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Developing Creative Business Strategies

Mark H. Friedman
President,
RealTimeStrategy LLC,
Boston

Francis J. Gouillart
Chief Research Officer,
Value Innovation Network,
Boston

Hans Juergen Ruhland
Managing Partner,
The Nice Company GmbH,
Frankfurt

Where do creative business strategies come from? In spite of a commonly held belief, data rarely generates strategic insights. This is particularly true in broad-based, rapidly changing environments. In those environments, the breadth of investigation is so enormous that the approach falls off its own weight (or of its own cost).

Ultimately, insights come from a spark created between two components: a *creative reading of the external world*, on one hand, and *an imaginative bending of existing capabilities*, on the other. In other words, an insight is generated when an outside-in element discovered in the external world is met by an inside-out capability, reaching out to harness the external element. The process we propose in this note is aimed at generating such a spark, by linking a unique stimulus which the company senses in its environment, and a distinctive response which it produces in response to that stimulus. Without one or the other, you have “the sound of one hand clapping.”

How can this view translate into an actionable strategic process? In our experience, the true creative cycle starts with *hypotheses*, then explores those hypotheses through a *combination of experiments and data analysis*, that eventually reveal *strategic insights*. In other words, starting with the answer (or at least a set of possible answers) is a more effective way of discovering the nature of the competitive terrain than to undertake a systematic exploration of that terrain.

The challenge is therefore to generate hypotheses in the first place. We believe that a combination of a process and content analogs drives the formation of early hypotheses. The process provides structure to guide and organize the executives thinking. Analog provide content input for the formulation of hypotheses.

Value Innovation is the overall framework we use to generate this creative spark between external world and internal capabilities. The key concept here is that of *Value*

Curve, a way to characterize what Key Elements of product, service and delivery a company has identified as the foundation of its value proposition.

The inside-out component of the Value Innovation methodology is not yet published in academic journals. It is also the piece based on a unique know-how designed to further reinforce the concept of Value Innovation in an applied setting.

We derive the insightful bending of existing capabilities from a methodology called *Stairway of Value Innovation*. Simply put, the Stairway of Value Innovation involves a layering of capabilities over time, producing economic results in different time horizons. This methodology can also be viewed as spiritually affiliated with Gary Hamel and CK Prahalad’s view of core competencies. It also has the advantage of being interpretable in the form of a Balanced Scorecard (you can take a Stairway of Value Innovation and drive it to a Balanced Scorecard for implementation purposes). The stairway of Value Innovation also has some elements in common with McKinsey’s Three Horizons methodology.

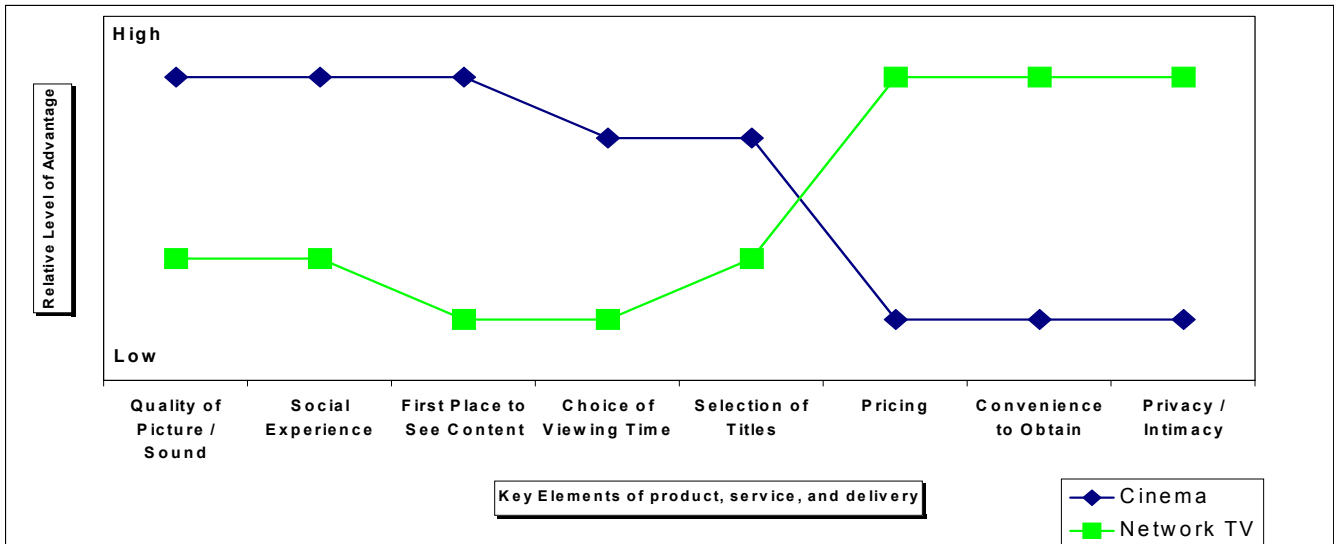
The idea behind the process is therefore to make a spark happen between a creative reading of the external world and a stretching of an internal capability aimed at harnessing the perceived external development for advantage. This, in our view, is where creative insights come from.

Generating A Creative Reading Of The External World

The process used to generate a creative reading of the external world involves two key concepts: the *Value Curve*, to characterize the “as is” offering of the firm, and the *Six Paths to Pursuing Innovation*, to modify the “as is” Value Curve for advantage.

The Value Curve

Each business can be characterized by a *Value Curve*, as described in the Value Innovation literature. Ultimately, we want to identify the key elements of product, service and



delivery we want to provide (hereafter, Key Elements). This is accomplished by asking four questions:

1. Which of the factors that our industry takes for granted should be eliminated?
This forces managers to consider whether the factors that companies compete on actually deliver value to consumers
2. Which factors should be reduced well below the industry's standard?
This drives managers to determine whether products and services have been over-designed in the race to match or beat the competition.
3. Which factors should be raised well above the industry's standard?
This pushes managers to uncover and perhaps break the trade-offs their industry forces customers to make.
4. Which factors should be created that the industry has never offered?
This helps managers break out of the industry's established boundaries to discover new sources of value for consumers.

The distillation process that follows these questions is used to generate the graphic called Value Curve. This curve

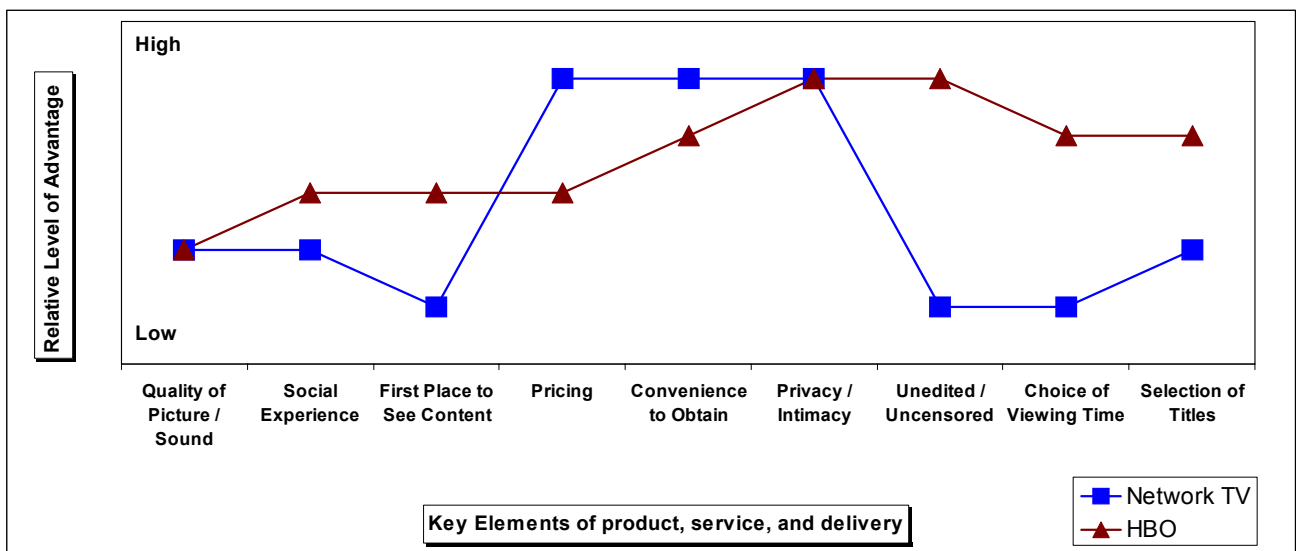
shows the Key Elements of the hypothesized offering on the horizontal axis and a relative level of advantage on the vertical axis. The curve generated in this fashion shows the point-to-point comparison of the hypothesized offer with the market's or a specific competitor's offering.

As an illustration, consider the film entertainment business, and more specifically, its distribution component.

Let us define the starting point in the history of film distribution as Cinemas (movie theaters) and Network Television. Comparing these two market offerings, we can identify 8 points of comparison. Each offer exploits these Key Elements in a different way to stake out its market space.

Cinemas dominate on elements such as quality of picture and sound, and the value of the social experience associated with going out to the movies. By contrast, Network TV has the advantage of being free (pricing), offering greater convenience to watch the movie (you don't have to go anywhere), and privacy or intimacy (you can watch the movie in your pajamas and slippers).

Now consider the introduction of HBO. HBO debuted in



1972, just after the passage of the FCC Open Skies Policy that paved the way for national pay broadcasting. The development of satellite technology also played a key role in the decisive growth of HBO that ensued. By 1973, HBO was carried by 14 cable systems. By 1974, more than 100 cable systems were carrying HBO. When HBO broadcast the Ali-Frazier fight in 1975, it had already reached national distribution.

Reviewing the HBO offering in the context of its historical competition reveals a very different Value Curve (the graph below compares HBO's Value Curve to the Network TV Value Curve). The three key Elements portrayed on the right hand side of the curve are particularly noteworthy. First, HBO capitalized on the introduction of a new Key Element we have called "Unedited, Uncensored Content." For the first time on television, viewers could enjoy films that had not been "edited for television," allowing to see movies as directors had originally intended for viewers to see them (and also allowing the private viewing of *risqué* programs in the anonymity of one's living room or bedroom). HBO also dramatically expanded the selection of movie titles one could see on television. It also broadened the choice of viewing times dramatically through its programming of movies around the clock.

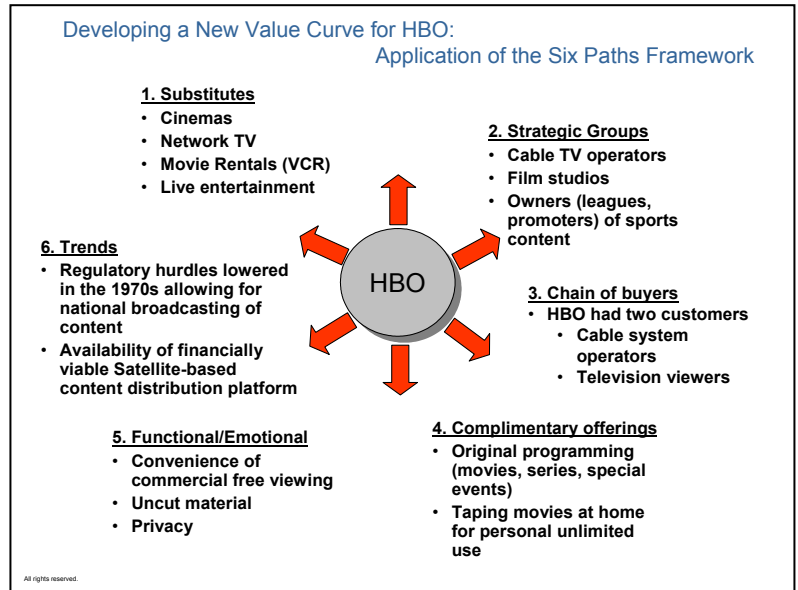
Where did these ideas come from? How did the creators of HBO determine what Key Elements to eliminate? What to reduce? What to raise? And what to create? Not having been there, we cannot say exactly. But we can illustrate how the Value Innovation process could have led (admittedly in somewhat revisionist fashion) to the definition of HBO's eventual offer.

The Six Paths to Pursuing Innovation

The Six Paths to Pursuing Innovation is a framework aimed at exploring the boundaries of the existing market space by providing a different pattern of strategic thinking. As Chan Kim and Renée Mauborgne state in "Creating New Market Space": *"Instead of looking within the accepted boundaries that define how we compete, managers can look systematically across them. By doing so, they can find unoccupied territory that represents a real breakthrough in*

value ... by looking across the conventionally defined boundaries of competition – across substitute industries, across strategic groups, across the chain of buyers, across complementary products and service offerings, across the functional-emotional orientation of an industry and even across time."

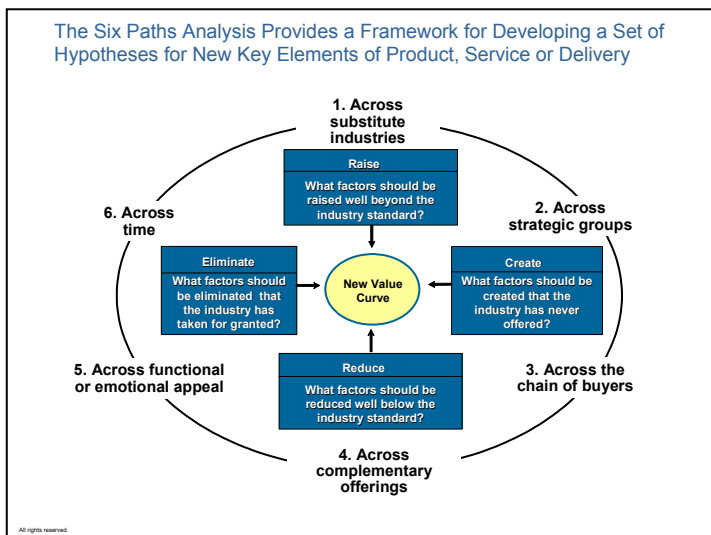
These six paths guide the executives' exploration into the market and help discover potential innovative opportunities. At the end of this stage, the leadership team is in a position to generate a set of path-specific hypotheses on how the business may evolve.



Looking at the HBO analog, we can hypothesize how the six-path framework could have been used to generate insights about the future HBO offer.

Looking at two of these paths for HBO (number two and number six), we can hypothesize what could have resulted from such an exploration.

- Looking across *strategic groups*, the HBO executive team would have found systems of cable TV operators, film studios and owners, leagues and promoters of sports content, entertainers and others, all participating in the HBO value chain, broadly defined. The team might have asked itself:
 - Could HBO's offering be extended to provide a national outlet for owners of sports content (leagues, teams, promoters), in a different form than what Network TV was providing?
 - Could original programming outside the rules of broadcast television fill a hole in the market space? More specifically, could HBO provide a national platform for comedians and actors outside the current rules of broadcast television?
 - What are the opportunities presented by the producers of film content? Could one create a new offer for cable TV operators by producing our own content?



- Looking *across trends*, the HBO team clearly realized that the FCC passage of the Open Skies Policy cleared the way for national broadcasting of pay television content. Additionally, the HBO team saw the opportunity created by the emergence of an economically viable way to distribute content through satellite-based platforms.
 - The rapid development of cable TV operators also allowed HBO to rapidly propagate its offering nationally.

We know how HBO answered those questions, extending its Value Curve over time to include more and more original programming in areas such as boxing, comedy and original series. These Value Curve extensions may be conceptualized as capitalizing on a blurring of the boundaries between historically different strategic groups, namely the producers and the distributors of content, as a result of the process advocated above.

The idea at this early stage is to generate hypotheses with minimal data, largely based on the executives' understanding of their own business and a few relevant analogs to trigger their imagination. In Value Curve terms, these ideas take the form of new Key Elements of Product, Service and Delivery. We have now accomplished the first step in what we set out to do, i.e., we have generated a potentially creative reading of the external world.

We now turn inside the business and start exploring how the business can stretch its existing capabilities and generate additional ideas for new Value Curves, this time in an inside-out process.

Bending Internal Capabilities To Harness New External Developments

How do we gain an understanding of how new Key Elements can result from a stretching of the capabilities of the organization?

To describe this, we use an analytic called the *Stairway of Value Innovation*. The Stairway is a metaphor we use to describe the layering of capabilities from today's to those required by the ultimate realization of the vision.

The Stairway has some unique attributes. Each step in the staircase is a mini-system of capabilities and processes that conspire to deliver Key Elements of the Value Curve and achieve a specific set of financial outcomes for the business. By the way, this structure of linking capabilities to processes to customer benefits to a financial results is also the one used in the Balanced Scorecard model you are quite familiar with. A Stairway of Value Innovation, once stabilized, can therefore be easily converted into measures, thereby offering a natural link between strategy formulation and implementation.

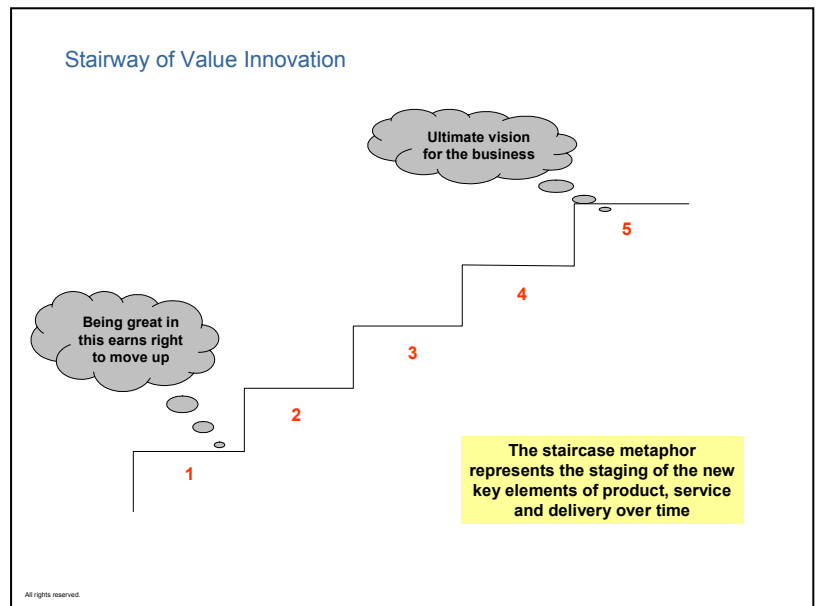
Another way of visualizing this stairway structure is to view it as a succession of waves of increasing amplitudes (rather than steps), whose cumulative effect over time will transform the company.

The last step in the stairway is the one where the Value Curve comes in full bloom. Some Key Elements of the Value Curve appear at each step, typically starting with basic economic requirements linked to competitiveness and pricing, and moving toward a richer and richer offering as new capabilities are layered on. The steps are not meant to imply a linear progression of focus for an organization. Businesses work on all steps at once, yet expectations of time-to-results is farther out as one moves from left to right.

Going back to the HBO example, we can describe the staging of the offer in stairway terms. As seen below, this view of the implementation shows HBO beginning as a national provider of uncut, commercial free movies at home. The company then furthers its offering by layering initial investments in original programming in comedy and sports. In 1990, joining Time Warner enables HBO to expand its original programming with movies and series. As the portfolio of content becomes broader, HBO is able to blanket the market with its multiplex offer.

The focus of the Stairway of Value Innovation is on capabilities and processes already in place. It invites a reflection on the part of the executive team on how these capabilities and processes can be distorted or "morphed" to deliver new Key Elements in the Value Curve. In the case of HBO, the executive team clearly reflected that it had now created a powerful capability by distributing content into consumers' homes. It then logically asked itself the question: now that I have this pipe into people's home, what premium services could I deliver to them besides movies? This led to the progressive extension of HBO's offering toward comedy (step 2) and movies made for HBO (step 3).

In similar fashion, the HBO executive team realized it had created a powerful brand with HBO and Cinemax. It then proceeded to stretch these two brands by creating its



multiplex offering of HBO1, HBO 2, Cinemax 1, Cinemax 2, etc. (step 4). The promise of video on-demand represents another capability which will generate another extension of HBO's Value Curve (step 5).

The academic literature is full of passionate debates about the relative merits of an outside-in and an inside-out approach to strategy. Our Value Innovation approach takes the ecumenical viewpoint that creativity exist in both components. Ultimately, an insight occurs when a Key Element generated by a creative reading of the external world connects with a stretched capability developed by the firm. The hypothesis generation process we advocate explores both components with equal vigor.

Validating The Hypotheses Created: The Role Of Analytical Research And Of Strategic Experiments

We now have a hypothetical Value Curve and a hypothetical Stairway of Value Innovation for the business in the larger context of the corporation. How do we validate this?

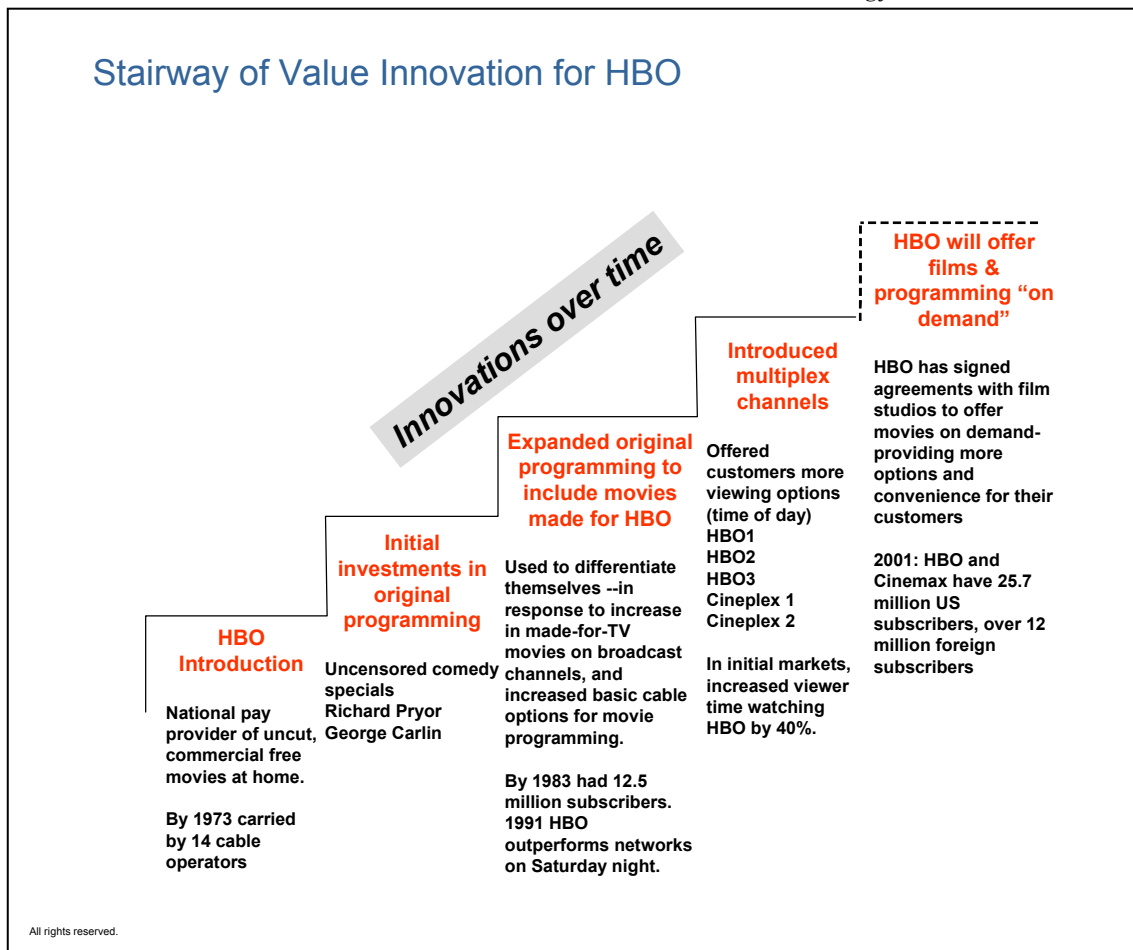
Validation is a combination of *thought experiments* (submitting the hypothesis to the fire of focused analytical research) and *actual experiments* (really doing stuff and see if it works).

Thought experiments are well understood, and involve the

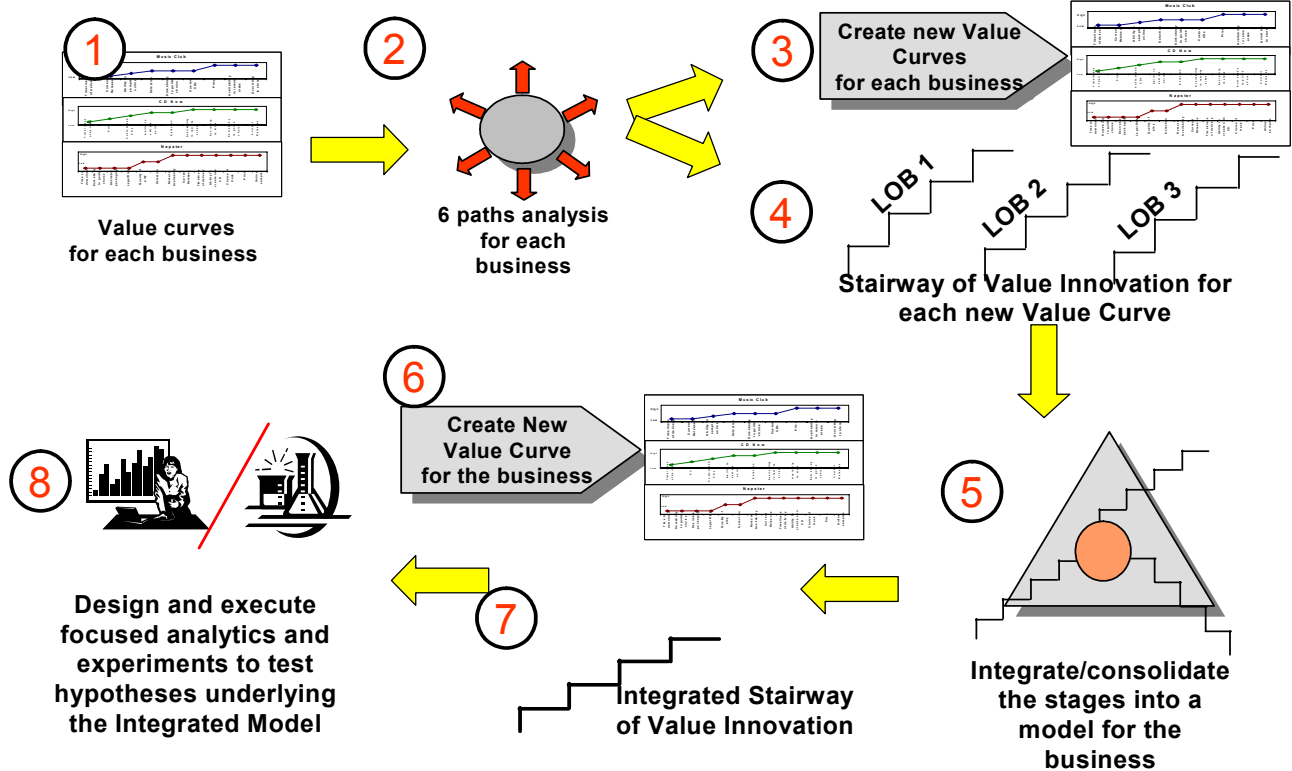
discipline of investigation. For example, in our next-to-last step for HBO ("ubiquity"), we can clearly learn a lot from an investigation of the market share of cable modems vs. DSL lines, typical content being downloaded over these systems, etc. This is classic strategy research. Notice however that this research is now done in the context of very specific hypotheses generated by the business leadership team, rather than as a massive, "boil-the-ocean" exercise.

In other cases, the only way to learn whether an hypothesis is sustainable or not is to set up an *actual experiment* and see whether it produces the expected result. Take our last step in the HBO staircase (the "all-in subscription" hypothesis). Today, because there is no such service, there is little to study (besides a few smaller-scale analogs). The best way to learn about the validity of such a step is to set up an actual experiment where HBO is actually distributed through an "all-in subscription," over a small geography, in the context of a broader AOL Time-Warner experiment. There again, this experiment is performed in a strategic context, with an explicit mandate from the leadership team, not as part of a "let's a thousand flowers bloom" runaway process.

In the Value Innovation approach, experiments are framed in the context of an overall strategy. Every step is itself a macro-hypothesis, but there is a consistent whole whereby those experiments reinforce each other in a game of increasing ambition. The combination of thought experiments and strategic experiments produces the validation of the strategy over time.



An 8 Step Process for Developing a Creative Multi-Business Strategy



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Summary and Conclusions

We have outlined an eight-step process for developing creative business strategies for a multi-division business. As we think in terms of a multi-division value proposition, this process could look something along the following lines:

In Step 1, we develop Value Curves for each line of business (e.g., retail bank, credit card, brokerage, etc.). In Step 2, we use the six-paths framework to explore innovative ways to create new value for each business individually, given their external environment. This results in hypothetical new Value Curves for each business (Step 3). Simultaneously, we explore whether the capabilities of each business can be stretched into new capabilities, represented by a Staircase of Value Innovation (Step 4).

In Steps 1 through 4, we operate at the level of the individual business. Once we have done this, we bring together the businesses that comprise the multi-business enterprise (Step 5). By de-constructing the various Value Curves associated with the various businesses and re-assembling them creatively, we produce a new Value Curve (6). Similarly, we produce a new Stairway of Value Innovation (7) by decomposing and re-assembling the capabilities of each individual business, thereby generating the template for the new business model of the organization.

In Step 8, we outline the combination of thought experiments and actual experiments required to validate the new Value Curve and Stairway of Value Innovation, and provide the foundation for implementation.