is a useful exercise in itself.

**Step 6: understanding the future (industry perspective)**

This focuses on the micro level and requires thinking about how both the demand and supply sides of an industry may change as a result of the macro-level scenarios developed in Step 5. It is useful here for strategists to think about the “customer of the future” by developing broad “customer archetypes” associated with each of the major scenarios.

These archetypes are profiled along dimensions such as key needs and problems to solve, values held and the kind of value propositions that will appeal most. For the supply side, strategists using the Wheel have been asked to “draw the industry” – produce a picture to represent how the industry landscape will “look” in the future. This has its roots in the work by Mercer Consulting and its representation of “profit patterns” but goes much further into graphic representation in an attempt to encourage strategists to draw on “both sides of the brain”.

**Step 7: developing a strategic ambition**

This step calls for the development of a succinct, customer-driven statement of ambition for a firm or brand. This is to give purpose to a firm and should represent an ambitious “stretch” rather than a comfortable “fit”.

This form of statement contrasts with what mission statements have become – bland statements of the obvious that are largely interchangeable between firms and therefore not strategic in the sense of providing a point of difference. The tasks in this step are to identify major opportunities (based on the analysis of the previous steps), rank them by value-creation potential and then encapsulate the biggest opportunity into a customer-centric statement of ambition.

Examples of statements that were both strategic (staked out a clear point of difference) and ambitious (stretch versus fit) as well as customer centric, were CNN’s original ambition to become a global news network and not a traditional network model, which was locally based and covered a range of programming; and Disney’s vision of...
becoming an integrated entertainment company of such excellence that people would want to spend some of “their valuable time with us” rather than a film production company that it and all its rival Hollywood studios were in the early 1980s.

Step 8: new business design

The final step contains two tasks. The first is to design a new business model that will achieve the strategic ambition; the second is to reassess a firm’s asset pool to decide what resource base is needed to enact the new business model. Some skills and assets will no longer be needed while others will have to be acquired through mergers and acquisitions, strategic alliances, organic growth or some combination of these.

To assist in this asset reconfiguration, we suggest using the visual representation of Figure 4. The guidelines are as follows:

- Assign a dot to each strategic asset currently within the firm’s boundaries
- Create a boundary around these assets. This is the current configuration of the firm
- Assign other dots to those strategic assets that currently lie outside the firm’s boundary that are needed to enact the new business design.
- Then, create a boundary around all of those strategic assets (whether currently inside or outside the firm’s boundary) that are required to enact the new business design. This is the desired future configuration of the firm.
- Are the strategic assets that lie outside this new boundary more valuable to someone else? (disposal candidates)
- Should those strategic assets needed to enact the new business design, but outside the current configuration, be bought (acquisition), created (organic) or be shared (joint venture or other form of alliance or long-term supply contract)?

No longer safe to be safe

Staking out a genuinely different position in an industry, and the minds of customers, is critical for success. But too often we see industries in which similar business models are being adopted to the detriment of both customers and shareholders. It’s no longer safe to be safe. As markets evolve, customer priorities change and the environmental landscape shifts, firms need to design new business models or they will fall into the maturity trap with their strategically converged rivals.

The best ideas may be the most simple; they may even, in themselves, not appear too radical. Regardless, what is needed is a constant restatement of assumptions underlying current strategies and the will to challenge them. And having found a new way of competing, the firm has to be careful not to immunise their new theory of competing from criticism or refutation. The hard (and the fun) part about strategy is that there is no one right answer; and an answer that works today is not likely to work forever. Keep that wheel spinning.

Resources


