

# Chapter 1

## The Need for Reinventing Strategy

This book is about an innovative, new approach to business strategy that better reflects the realities of the global marketplace in a network economy. It was developed at MIT to help managers formulate, articulate, and implement more effective ways to achieve superior and sustainable financial performance and long-term profitability, providing a completely different perspective from the conventional strategic approaches used by most managers.

As you will see, our Delta Model (after the Greek letter delta, standing for transformation and change) encompasses a unique set of frameworks and methodologies that grew from our conviction that changes being experienced in the world of business were of such magnitude that existing managerial frameworks had become either invalid or incomplete. Moreover, the emergence of the Internet, with its previously unimagined potential for communication, and the incredible technologies surrounding e-business and e-commerce are enabling completely different business approaches than had ever been possible before.

### The Dangers of the Conventional Definition of Strategy – Strategy as Rivalry

Until now, the prevailing view – shared by most practicing managers and academics – has been to define the goal of strategy as achieving sustainable competitive advantage. Most, if not all, of the most respected and popular frameworks that guide the strategy development process are anchored in this concept. This is a mindset likely to cause severe problems moving forward.

First, it puts our competitors at the center of our management process. Competitors become our driving force, our relevant benchmark. We look at strategy, and consequently at management, as rivalry. In order for us to succeed, we have to beat someone. Strategy is destructive; strategy is war. As recent history has confirmed, again, wars do not have victors. Wars only produce devastation and loss. Lord Wellington observed after defeating Napoleon at Waterloo, where tens of thousands of soldiers lay dead on the battlefield, “I can only imagine one thing worse

than winning a war and that is losing it.” Not a very encouraging comment! Not a very promising strategy.

Second, and equally troublesome, using our competitors as a way to define our course of action basically anchors us in the past. On reflection, this is an approach that seems counterproductive in a time of revolutionary change, when we want to create discontinuities, not reaffirm old practices. Is this what we should be aiming at in today’s turbulent environment, when change is virtually mandatory? We must challenge our previous state of business. We must have the ability to be creative and separate ourselves from the herd, to find a new and unique way of conducting business.

Often, companies seem obsessed with their competition, studying and watching it intensely to detect anything that could signal a way to operate more effectively. This might not be a very smart way to manage. I tell my students, “Study your competition deeply, but do not imitate them.” I believe that strongly. It is a meaningful challenge. To separate ourselves from our competitors, we must offer our customers something that is truly unique and distinctive. How do we do that?

Third, the excessive concern about competitors can lead us, consciously or otherwise, into imitating their behavior. Our products begin to take on similar characteristics of those of the leaders. The development of our new products adheres to the prevailing standard of the industry, the channels of distribution that access our customer base are indistinguishable – in other words, the industry begins to converge into a well-established set of norms and standards. The result of this congruency leads toward the commoditization of our business, which is the worst possible outcome for all players.

## **Reject Commoditization – The Essence of Strategy Is to Achieve Customer Bonding**

It is alarming to see how many firms are in a situation where a large percentage of their business has become commoditized.

The fundamental objective of any firm as a whole, as well as the individual businesses of the firm, is to achieve superior and sustainable financial performance as measured by long-term profitability. In order to achieve this outcome, we need to differentiate ourselves through leadership and a sense that our business is distinctive, which is exactly the opposite of a commodity. Commodities, by their nature, are ordinary and undifferentiated. It is not realistic to expect that a lackluster, commoditized business could generate any superior performance, let alone sustain it. The commoditization of an industry tends to erode everyone’s profitability because it exacerbates the rivalry among competitors primarily by driving down prices for standardized products.

For superior financial performance to be sustainable, not only should the business aim at achieving a solid leadership position, but this position should be long-lasting, unassailable, and able to endure the inevitable changes that the environment will

**generate.** This calls for flexible adaptation to new circumstances and the will and ability to transform the organization continuously. We should look forward, not backward. We should never be complacent. We should experiment and engage in a continuous learning process that propels us into uncharted territory. This will never happen if we are simply imitating or following in our competitors' footsteps. Using competitors as a benchmark leads to sameness, and sameness will never lead us to greatness.

The dangers of commoditization are real, and if you fall into it, the consequences are devastating. We believe that this is one of the greatest challenges companies face. The way to fight it is to abandon the mindset that accepts product standardization and industry convergence as an unavoidable reality. **Instead, you must recognize that it is the customer who really matters, and that the customers are always different.** It is a fatal mistake to commoditize them.

It is critical that you try to understand your customers' needs, to segment them so that you can recognize their differences, and to assess your competencies as a firm so that you can offer not just products, but also creative and unique solutions to each customer's pressing needs. Your own view of the enterprise must shift from that of an engine just developing, making, and distributing standardized goods or services **to one possessing a bundle of competencies that can be packaged into a well-integrated portfolio of products and services that represent a unique value proposition to each customer.**

This paradigm shift constitutes a big transformation that can produce a constructive, long-term relationship with the customer and culminate in **customer bonding, a mutually beneficial engagement based upon unbreakable trust and transparency.** Under this fundamentally different way of approaching the customer relationship, the essence of strategy becomes *not* to achieve sustainable competitive advantage with competitors as the benchmark – but to achieve customer bonding, with the customer as the driving force.

## **Managing in the Large and in the Small – The Extended Enterprise and the Individualized Customer**

We come to what seems to be an inherent paradox: a desire to build an extended enterprise with individualized customers. In order to achieve this outcome, we need to simultaneously manage with the largest possible scope – to be able to offer up all of the capacities of all of the relevant players in our network – and to target each individual customer in the most granular way. This is only possible to a great extent due to the remarkable technological capabilities of the Internet. Let us be explicit.

**Managing in the large means you cannot play the game alone.** Regardless of how many resources you control, you will always need external support if you want to conduct your business intelligently. **This calls for recognizing what we refer to as the *Extended Enterprise*, which includes you, your customers, your suppliers, and your complementors** – meaning those organizations that provide products

and services that complement and enhance your offers. Many great companies have understood this lesson well and have made it the cornerstone of their strategy. Think of Wal-Mart and Dell, two excellent companies that have adopted the concept of the extended enterprise as an extraordinary way of delivering remarkable value to their customers. Both of these companies have developed “virtual organizations” by linking themselves electronically to their customers and suppliers, obtaining a web of interactions that produces remarkable value. Wal-Mart knows, in real time, every transaction that takes place in every single one of its stores, communicating that information to all the relevant suppliers so that they know how to replenish their inventories optimally. Dell manufactures every computer according to customer specifications and delivers it by simultaneously executing the orders with all the relevant suppliers.

Managing in the small, on the other hand, means that, ideally, we should be treating each customer individually and providing a specific and singular solution to satisfy each customer need. Think of Amazon and iTunes. Whenever I log into their system, I am treated as a unique individual. The system knows my pattern of previous purchases and is able to recommend new purchases that are tailor-made to satisfy my demonstrated interests or needs.

Operating this way allows for customer bonding to become a reality, because you support the value proposition you offer to your customer based on the individualized knowledge that you acquire and through the support and assistance that you get from the full network of the extended enterprise.

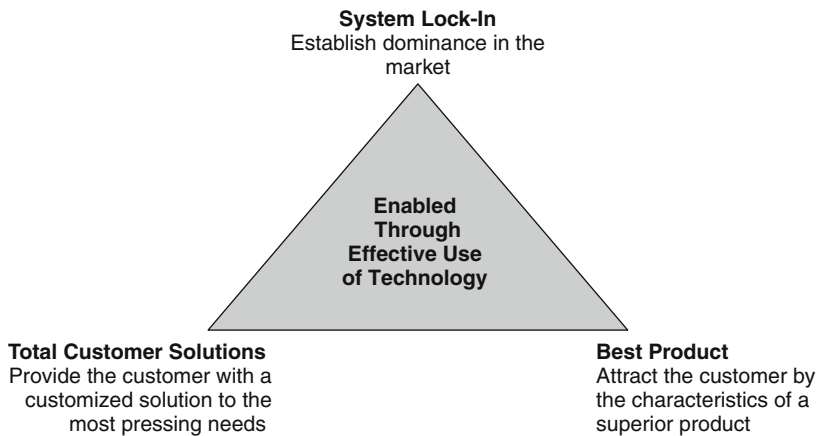
This is a model that circumvents rivalry and competition as a basis for strategy and substitutes cooperation, close association, and customer intimacy instead.

## The Selection of a Strategy and the Identification of the Required Competencies – A Preview of the Delta Model

One of the most distinctive aspects of the Delta Model is that it provides you with guidance on how to select the strategic positioning of your business and gives you the analytical tools to achieve it. This is a feature that is not available in any other business model, as far as we know.

How do you begin to develop a strategy based on a granular understanding of individual customer needs? As we have already asserted, the fundamental strategic objective is to obtain customer bonding – that is to attract, satisfy, and retain the customer. The Delta Model offers you three distinct options to reach that objective which can be applied, if you wish, one customer at a time. The three strategic options are presented in the triangle in Fig. 1.1.

In the **Best Product** option, the customer comes to you because of the superiority of your price offering – due to your low-cost infrastructure – or for some aspect related to the product functionality, brand, or appearance that differentiates itself from the competitive offers. In the **Total Customer Solutions** option, the customer is attracted because you are offering something beyond the product itself,



**Fig. 1.1** The triangle – the three strategic options of the Delta Model

which implies transferring knowledge and services that address pressing needs the customer has. In the **System Lock-In** option, you have achieved such a strong dominance in the marketplace that the customer does not have options better than yours.

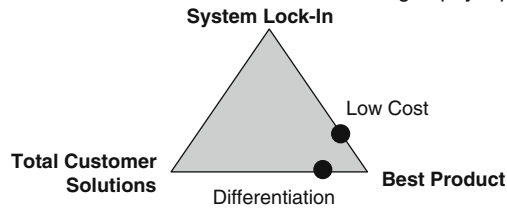
Figure 1.2 offers a highly summarized description of the characteristics of each of the three primary strategic options of the Delta Model and the necessary competencies that are required for their support. The resulting eight competencies that are part of the Delta Model framework are summarized in Fig. 1.3.

We will elaborate in later chapters the step-by-step process you must undertake in order to develop a customer bonding strategy tailored to your own organization. Our objective here is to introduce you to the idea that there are options other than the simple offering of a product – which is the dominant mindset of most executives – on which to base a successful business strategy. Moreover, the Delta Model framework assists you in examining the state of your existing competencies and – most importantly – in identifying the competencies you need to acquire to develop a truly winning strategy. We believe these two perspectives – strategic options and competencies – make the Delta Model an exceedingly useful device to guide your strategic thinking.

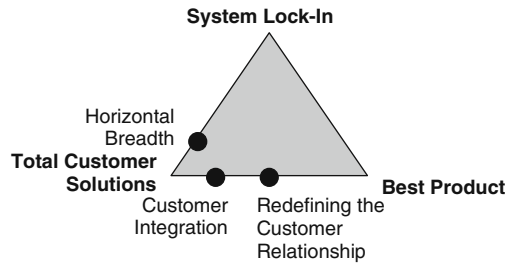
## The Strategic Tasks of the Delta Model

The Delta Model, as we have argued in this introductory chapter, provides innovative new concepts and ideas that will make you see your business strategy from a fresh perspective, not anchored in the transitions of the past. It also provides you with a set of pragmatic tools to help you to carry on a rigorous, systematic, and

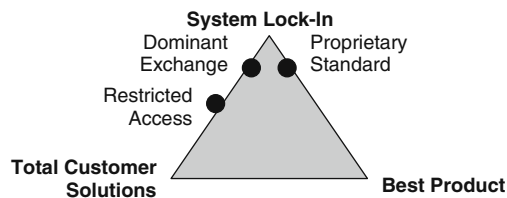
**Best Product** – The customer is attracted by the inherent characteristics of the product being offered. This is accomplished through a low cost – which allows offering the lowest price to the customer resulting from an efficient infrastructure – or by offering a differentiated product that the customer values and is willing to pay a premium for.



**Total Customer Solutions** – Customer bonding results from enhancing the capabilities of the customer by offering integrated solutions to address its critical needs. It is accomplished by a close proximity to the customer (Redefining the Customer Relationship), by transferring substantive capabilities and knowledge (Customer Integration), and by providing a full spectrum of products and services that satisfy most, if not all, of its needs (Horizontal Breadth).



**System Lock-In** – The firm achieves a dominant position in the market that gives it uncontested leadership. This is accomplished through the development and ownership of the standards of the industry (Proprietary Standard), by becoming the interface between the customer and its suppliers (Dominant Exchange), or by becoming the sole source of the customer needs (Restricted Access).



**Fig. 1.2** The Delta Model – the three strategic options

thoughtful process of diagnosis and formulation of your own successful business strategy. Most of this book addresses that need.

After many years of working with numerous organizations around the world, we have learned that it is very important to keep the planning process as simple as possible, while retaining the ability to perform a careful, highly practical examination

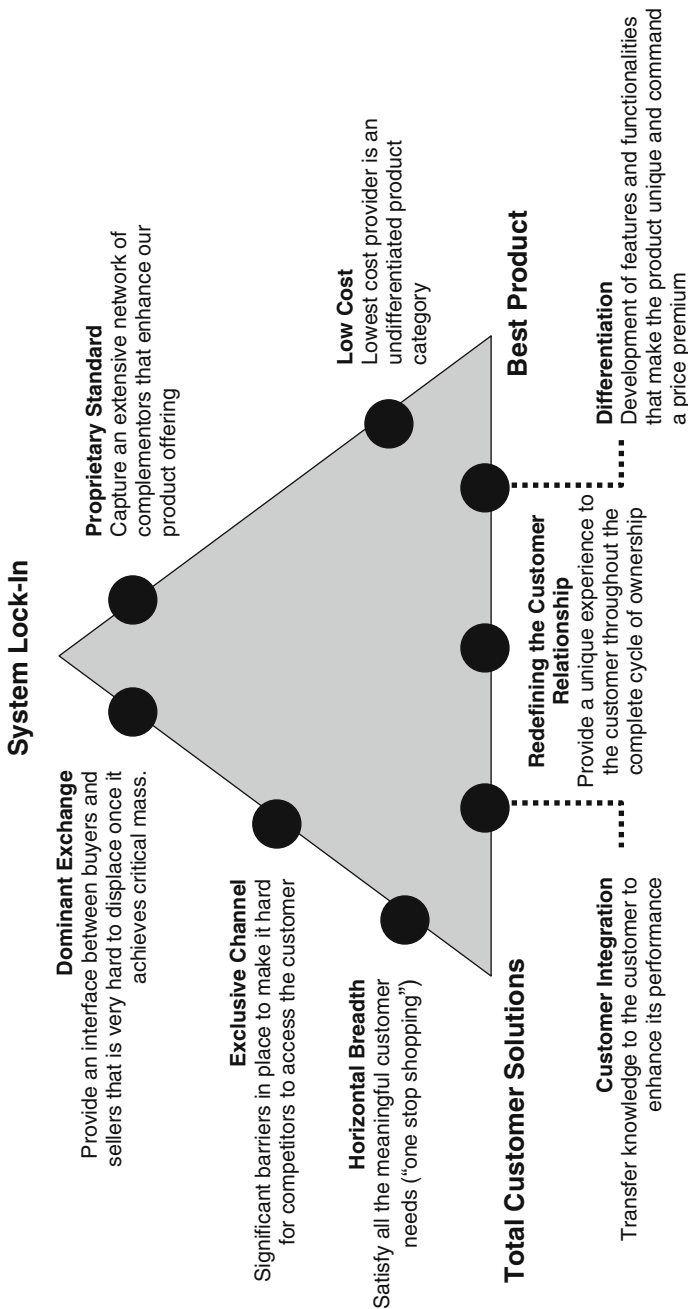
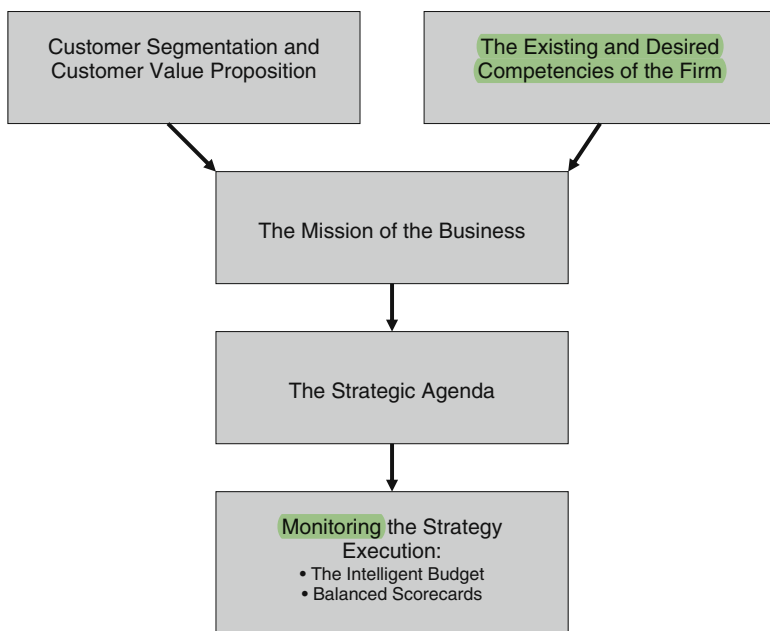


Fig. 1.3 Identifying the competencies of the business – the eight strategic positions as a guiding framework

of the complex environments and circumstances that surround your business. It is an enormously challenging and exciting task: to give purpose and direction to an organization and end up with an agenda that assures the proper implementation of a well-designed strategy. To that end, **we have identified five broad tasks** that will help you do this work, illustrated in Fig. 1.4. Throughout the book we will explain these tasks with considerable detail and provide real-life applications to illustrate how we have used them – and you can use them – in practice.



**Fig. 1.4** The strategic tasks of the Delta Model

### ***Task 1 Customer Segmentation and Customer Value Proposition (Chapter 3)***

The first task we must undertake addresses the customer. **We need to abandon our preconceptions** and try to be as creative as possible in finding original ways to serve the customer. We begin by segmenting the customer base so that we can identify **subsets of customers sharing similar needs**, to which we will be providing distinct value propositions. We cannot overemphasize the importance of this task. It is the true foundation of a well laid out strategy. The Delta Model provides unique mechanisms to guide you through this process. The resulting customer value propositions should satisfy the following requirements:



- They must be **unique** – meaning that they truly differentiate us from what is ordinarily offered.
- They must be **sustainable** – meaning that their uniqueness cannot be easily imitated or substituted.
- They must **provide a great deal of value** to our customers and to us.
- They must **create a significant amount of bonding** among our customers and us.

### ***Task 2 The Existing and Desired Competencies of the Firm (Chapter 4)***

The previous task allows us to understand the demand side of our business in a creative way. This task forces us to deeply **focus on the supply side**, on our own capabilities. We perform it using another form of segmentation that is based on the **eight strategic positions** described briefly in Fig. 1.3. Every firm is a bundle of competencies. What are ours? These eight positions help us to assess our existing competencies and identify those that we must acquire in order to deliver the customer value propositions that we have identified in Task 1. The eight strategic competencies that are part of the Delta Model framework provide a powerful, concrete diagnosis of the capabilities we already possess, and the capabilities we need to develop to achieve a true position of leadership and excellence.

### ***Task 3 The Mission of the Business (Chapter 5)***

The previous two tasks – customer segmentation and customer value proposition; and existing and desired competencies – are the foundation of our overall diagnosis. What emerges is a clear understanding of where we are and what changes will be required to improve our existing circumstance. The true purpose of the mission statement is to **capture and clearly articulate our intent**. It is a critical task because it integrates the strategic tasks that we have conducted into a sole statement that defines the purpose of the organization and the challenges we face to move it in the desired direction. **The mission is a fundamental vehicle to communicate our sense of direction, both inside and outside the organization.**

### ***Task 4 The Strategic Agenda (Chapter 6)***

The strategic agenda attempts to **identify and lay out** in very pragmatic and concrete terms the **specific tasks that we must undertake in order to serve our customers**, define our new capabilities, and move the organization forward into the desired state of leadership. It should not only spell out the tasks but also identify who is accountable for their execution, as well as how to establish the necessary organization, information, and control mechanisms for its proper implementation.

## ***Task 5 Monitoring the Strategy Execution (Chapter 7)***

What happens after we have formulated what we hope is a winning strategy? The answer is obvious: **we need to assure its proper implementation.** In other words, we need to “manage by strategy” – so that strategy becomes the compass that directs the myriad tasks that are part of the routines of management.

Two important elements are required to assure proper implementation of the strategy, in addition to the unbounded attention that managers have to devote to its proper execution. The first is the development of an **“intelligent budget.”** The budget is crucial because it is what most organizations use as an implementation tool, and it commits a host of managers to delivering “the numbers” which, in turn, are part of the reward system. **It is imperative to have a budget that is perfectly aligned with our strategic pursuits.** To achieve that, the budget must pay equal attention to strategy and operations and effectively balance the short- and long-term implications of our actions. We will expand on the elusive concept of the intelligent budget in Chapter 7. We say elusive because we find that most organizations develop budgets that are exceedingly biased toward short-term results, a practice, and that would invalidate or obstruct our strategic commitments.

The second vehicle required to assure proper implementation is the use of the **Balanced Scorecard**, both at the business and individual customer tier. This allows us to continue to focus on how we deliver the differentiated value propositions for each individual customer group.

## **The Haxioms**

The Delta Model challenges the conventional wisdom and the prevailing models of business strategy. As such, it is founded on a different set of principles, which jokingly I have come to call the “Haxioms.” They constitute the basis for a philosophy of management, which might be useful for the reader to be aware of from the very beginning and are the underlying principles behind the Delta Model, gleaned from years of research and personal observation.

I pose these Haxioms in no particular order. Perhaps they will shed more light on the strategic philosophy, which I am so ardently championing.

### **1. The center of strategy is the customer**

This is the core of the Delta Model. It places the customer as the driving force of management, and if we accept this imperative, everything else follows. We need to understand the customer, and our challenge is how to provide our spectrum of customers the most creative, unique, and high value-added value proposition.

### **2. You don’t win by beating the competition; you win by achieving customer bonding**

If the central focus of management is the customer, the essence of strategy is to achieve customer bonding. Bonding is realized when the relationships

characterizing our involvement with the customer are based on fairness and transparency, producing long-lasting, mutual benefits. Bonding goes beyond intimacy and proximity, it denotes trust and affection.

3. **Strategy is not war; it is love**

By rejecting the notion that strategy is rivalry and its ultimate goal is to defeat your competitors, we open a much more **constructive mindset**. Instead of perceiving ourselves as in confrontation with our key constituencies, we should adopt the attitude of cooperation, understanding, and love. It sounds rather corny, but I really mean it. Imagine how much better the world would be if we all would assume this stance. I sincerely believe that this behavior constitutes a better and more effective way to manage. Caring about the customer with a high sense of integrity is the smartest way of doing business.

4. **A product-centric mentality is constraining; open your mindset to include the customers, the suppliers, and the complementors as your key constituencies**

Don't play the game alone. **The relevant entity is the *extended enterprise***. I don't care how many resources we might have access to. Given the complexities of global business, we will never be self-sufficient. We should accept that from the start and recognize how important it is to draw from all our natural partners to provide the elusive unique value proposition to our customers.

5. **Try to understand your customer deeply. Strategy is done one customer at a time**

We have to focus our attention on the customer in a granular way, meaning that ideally we should consider each customer individually. We can accomplish this personally if the importance of the customer warrants it, or electronically if the personal contact is economically infeasible. The capabilities of the Internet are making possible something that was unimaginable in the past.

Gone are the days that we define abstract business units, that we used to call the Strategic Business Units – or SBUs for short – as the focus of strategic analysis. This was a composite of products and markets aggregated in a form that obscured our capacity to provide tailor-made solutions to individual customers.

6. **Commodities only exist in the minds of the inept**

The commoditization of a business results when we cannot claim any differentiation from what our competitors are offering. It is typically the consequence of paying excessive attention to the competition, which often leads to imitation and sameness. It is a prevailing situation in many businesses in the world. It is the most undesirable state to fall into because it deprives us of achieving any form of leadership, of gaining superior financial returns, of serving our customers uniquely, and of attracting top talent. The surprising fact is that commoditization should never happen if we are managing our business intelligently, simply because commodity businesses should not exist. **A product can be a commodity – say, copper – but a business is not because every customer is different.** Commodities occur when we commoditize the customer, which means that we do not try to understand deeply the customer's needs and just offer the same “me too” products to everyone. Take the case of copper. The

way Siemens uses it for its power plants is quite different from the way Carrier uses it to make air-conditioning units, or the way General Motors uses it to build cars. If we do not understand this, we do not understand our business.

If we focus our attention granularly on the customer, commoditization can always be avoided. That is why I claim that “commodities only exist in the minds of the inept” – a strong statement to call our attention to an important issue.

#### 7. The foundations of strategy are two:

- **Customer Segmentation and Customer Value Proposition**
- **The Firm as a Bundle of Competencies**

We have to understand both the demand and the supply sides of the business.

The customer represents the demand. Our first task is to segment the customer – so that we do not treat every customer in the same way – and to develop unique, sustainable, and high value-added propositions that create a great deal of bonding.

The supply is represented by our firm’s capabilities. The Delta Model provides a singular methodology to assess our existing and desired competencies according to our abilities to develop a full spectrum of strategic positions.

The Delta Model gives us the conceptual understanding and the portfolio of tools that allow us to develop these two foundations of strategy.

#### 8. Reject the two truisms:

- “The customer is always right,” and
- “I know the customer needs and how to satisfy them.”

We are not selling standardized products; we are dealing with customer solutions.

How could the customers be “right” if they do not have a clue as to what we can offer them; and how could we be right if we have not yet achieved a close relationship with the customers that allows us to understand their needs and what we can do together to develop a great value proposition?

The identification and satisfaction of the customer solutions can only be done by working jointly with the customers.

#### 9. The strategic planning process is a dialog among the key executives of the firm – seeking consensus on the direction of the organization

The most important output of the strategic planning process is the process itself.

My approach for a proper process is to engage all the key executives of the business in an open dialog, where ideas are candidly debated, that ultimately leads to consensus. What does consensus mean? I was once asked that question when I was helping Saturn – a company with one of the most participatory management styles that I have ever seen. My answer was – and still is – “Consensus is 70% agreement and 100% buy-in.” This means that there is a time when you want to have every idea challenged through a constructive conflict, but then there is a time to come to a decision on where we want to go and how we are

going to get there. You cannot expect 100% agreement; this would probably lead to paralysis. Seventy percent is a sound and comfortable consensus, but with the understanding that everyone is now aligned with the final decisions. If we have conducted the process effectively, there should be “sparks in the eyes” of the executives, meaning that we have reached a level of contagious enthusiasm that will assure that we have the energy and the commitment to implement the resulting strategic agenda.

10. **Metrics are essential; experimentation is crucial**

Metrics are essential to quantify the value we create for our customer and ourselves and to monitor the progress we make in the implementation of the proposed strategic agenda. The granularity requirement of the Delta Model demands that we develop a customer data bank, which contains information about the potential market available for each customer and the value created by our propositions.

Experimentation is crucial because the Delta Model often generates significant departure from existing practices. This means that we will be walking in untested territory – with the associated risks that are to be expected. Instead of implementing a full strategy under those conditions, it is wise to experiment first. We may want to conduct preliminary pilot programs, with select customers, to identify the best options to implement on a large scale.

**These are the most significant principles that guide the Delta Model.** Throughout the book you will learn about a variety of pragmatic tools to help you make these principles a reality in your organization.