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How to See Gold Where Others See Risk: Identify More Choices to Get the Gold

"Strategy formulation involves the constant search for ways in which the firm's unique resources can be redeployed in changing circumstances."

—Richard Rumelt

In most industries, the major players are well aware of what customers are looking for (generically, more value for money). Yet at any given point in time, many of the customers' desired value propositions (whether price, quality, quantity, and so forth) remain unfulfilled because existing business models are incapable of delivering these values in a manner that is also profitable for the firm. However, if a firm can solve this trade-off, then the profits are almost guaranteed.

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Many firms take a linear approach in trying to solve this trade-off—through R&D (research and development) or other resource-intensive processes. Clearly, there is a place for R&D and other forms of capital investments. However, there are several drawbacks in taking a linear, resource-intensive approach. First and foremost, focusing on R&D or capital investments as a solution is inherently more risky simply by virtue of the capital commitment. Second, because this linear approach is the most common, it will most likely force your firm to play in the same playing field as everyone else. Thus, even if your firm develops the capabilities to deliver a value proposition profitably, the differentiating factor amongst competing firms is likely to be execution. This chapter develops a common sense but different way of approaching these issues that should complement the linear approach. Yet, very few firms consciously adopt this approach as part of their strategic planning processes. *The principle underlying this approach is very simple: If your firm can consistently identify more options that can deliver the same value proposition, it will likely be able to reduce the risk of failure by choosing an option where the risk can be managed to practical proportions.* This chapter recommends that the brute-force approach should be adopted only after you have exhausted less resource-intensive options. In the following pages, a framework is developed for identifying multiple options that require much less resource investment.

To Visualize More Options, You Need an Outside-In Perspective

Consider a journey by car to a new city that a traveler is unfamiliar with. The traveler has charted out a route plan but suddenly finds herself at a roadblock. She has to figure out a way to get around the roadblock to reach her destination. Because she is in uncertain territory, her odds of taking a wrong turn are significantly increased. However, if she uses GPS (Global Positioning System) to navigate her

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to the destination, she will be able to see multiple possibilities and choose the one that best fits her driving style and allows her to reach her destination on time. The framework developed in this chapter first considers the big picture (in this case, GPS), which allows your firm to see many possible routes to its ultimate objective, understand the risks inherent in each route, and then work back to the set of capabilities that can minimize the risks while still reaching the destination. With this approach, your firm considers its own capabilities only in the context of the capabilities identified for the different routes. This process highlights the key difference from traditional frameworks, such as SWOT (Strengths, Weakness, Opportunities, and Threats). Traditional frameworks are intuitive and appealing because of their simplicity—concentrate on your strengths or core competencies and identify a strategy that fits with your strengths. In other words, most firms utilizing traditional frameworks first focus on their core competencies and then try to see if these competencies can be used to reach the destination. You will soon see why it is virtually impossible to see multiple options with this traditional approach. Moreover, there is a real danger that the traditional approaches may very likely blindside a firm from the true risks of the business because it almost always results in an inside-out perspective.

The Traditional Frameworks Lead To an Inside-Out Perspective

Case 1: The Space Pen

When NASA first started sending up astronauts, it quickly discovered that ballpoint pens would not work in zero gravity. To combat the problem, NASA commissioned Fisher to develop a (space) pen that would write in zero gravity, upside down, underwater, on almost any surface, including glass, and at temperatures ranging from below freezing to 300C.

The Soviets used a pencil!

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This is a classic illustration of the inherent risks in being focused on your existing competencies. It leads to an inside-out view of strategy. It precludes other options that can deliver the desired goal more efficiently. Typically, this perspective is characterized by the following:

- Alternatives are defined by the problem.
- Focusing on existing competencies/strengths/resources to solve the problem.
- Managers quickly get locked into one option.

The lesson from the NASA story is that just because you have the resources available to develop a space pen does not mean that it is the optimal strategy (see Figure 1.1). Unfortunately, companies do this all the time.

Case 2: Anticipating Competitive Risks

A business equipment firm (such as Xerox) knows that its good service network allows it to enjoy competitive advantage. Xerox has determined that it is difficult for new entrants to develop a comparable service network. How would Xerox determine whether this competitive advantage is sustainable?

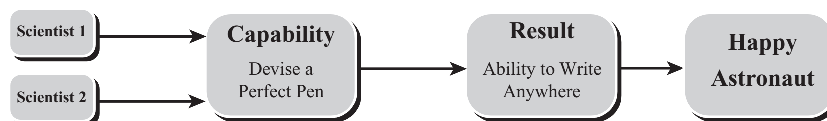

FIGURE 1.1 Inside-out focuses on the problem at hand.

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In this case, if you focus on studying how your existing service network compares to the competition, you are likely to get blindsided. This may happen even if you are making every effort to continually improve your service network. You may think you are focusing on your unique resources or competencies and making them even stronger will keep competitors at bay. Perhaps, but you are not asking whether these are the *relevant* strengths to protect you in the future or if there other ways competitors can undermine your advantage. This is the trap of inside-out thinking—focusing on what you do best and not if this is something that you *should* be thinking about.

> **"This internal focus has wasted our time, wasted our energy, frustrated us, made us so mad some nights over some bureaucratic jackass boss that we'd punch a hole in the wall."**
>
> **—Jack Welch[1]**

Basically, inside-out is the wrong way to think about strategy.

Focus on Desired Outcomes to Identify Multiple Options

Just about everyone these days talks about starting with the customers' needs first. However, if you and your competitors all start with customers' needs, it is highly likely that you all visualize the same value chain. Following through, if you and your competitors basically work from the same value chain, it will come down to an execution battle fought with the same business model. On the other hand, after you have identified multiple value chains, you can use frameworks such as SWOT or core competencies to pick the one that plays to your strengths. In other words, you have reduced the competitive risk by not only choosing a business model that is different from your competitors, but also execution risk because the business model

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matches either your existing capabilities or capabilities that you can acquire inexpensively. Unfortunately, focusing on customer needs is of little help in visualizing multiple business models.

Simply asking customers about their needs cannot start this process. Customers are unable to phrase their needs in a way that lends itself to multiple business models. Of course, you need to talk to your customers, but to identify multiple business models, you have to *rephrase* the needs and priorities. As an aside, this is one reason why we do not recommend using focus groups when designing a new strategy. Focus-group participants invariably translate their needs into existing products or services. The moment you start thinking in terms of concrete products or services, you have lost your edge by way of your competitors.

To get away from the customer needs-driven mindset, you need to spend more time thinking, "What is the ultimate outcome the customer is looking for?" Customers have needs, but what they are really paying for are outcomes. You will find that by focusing on the outcomes, you are able to identify multiple business models and increase the odds that you can come up with a solution that is simpler, more efficient, and less risky to implement. Traditional market research and focus groups are not very useful in identifying outcomes. You are much better off observing customer behavior and rephrasing their needs in terms of outcomes.

Case 3: Multiple Options for Developing Stents

Stents are one of the major medical innovations of the 1980s. They are used to prop open blocked coronary arteries to prevent heart attacks. However, stents quite often had to be replaced because of scar tissues that form around it, increasing the risk of reblockage. In March 2004, Boston Scientific Corp. of Natick, Mass., won Food and Drug Administration approval for a coronary stent coated with the cancer drug Paclitaxel. Paclitaxel prevents tumor growth and thus prevents scar tissue from developing around the

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stent. Angiotech holds the patent for this coated stent and licenses the product to Boston Scientific.

Dr. Hunter, the CEO of Angiotech, traced the innovation of the coated stent from the manner in which his company asked doctors about their needs regarding stents.[2]

> "Medical equipment makers typically ask surgeons, 'How can we build a better stent?' and then get the answer, 'You should make it more flexible, easier to see and stronger,'" Dr. Hunter notes. "But we've been asking, 'What does the body do to these stents and why do they fail?' When you ask that, you get to the scar-tissue problem."

Outcome To (Competitive) Objective

Even though Angiotech did not call it as such, in effect, the company was asking the doctors what the ultimate outcome was they were looking for. By asking the customers (users in this case) about the current product, it is usually impossible to get ideas for new products that will satisfy the customers' needs when they see it. Most companies try to focus on marginally improving the existing internal outputs (which lead to the current products or services) by investing in new capabilities. However, if you do this, you are invariably taken to the same playing field as your competitors, and you become vulnerable to competitive risks. You want to deliver what the customer truly wants by using a product or service configuration that is different from existing competitors. This reduces competitive risk without being vulnerable to demand risk. By considering outcomes instead of outputs (products or services), you increase your odds of visualizing multiple internal outputs that lead to new, sometimes radically new, product or service configurations that other competitors are not considering. To design a low-risk strategy, simply select the output that *you* can deliver with the lowest risk.

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Case 4: Multiple Options for Developing a Longer-Lasting Hearing-Aid Battery

A battery manufacturer was considering investing in a major research effort for a longer-lasting hearing-aid battery. It assembled a focus group of older people to find out about the size or shape of the battery that would most likely appeal to them. The company's real insight did not come from what the focus group told them but from observing the process by which the participants went about replacing their batteries. The company realized it is very difficult for older people to replace a small hearing-aid battery. Of course, one solution to the problem is spending research dollars to come up with a battery that is longer-lasting. However, the outcome that hearing-aid users really wanted was simply to have a hearing aid with a working battery all the time. The battery manufacturer decided to develop a package that made *replacing* the battery foolproof. Not only did they save the research dollars, but they were selling more batteries in larger packets.

The basic difference between the inside-out/core competency view and an outcome-focused view is the starting point. In the outcome-objective view:

- Alternatives are defined by the desired outcomes.
- It is easier to identify multiple fronts on which you can compete.
- Competitive objectives (this includes your outputs that satisfy the customers' desired outcomes) are stated with greater clarity. (This is the kernel of your business model.)
- Focusing on outcomes makes it easier to identify multiple competitive objectives.

Consider the NASA example again. Instead of *devising a perfect pen*, NASA could have rephrased the desired outcome as *recording information*. This leads to the objective indicated in Figure 1.2. Now

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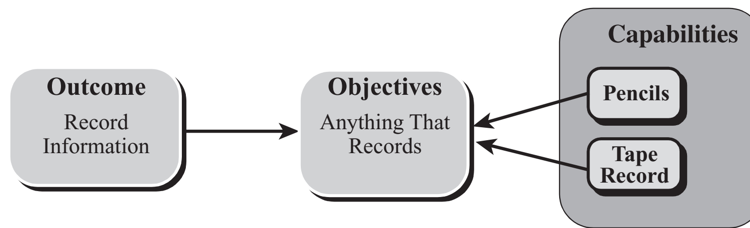
you can deliver the outcome without undertaking costly investments, such as the space pen. You can use off-the-shelf products like a pencil or a cassette tape recorder to deliver the desired outcome.



Outcome-Objectives: Begins with Customer Outcome—Presumes Necessary Capabilities Can Be Obtained or Developed

FIGURE 1.2 Outcome to objectives framing of a market opportunity.

Case 5: Multiple Options for Competitive Risks—Branded Home-Maintenance Products

In the late 1990s, two branded home-maintenance products produced by Company X and Company Y were vying for shelf space with Home Depot and Lowe's Corporation. Company Y had recently started airing a series of ads with a prominent Cincinnati Reds baseball player. Company Y expected the ads to produce a brand awareness that would give it some leverage over Home Depot. Company X, which was recently acquired by a holding company, did not have the marketing dollars to respond.

Company X's product has been around for a long time and is well-known to the public, whereas Company Y was trying to build awareness for its relatively new product. Home Depot wanted to carry Company Y's products given its recent ads. Further, Home Depot wanted to have more than one vendor of the same product to increase its leverage.

Company X noticed that Home Depot tended to organize its shelves by brand name in long, 18-foot shelves. Company X

continues

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Case 5: Multiple Options for Competitive Risks—Branded Home-Maintenance Products (Continued)

suggested to Home Depot that it reorganize their stores by categories instead of brand names. Company X suggested that keeping similar products in one area will facilitate the end-consumer's shopping experience. Home Depot had always distinguished itself by being extremely user-friendly for the do-it-yourself consumer and, therefore, this suggestion was quickly implemented.

After Home Depot went into the shelf arrangement by category type, it quickly realized Company X was selling more, and economics justified carrying only one product, so Company Y was dropped by Home Depot.

Clearly, the goal of Company X was to be the sole supplier to Home Depot. The problem that Company X was facing was simply competitive risk from a well-financed new entrant to a space that Company X had basically owned for a long time. If Company X had the financial wherewithal, it might have launched a counter advertising blitz. However, the company did not have the money and had to identify a different way of reaching its goal. Of course, Company X could have tried to use the franchise value of its product to convince Home Depot not to carry Company Y's product. More than likely, such an approach would have been seen by Home Depot as a way of regaining supplier power that Company X had lost because of the new brand introduced by Company Y. Therefore, Company X had to figure out other options to reach the same goal.

Let us analyze this situation through the lens of the outcome-to-objective framework. Company X decided to leverage the outcomes desired by Home Depot—reduce its inventory and improve inventory turnover—to its advantage. However, if Company X simply offered Home Depot its services in managing Home Depot's inventory, Company X might have been sidetracked by standard supply-chain issues of delivering its product just-in-time or helping with store

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display. The business model that Company X had to develop was delivering this inventory management outcome in a manner that *also promoted the sale of Company X's product*.

To develop the business model, Company X focused on a second outcome desired, not by Home Depot, but by the end-consumer. In simple terms, Company X wanted to make it easy for the end-consumer to buy what he or she needed quickly and with confidence. This outcome for the end-consumer was also an important internal objective for Home Depot, so this suggestion was well-received. Company X then went about operationalizing this suggestion using its store display strategy described in the sidebar. Instead of trying to convince Home Depot to not carry Company Y's product, Company X reformulated its competitive objective by developing a store display strategy that (a) satisfied the desired outcome of the end-consumer, and (b) made it obvious to Home Depot that it wasn't economical to carry two brands. Thus, by focusing on two outcomes—purchase flexibility for the end-consumer and inventory rationalization for Home Depot—Company X managed to become the sole supplier to the largest do-it-yourself store in the country[3] without countering Company Y's ads.

Even though the story ended to the satisfaction of Company X, this strategy was not without risks. Company X made some critical assumptions before it formulated the design of the business model. Company X strongly believed that its product had a better brand-name than its competitor, Company Y, despite its recent ads. Company X believed that if the end-consumer saw the two products side-by-side, then the end-consumer would choose Company X's product. If this assumption were incorrect, placing its products alongside competitors' products at Home Depot would be a grave logical error. The category management strategy is a low-risk option only if the franchise value of Company X's product overcame the recent advertising by Company Y.

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There is a postscript to the story. The competing brand, Company Y, went to Lowe's Corporation and persuaded Lowe's to carry its products as sole supplier as a buffer against Home Depot. Unfortunately, Lowe's soon found out that Home Depot was cornering most of the sales in this product category. This resulted in Company Y's product being removed from Lowe's, and Company X became the sole supplier to both Home Depot and Lowe's. Clearly, the objective of Company X was to increase its market share with Home Depot and Lowe's. There were many ways that it could have tried to achieve this. The more expensive and risky options would have been to get into an advertising battle. Equally expensive would be to cut prices or take over the inventory management function of Home Depot and Lowe's by integrating with their supply chains. Both of these choices are risky because they either jeopardize the financial viability of the company or require additional investment. What Company X did was very similar to our outcome-to-objective process (of course, it did not call it as such). Company X managed not only to attain its objective, but it did so without investment in new capabilities.

We Can Anticipate Competitive Risks Better by Focusing on Outcomes

Consider the service network case (Case 2) once more. It is not enough to analyze the difficulty of a competitor imitating the service network. Rather, it is necessary to figure out whether the service network is the only way a new competitor can match the incumbent's competitive advantage. Using either SWOT or a core competency framework, this becomes a completely open-ended question.

However, if you move away from viewing the competency (the service network) as the basis of the competitive advantage, and instead look at how you can deliver the outcome that customers desire, the vulnerabilities of the current strategy are easy to understand. In this case, customers would be loyal to Xerox not because of

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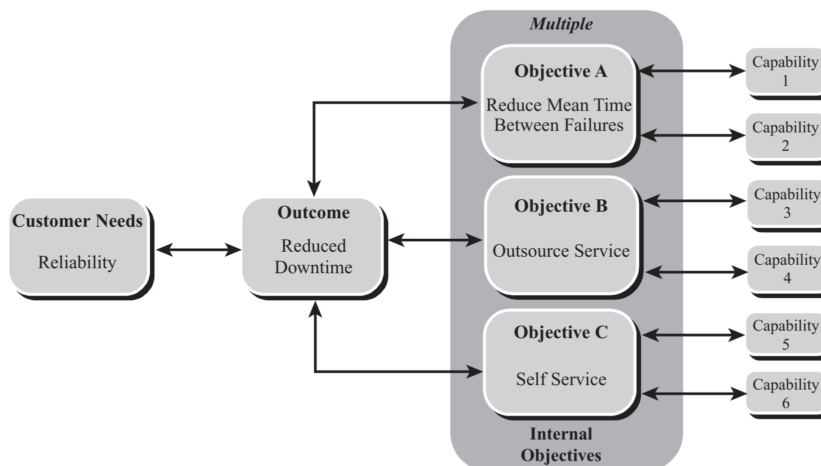
its service network per se, but because the service network prevents downtime. If you start the analysis by questioning whether others can deliver the same "uptime" outcome, possibilities beyond mere imitation of the service network open up (see Figure 1.3). A competitor may be able to deliver the same outcome of reduced downtime through a different resource, such as by manufacturing excellence (so that a machine needs few repairs) or by designing a machine that customers can service easily by themselves. Canon's entry into the personal copier market and the office equipment market utilized both design and manufacturing strategies to get around its lack of service and other infrastructures in the copier market (see Chapter 4 on Canon's actual implementation).

The outcome-to-objective framework is a thinking style that can be applied in just about any situation where you can benefit from identifying multiple options. In the following case, this framework illustrates how operational efficiency can be attained by avoiding resource-intensive solutions.



An Outside-In Approach Opens the Door to Develop Multiple Alternatives Objectives for Delivering Value to Customers.

FIGURE 1.3 The outcome-to-objectives approach.

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Case 6: Rephrasing Outcomes of an Operational Problem

Large efficiency costs result when an assembly line has to be stopped for any reason. Crown Cork and Seal ran into this problem when it found its assembly-line supervisors had to run from the can seamer end to solve problems at the labeling end because of problems with the labeling machine that the labeling-end worker was not trained to solve. The minute or two that it took the supervisor to reach the other end of the assembly line was enough to cause a blockage and, therefore, the line had to be stopped even though the problem itself could be resolved in a few seconds. How can you try to solve this problem most efficiently, so the line does not have to be stopped?

You can identify solutions that involve training the assembly-line worker, hiring a new supervisor for the labeling end, or buying a more robust labeling machine. However, then you have basically applied a competency-based solution to the problem: acquire competencies to develop competitive advantage, in this case, by reducing downtime costs. In terms of SWOT, managers have identified a weakness in their value delivery system, and they get rid of the weakness by acquiring the skills. The SWOT or other traditional frameworks focus on the current output—keeping both machines running 100% of the time. Therefore, the obvious solution is to invest in better machines, more training for its workers, and perhaps a second supervisor. This is an inside-out approach, which would have added other risks because of the increased commitment. However, let us consider the situation by isolating the cause of the line stoppage. The outcome that actually triggers the stoppage is not the failure of the machines but the inability of the supervisor to reach the labeling end quickly enough to prevent a blockage. With the outcome–to-objective framework, you now need to focus on avoiding the adverse outcome of

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the supervisor's inability to have access to both ends quickly. The objective that follows from this desired outcome is an assembly-line configuration where both ends can be accessed simultaneously *without costly investments*. Considering this desired outcome, it is easy to visualize the unorthodox, creative, and inexpensive solution that Crown Cork and Seal came up with. They made the assembly-line U shaped. This does not mean the U-shaped option is the optimal one. It is only optimal if this is the least expensive option without any adverse consequences in the desired outcome. All we are saying is that if you focus on outcomes, such as lack of downtime, instead of the means to deliver it, such as a service network, you will be able to visualize multiple business options and, by extension, multiple business models. This ability is the first step in avoiding unnecessary business risks.

An Aside on Creativity and Choice

You may feel that the concepts here are similar to creative thinking, and there is some truth to this. Creativity occasionally leads to breakthrough innovation, but the bulk of creative business models usually just uses existing ideas in a different context. For example, a design group in IDEO saw the possibility of using the heart valve used in medical products to design a "slit valve" for a bicycle water bottle. To see the possibilities, however, you have to ask the questions that can lead you to see the choices. This is exactly the approach that Dr. William Hunter, CEO of Vancouver-based Angiotech Pharmaceuticals, wants his employees to take. According to Doctor Hunter, "The difference between good science and great science is the quality of the questions posed."[4] By focusing on outcomes, you can improve the quality of the questions you ask as you design a strategy.

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Decide on Objectives Based on How Your Firm Wants To Compete

To summarize, the notion of competitive objective allows us to understand the logic of the output that we can deliver (different from our competitors) in order to satisfy the customer-desired outcomes. But how do you decide which objectives to focus on? In Chapter 2, "Three Steps to Design a Low Risk Strategy," you will consider a three-step methodology that distills the essential logic of how you are going to compete. However, this is not necessarily a linear process. By using the outcome-to-objective framework, you are able to identify multiple internal outputs that reduce competitive risks. However, you still may not be able to deliver the new output with capabilities you possess or can acquire at a cost that allows you to make a profit. The competitive objective should be designed not only to ensure that your outputs can deliver the customer outcomes, but also to avoid any increased risk of loss. This is an iterative process that leads to the final competitive objective that you should settle on and clearly articulate when designing a strategy.

In the case of the hearing-aid battery maker, the company finally decided to compete on the basis of packages and not product. The battery company clearly understood the logic of why packages can allow it to deliver the same desired outcome instead of creating a new product. Compared to the uncertainties involved in developing a new product the option of focusing on a competitive objective by developing a package has tremendous appeal. This objective avoids competitive risks (no one else has thought of it yet) and has a higher probability of being developed (they are more likely to come up with a packaging innovation than a new product) without costly and uncertain R&D investments. In the case of the coated stent, the company decided to compete on existing coating technology with an existing drug rather than new mechanical engineering. The competitive objective for Company X was to persuade Home Depot to adopt category management. Persuading Home Depot to adopt category

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management is a much lower risk than investing in expensive advertising or a supply-chain management capability. Basically, all of these examples repeat a theme you shall see used by many low-risk strategies that we use as examples in this book. In all of these cases, the companies might have considered other product or service configurations, but the option of using existing or off-the-shelf capabilities swayed the final decision.[5]

This brings us to the final concept, which you will explore further in Chapter 2. Even if you manage to reduce competitive risks by identifying a competitive logic that is distinctly different from competitors, you are still vulnerable to capability risks. Do you really have the capabilities needed to deliver the outputs dictated by this logic? This is where many strategies sow the seeds of failure. They do not simply take the time to think through what the firm has to do to make its business model work, and in failing to do so, they implement a strategy that is difficult to execute. To mitigate execution risk, you need a dashboard that alerts you to the failure of critical components of your business model in real-time. This dashboard, in conjunction with the outcome-to-objective framework, allows you to seek out gold where others see risk.

Endnotes

1 Stratford P Sherman. "Inside the Mind of Jack Welch." *Fortune* 27 Mar. 1989: 38.

2 Carol Hymowitz . "The Best Innovations Are Those That Come From Smart Questions." *The Wall Street Journal* April 13, 2004; Page B1.

3 This example also illustrates the power of creating value by making the attributes of your product or service visible to the customer. This framework is developed in Chapter 5.

4 Hymowitz. Op. Cit.

5 We need to emphasize the difference between the outcome-to-objective framework and the traditional core competency frameworks. Our framework considers a firm's core competency, but only after identifying multiple objectives using an outside-in process that starts with customer-desired outcomes.

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