Breakthrough Thoughts
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The New Strategy and Why It Is New

Once the subject of annual planning, strategy today must live inside the fiber of the enterprise.

Senior executives used to know what a strategy was: a multiyear plan to create or protect a defensible competitive advantage in the marketplace. Often it was based on creating long-term advantage through scale and physical assets. Industrial giants like United States Steel and the General Motors Corporation were built through just such a focus.

However, in many — maybe most — industries, the old approach to strategy no longer holds. The world in which economies and institutions operate has changed dramatically, thanks to three revolutionary, if familiar, sources of business upheaval:

• **New and disruptive technologies** create uncertainty. Value chains are transforming, creating new sources of value that can be exploited by new as well as existing players able to create and leverage innovative business models. In this environment, competitive advantage is often short-lived. We can determine strategies to win today, but we can only guess at what will be required to win tomorrow.

• **Deregulation and globalization** are making the economy more efficient as well as more volatile. In an increasingly deregulated world, competition forces business models to adapt quickly to meet customer needs, and to do so on a global basis. More efficient transactional relationships allow companies to focus on specific links in the value chain, while participating in (and competing as) extended, coordinated chains. With these new structures, technological and strategic innovation can be more quickly leveraged across global markets.

• **Capital markets** have become more efficient, putting more pressure on senior executives to increase shareholder value. It is no longer sufficient to manage the existing business competently; executives must create new growth platforms to drive substantial growth in shareholder value. Failure to meet expectations can result in dire consequences for management.

For these reasons, in many industries, the old approach to strategy is under assault.

Today, the long-range planning

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process, usually employed to craft strategy, functions mostly as a feed into the budgeting and coordination procedures necessary to run the business from day to day. Its methods for managing operations are woefully inadequate for determining the actions, priorities, and decisions required to win in today's markets. These traditional strategic-planning efforts may fulfill the planning function, but they are no longer strategic.

The simple fact is that strategy and decision making — functions that for decades were causally related and sequenced — are becoming increasingly difficult to separate. Whereas strategy once determined the decisions and transactions necessary to advance the company, today operational decisions and transactions can often redefine the company's strategy and thus alter the path forward. In this interlinked environment, strategic learning by the management team can be as important as the strategic plan. And adapting the strategy is as crucial as the initial approach.

No firm should ever abandon its traditional focus on the underlying economics of its business. Nor should senior executives cease trying to identify the fundamental levers for creating and capturing sustainable customer value. But traditional strategies aimed only at shaping and protecting long-term positions need to be supplanted by a focus on continuous transformation, to forge capabilities required to win in the next game. And the next. And the next.

Managing a Fleeting Advantage

For all the changes in global and sectoral economies, the principal objective of business — and thus the objective of strategy — has remained fairly stable: to earn superior returns on shareholders' capital. Strategy development, therefore, still must start with a fundamental analysis of what it takes to win in the market — what creates customer value, what drives costs, and how to maximize profit.

But in today's fastest-moving industries, the methods for developing a strategy have changed. The time dimension is different. It used to be sufficient for a firm to create a strategy, build the facilities and capabilities to support it, and plan for a strategic position that could be ensured for five years, often longer. For example, finance, organization, technology development, and marketing models enabled General Motors to surpass Ford Motor Company in the late 1920s and kept GM the world's No. 1 vehicle manufacturer for the rest of the century.

Now, competitive advantage is so transitory as to be meaningless. The accelerating pace of technology transfer, the velocity of communications, and the speed of global capital flows require companies to do much more than defend a static definition of the enterprise; they must continuously evolve from strategic position to strategic position. So, in addition to strategizing to capture value from the company's current position, companies also must base their strategies, at least in part, on creating options to occupy future positions that may have value.

The Nokia Corporation, for example, was a small Finnish industrial conglomerate that transformed itself into the world's leading mobile telephone company. But, even as it was solidifying its lead in the mobile market in the late 1990s, Nokia's management was fully aware of imitators that could unseat the company. It's no surprise that Nokia has been focused for several years on laying the groundwork for winning the next game — which it believes is 3G (third-generation) mobile communications technologies.

Navigating Value Constellations

Strategy also has its spatial dimension. When a company (or its business units) operated within a linear value chain, it was a relatively simple matter for a single firm to identify, secure profit from, and protect its value-added activities.

Now, the information and transaction costs that historically led firms to vertically integrate have declined to the point where firms, and even entire industries, have an impetus to dis-integrate. The linear value chain is, in many industries, developing into a three-dimensional value web or constellation, where both threats and opportunities can arise more easily in almost any one of a firm's competencies or capabilities. Companies are thus changing from self-contained value-creation and -capture mechanisms into members of interdependent ecosystems wherein the responsibility for value creation and the right to value capture is continually negotiated among all participants.

In an economy of value constellations, companies increasingly must build extended enterprises, because competition is no longer between individual enterprises. For a contemporary example, consider the airline industry, where increasingly the battles are not between individual carriers, but among alliances of multiple carriers and the suppliers who support them.

As the constellation model indicates, there often is opportunity in moving from protecting the existing business franchise to creating and capturing new sources of value along the entire chain and across the total customer life cycle. There also is risk for a company in ignoring noncompetitive parts of its value chain, even though they may be distantly upstream or downstream from the company's own operations. Simply knowing with whom you directly compete is not enough; understanding the defensibility of strategies along each of the value chain positions is important. The real war will be fought and won in the trenches of the value chain; from one situation to the next, the enemy may be the same or completely different.

Strategy + Transformation

Because strategies must be more dynamic than ever before, companies must mobilize their organizations to execute new strategies, often in situations where the risk–reward ratios are very different from those to which executives have been accustomed. At all times, a company should be in the process of transforming itself to occupy a new strategic position.

The experience of change-habituated industries like airlines and telecommunications will undoubtedly be replicated even in today's more stable sectors. The three forces of upheaval will allow no reversion to the more leisurely tempo of earlier years.

Take, for example, the aircraft-engines industry. For years, engine manufacturers competed on the basis of product innovation, investing huge amounts of resources to develop engines with more power, greater efficiency, and better reliability. Yet manufacturers often were unable to capture the value created, most of which was passed through the airlines and then to consumers. Superior product functionality and performance advantages alone were short-lived, given relentless competition and shorter product cycles.

GE Aircraft Engines (GEAE)

The new strategy is not something enterprises do. It's something they live.

recognized that the profit model had shifted. It repositioned itself in the value chain from a pure product company to one of the largest value-creating partners for airlines. GEAE's new business model included building a highly profitable after-market services business. Today, GEAE is growing in large part because of its third-party engine overhaul and maintenance business. Still, the questions for GEAE are, What will the next profit model be? Alternatively, how can the current profit model be transformed to allow GEAE to win in the next round? How can the organization mobilize its full capabilities to support this new strategic position?

We call this semi-continuous process *strategic business transformation*. It has two components: the options horizon and the adaptation round.

The Options Horizon. This stage begins with defining what we call the company-forward perspective. This requires using the traditional tools of strategic analysis — gaining insight into the economics of competition in relation to the fulfillment of customer needs, searching for opportunities to reduce costs, choosing the right technologies, and determining appropriate levels of vertical integration.

At the same time, the company must adopt a "future-back" perspective, understanding what is likely to create value in the future within its broadly defined value-chain enterprise, and where valuable options may lie for the firm. The future-back perspective scans the horizon for areas of significant potential discontinuity that might redefine the value of customer needs, and drives the current strategy toward creating options that are likely to accrue value as the future evolves toward those dislocations. It also positions the company for near-term success.

Through the company-forward and future-back analyses, the firm settles on the next games. This analysis identifies the central customer segments or customer needs and how they will be addressed in a way that is dramatically different from the current strategy. Once this is clear, the appropriate future value proposition, business model, and economics of value capture can be defined.

The Microsoft Corporation is an extreme example of a company positioning itself along an options horizon. Its strategy is to have its hands in as many options as possible. In addition to its core Windows operating system and Office suite, Microsoft has options in enterprise software, game consoles, ISP networks, and broadband communications, to name only a few. Aided, admittedly, by a large store of cash, Microsoft continually scans the horizon for its next pot of gold, in both the medium term and longer term.

The Adaptation Round. Once the next games are defined, the company must adapt to win them, navigating the path from now to then while protecting the value of the existing franchise. In today's volatile business environment, this process of objective-driven change must remain flexible in regard to both the objective and the path. The organization must be prepared to develop new capabilities and rely on entrepreneurial decision making deeper in the organization than used to be the norm.

Transforming the organization to occupy a new strategic position is not usually accomplished when driven only from the top. Instead, implementation success means devolving authority *within* the organization, and managing incentives and decision rights appropriately. The key elements include a full understanding of the strategy by line management; aggressive targets for each division; the cascade of the change process into the organization; regular review by senior management; and a focus on capability-building for future rounds, as well as on near-term profit improvement.

Strategic Learning

Finally, since transformation requires navigating new territory, strategic learning is necessary. We see the need for a sensing network that keeps track of both present and future opportunities. The sensing network must be tuned to activity in three critical areas — customers, business-model evolution, and the economics of value capture — as it attempts to gauge answers to such questions as: Are customers satisfied? Are we creating perceived customer value? Are there opportunities we have previously ignored? What changes will improve the value proposition? Is our business model efficient? Are all the elements of the enterprise value chain competitive? How are competitors modifying their business model? Are there business-model opportunities we have previously ignored? What changes internally or within the extended enterprise will improve the business model? What is our profitability by business, customer, or market segment? Is the area profitably scalable? What is the apparent profitability of competitors by business, customer, and market segment? What changes within the extended enterprise will improve value capture?

Companies can no longer afford the luxury of cycling among these goals, or pursuing a sequential agenda. In practical terms, rapid, semi-continuous strategic transformation requires the development of people and processes capable of grappling simultaneously with three functions that traditionally were managed discretely within the corporation. These are: creating value (producing strategic innovation in products, processes, and business models); aligning people to value (leading and motivating change and stimulating people to become higher-performance "human engines"); and delivering value (capturing the profits and other results that are promised by every strategy).

The new strategy is similar to the old strategy in its goals and some of its key components, but different in several critical aspects. Most importantly, the new strategy is not something the enterprise does, but something it lives. It focuses on semi-continuous transformation, not just planning for the next round but expecting to transform again. It uses the discipline of objective-driven change to mobilize the entire organization to support the transformation to new strategic positions. ✚

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