

Chapter One

Strategy: From Following the Rules to Making the Rules

The theory and practice of strategy parted company some time ago. Practising managers and strategy gurus live on different planets. Occasionally they will meet at a neutral venue, such as a conference. The strategy guru will then get on stage, wave his arms and make a brilliant and inspirational speech. After which, nothing happens. The practising manager will return to his business and discover that the best predictor of next year's strategy is this year's strategy. It may be tweaked a little, but it will essentially be the same. There may be more emphasis on one channel, customer or product group. Or perhaps the pace of globalisation will be accelerated, or perhaps a daring CEO might make an acquisition or two. But essentially, the business will maintain roughly its previous trajectory. The exceptions to this rule are notable for being exceptions, not the rule. WPP was a shell company which made supermarket trolleys before it became the world's largest advertising company. Nokia has its roots in forest products. But if you look at the components of the Dow index, you will find all of them would

be recognisable to an executive from the same company 10 years ago. Strategy theory is in danger of becoming one of the great victims of the management revolution. This is probably a good thing. Strategy theory is at best irrelevant to many companies, and at worst it is positively dangerous. The practice of strategy may be duller and more difficult than the glib answers from the gurus. But practice trumps theory every time. In this chapter we will look at why strategy theory is collapsing under the weight of its own contradictions. And then we will look at the practice that is emerging to replace it. First, we have to discover what strategy is. For many managers “strategy” simply means “important”. It is often used to justify something for which there is no other justification. It is little more than puffery, for instance:

- “This strategic IT initiative ... which costs \$100 million ... is essential to the survival of the firm” is a way of saying that the IT project has no financial business case to justify it.
- “Strategic Human Capital Division” is a grand way of referring to the Personnel Department.
- “This strategic programme ...” means that the speaker thinks it is important, even if no-one else does.

Strategic should mean more than “important”. In truth, everyone has a different definition of strategy, which they defend with great vigour. A working definition might be something like this:

- “Optimise the role and resources of the firm to realise its vision.”

This definition raises the basic strategic issues such as:

- Where should we play in the marketplace, against whom (if anyone)?
- Where do we focus our limited resources?
- How do we configure our internal and external value chain?
- What is the best way of serving our market, economically and competitively?
- Do we need to acquire, make alliances or divest to achieve our goals?

It is against this definition we will test both the theory and practice of strategy. And we will test strategy theory against three criteria:

- Does it consistently explain past successes and failures?
- Does it consistently predict future successes and failures?
- Does it prescribe accurately what organisations should do in future?

A theory which can explain, predict and prescribe is going to be very useful to managers. As we shall see, most theory fails on at least one or two of the criteria.

Strategy theory

The theory of business strategy has gone through two major phases: the classical era and the modern era. Both eras are children of the Enlightenment and of modern management: they seek universal laws which can transform average businesses into great businesses. They offer comforting simplicity in a complicated world. If they worked, that would be good. But the strategic medicine on offer is

as reliable as the medicine sold by quack doctors in the Wild West. They are simplistic formulas which are weak in theory and dangerous in practice. We are now entering a third era of strategic thinking, which requires real thinking not just dumb application of an unsound formula. This is the post modern era in which there are no universal and eternal rules of success: there is only what works for each firm in the context of its time and its market. The best success formulas are discovered in practice, not designed by clever analysis.

The classical era

The classical era of strategy theory was in the true spirit of the Enlightenment. Professors, gurus and consultants all searched diligently for the empirical laws of strategy which could explain and predict the success and demise of different organisations. And they all had some success. At the heart of classical strategy are two closely linked theories:

- Porter's Five Forces analytical framework
- The BCG growth/share matrix.

In 1979 Michael Porter wrote "How competitive forces shape strategy" in the Harvard Business Review. It showed that the economic success or otherwise of a firm was dictated by five forces:

- Competitive rivalry within the marketplace
- Threat of new entrants
- Bargaining power of suppliers
- Bargaining power of buyers
- Threat of substitute products.

Nowadays, this would be called a BFO: a Blinding Flash of the Obvious. A company which faces intense pressure on all five forces is going to struggle to be more profitable than a firm which faces little pressure on all five forces. Even more modern theories, such as Blue Ocean Strategy, (Kim and Mauborgne) hark back to Porter: they argue that we should create new uncontested market space. “Blue Ocean” is a fancy way of saying what Porter said 30 years ago: compete where the competitive forces are weakest. Generally speaking, this is a good idea, unless you are an established business in an established market. The idea that an engineering company should reinvent itself as a specialist finance company, or as a creative dot.com, makes sense only to the guru inspiring jaded executives at the big conference. The Five Forces analysis offers neither hope nor insight to executives who are fighting for survival in a heavily contested industry.

The strength and the weakness of “Five Forces” is that it is fuzzy. You cannot easily quantify any of the forces. It does not lend itself to a stunning equation such as $e = mc^2$. This makes it hard to either prove or disprove. It is even difficult to define at what level the analysis should take place. Ferrari and Fiat compete in the auto industry, but arguably do not compete against each other and face very different competitive forces in their market segments. Definitions aside, Five Forces can be very dangerous when applied in practice. It leads to a self-defeating and self-fulfilling prophecy that certain markets are not worth contesting because they are so intensely competed. Household detergents, the oil industry and supermarket retailing are all intensely competed with intense buyer pressure. That does not stop Procter & Gamble, BP or Wal-Mart from being profitable. The steel industry does very poorly on the Five Forces analysis: intense rivalry,

high threat of substitutes, intense buyer pressure. It would take a brave person to tell Lakshmi Mittal that steel is not an industry worth going into: he has become a billionaire by building up Arcelor Mittal. Nor does the Five Forces industry give any insight as to how to succeed in such industries. Nucor has done relatively well by having an innovative business model based on mini-mills and recycling steel. For a practicing manager in an industry, Five Forces is profoundly unhelpful. To be told that you are in an unattractive industry leads to the obvious question: so what? Should we all disappear and set up a dot.com or a vegan farm in Vermont? Nor does it give us any insight as to how we can make the most of the industry in which we are.

The Five Forces found more precise definition in the BCG (Boston Consulting Group) growth/share matrix and its close relative, The GE (General Electric) grid. BCG looked at the relative market share of a company versus the relative market growth of the industry. Share relative to competition was used as a proxy for the competitive strength of the firm. Growth of the market relative to nominal GDP was used as a proxy for the attractiveness of the market. The GE grid used similar dimensions, but allowed for a more qualitative assessment of the attractiveness of the market and the competitive position of the firm.

Both the GE grid and the BCG matrix focused on the individual firm, not just on the industry as a whole. They were also used as diagnostic and prescriptive tools. Depending on where each business was placed on the grid, it was to be treated differently as shown in Figure 1.1 on page 34.

Before we bury the consultant's world of the two by two matrix (or three by three if you are very sophisticated), let us first praise it. First, the growth share matrix is supported by research and

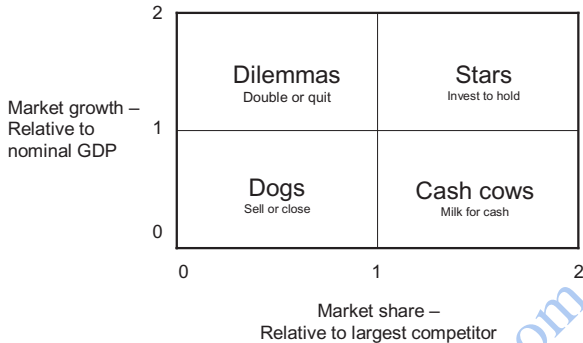


Figure 1.1 BCG growth/share matrix

experience. Market leaders find it easier to generate cash than market followers. This is not surprising. In any business, there are significant fixed costs: the higher volume business (the market leader) gets more revenue for the same fixed cost. Even today, that is a good recipe for better profitability. The problems start when the matrix is used as a substitute for thinking, not an aid for thinking. Then the framework becomes a prison, and a very dangerous prison, for anyone who goes there. Below is a classic output from a portfolio analysis: it arrayed all of the businesses of a food company on the BCG matrix. The size of each circle is in proportion to the sales of each business unit.

When we adjusted the analysis for the requirements of the GE grid, the results were broadly similar. The results illustrate three of the most common problems with such analysis:

1. There were huge problems of definition: were cafes one business or separate businesses for separate chains? Were milling

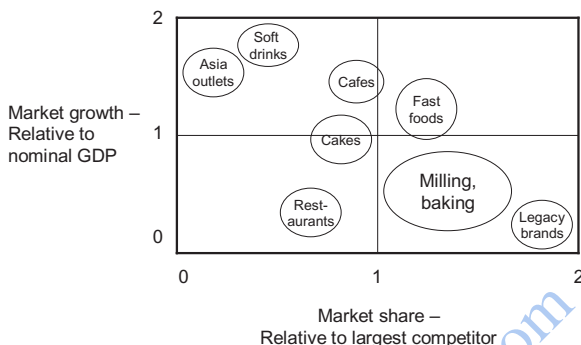


Figure 1.2 BCG Growth/share matrix for a foods group

and baking different or the same? What was the relevant market to compare them against?

- The results tended to cluster around the middle of the chart (for the sake of clarity, the figure has spread them out further than the actual analysis). This made potentially huge decisions rest on very minor changes in either the data or the definitions: it was a recipe for arguments and politicking.
- The prescriptions suggested by the analysis would have killed the patient, not cured it, as we shall see below. Clearly, it is the third problem which is the greatest. The analysis suggested that milling and baking should be quietly run down for cash, while the business focused on becoming a world beater in frozen foods and perhaps a couple of other high growth businesses. But the business was essentially based on milling and baking: that is what they knew how to do best. The more insightful prescription was to invest even more in milling and baking, and to take over other milling and baking operations. Since everyone in the industry was doing the same analysis,

they were more than pleased to dump their milling and baking businesses at low cost. Meanwhile, we sold off the niche businesses in cafes, frozen foods, Asia and the like: these commanded huge prices because everyone who was following the orthodox strategy thought that they should be investing in such high growth businesses. As a result, the baker raised large amounts of money to invest in more baking operations: it improved its operations, market position and cash flow.

Even more radically, another competitor realised that all the major companies were rationalising their brand line ups and wanted to dump their declining legacy brands. It built a large portfolio of such ageing brands, and built expertise in sustaining them: they could give them more care and attention than the large FMCG (fast moving consumer goods) companies.

The experience of these two companies hints at the fatal flaw in classical strategy: it is self-defeating. If one firm follows a strategy it may be strategically brilliant. If everyone follows the same strategy you have competitive suicide. Entire industries have shown that they are highly capable of following suicidal collective strategies. Over the period of 1968 to 2005 ICAO estimate that the global airline industry has lost \$4 billion. Although there are some winners, such as the low cost airlines and some oligopolies, the rest of the industry operates a broken model from which they cannot escape. Other industries get caught up in the hype of the newest idea like the dot.com boom. They think it will be different this time and that everyone will succeed. The madness of crowds affects the boardroom as much as the post room. Four examples will make the point:

1. *Financial Service deregulation UK 1986 (Big Bang)*: Until 1986 only four firms were allowed to make markets in UK government bonds. After deregulation everyone did the same analysis which showed that this would be a very attractive market. 26 players entered the market, and they all lost money for years: too many competitors chasing too little business. Two firms stood against the fashion rush: Schrodgers and Lloyds avoided the market and became highly profitable at least partly as a result.
2. *Telco 3G licences (UK)*: after a marathon 150 rounds of bidding five firms won 3G telco licences in the UK at a cost of £22.4 billion, way beyond the expected outcome of about £5 billion. The price paid came to over £500 per adult in the UK. This was a good example of the winners' curse: they all managed to overpay significantly in their desperation to win.
3. *Dot.com mania 1998–2000*: Dot.com became dot.bomb as the world discovered that the laws of competition had not been suspended for the internet. The tech heavy NASDAQ has essentially been in a bear market for the nine years since the bubble burst.
4. *Global Financial Services (again)*: 2008–2009 credit crunch. Financial services firms thought they had discovered the secret of alchemy: they could lend sub-prime then package up the debt and diversify away the risk. They all made the same, flawed assumptions about risk and diversification. Bankers thought they could make a jewel from a pile of junk through the miracles of diversification and financial packaging. We now know the truth: junk is junk and a pile of junk is not a jewel; it is more junk. The risk did not disappear: the risk bubble grew until it burst and led to global recession.

In each case, very smart managers, bankers, consultants and entrepreneurs were doing the same industry analysis to persuade themselves that they had found a gold mine. It turned out to be fool's gold. They were not digging for gold: they were digging a grave for their shareholders' money.

Let's see how classical strategy tools measure up against the three tests outlined earlier in this chapter:

1. Does it consistently explain past successes and failures? On average, classical strategy diagnostics help sort winners from losers. But on average a human being is 51% female and has less than two eyes. Much of the real interest is in the outliers: firms which succeed in spite of the predictions of classical diagnostics. We can learn as much about strategy from the outliers as we can from the mainstream. As a set of theories, classical strategy suffers from the problem of apples falling upwards: there are too many exceptions to make the theory sound.
2. Does it consistently predict future successes and failures? At an industry level, classical strategy gives an idea of which industries are likely to be profitable. At a company level, it predicts that leaders will remain leaders and laggards will remain laggards. This is broadly true, but the exceptions are numerous and as interesting as the mainstream.
3. Does it prescribe accurately what organisations should do in future? This is the main failure of classical strategy. It either gives no insight as to what managers should do (Five Forces) or it gives potentially the wrong insight (BCG grids). Many of the most successful strategies are creative and owe nothing to the mechanistic prescriptions of classical strategy.

Modern strategy

In the last 20 years there has been a revolt against classical strategy. At the head of the revolution was CK Prahalad, who nurtured a generation of revolutionary followers such as Gary Hamel, Chan Kim and Venkat Ramaswamy who all have Michigan Business School in their backgrounds. The manifesto for modern strategy came in two Harvard Business Review articles on Strategic Intent and Core Competence. Over the years, these ideas have been watered down. Consultants and managers now use “Strategic Intent” as a grand way of referring to a target, and “Core Competence” as a grand way of referring to an thing the firm may be good at doing.

The ideas that CK Prahalad and his acolytes developed were powerful and original. They rejected the highly mechanistic view of the world which Porter and BCG implied. They noticed that many of the big strategic winners were firms which on any rational basis should not have succeeded.

The Introduction showed how the industrial landscape has been changed by upstarts who appeared out of the competitive wilderness. CNN, Canon, Dell, Toyota and SouthWest Airlines all took on heavily entrenched incumbents and succeeded.

Thirty years ago they were competitively irrelevant. The challengers had none of the resources, market power, financial muscle or technology of the incumbents. On any rational strategic analysis they stood no chance of succeeding against the incumbents. And yet in every case the challengers found ways of undermining and overthrowing the incumbents. Also, none of the incumbents relied on the internet revolution: their success was not about technology, it was about management. Clearly, there was something to be learned from these stories.

The answer that CK Prahalad came up with was Strategic Intent and Core Competence. Each of the challengers was very focused on a highly ambitious goal (strategic intent) and carefully built up all the market and technical capabilities required to achieve the goal (core competence). As an example of core competence he would show how Honda's expertise in motors allowed it to play in the markets for everything from snowmobiles, to outboard motors, motorbikes, lawn mowers and small cars.

Although the theory sounds exciting, there are three reasons why the reality does not live up to the hype:

1. *None of the examples of strategic intent and core competence used Strategic Intent or Core Competence.* The theory was retrofitted onto reality. Canon, Xerox, Honda and Komatsu did not use Strategic Intent and Core Competence, although they are held up as examples of it. This is not necessarily bad: an apple does not know about gravity but it still obeys gravity when it falls. Unlike apples, most managers have thought and intention, so we should be cautious about theories based on examples where the theory was not used. There was no systematic test of companies using strategic intent versus a control group not using it. In the absence of such a test, the theory looks like special pleading and story telling more than anything which a professor should put his name to. The theory lacks intellectual rigour or credibility.
2. *There are plenty of other reasons why the challenges succeeded.* The quality movement can claim that the quality revolution was at the heart of the success of Toyota and Honda: a radical re-engineering of the value chain drove Dell's success and that of Ryanair and Southwest followed one of the oldest strategies of all, cheap and low cost.

3. *Strategic intent and core competence are not easily replicated by management.* In practice, they are used as rallying calls to get managers to accept tough goals and to focus limited resources better. These are worthy objectives, but scarcely revolutionary.

A second generation of modern strategy arrived with CK Prahalad's protégé, Chan Kim. Chan Kim, assisted by Renée Mauborgne, introduced Blue Ocean Strategy to the world. There were two core ideas at the heart of Blue Ocean Strategy. First, it is better to seek out uncontested territory (Blue Oceans) rather than compete in highly contested existing markets (Red Oceans). As a way of finding uncontested territory, managers were to draw value curves of what their customers really wanted and what their competitors offered and then re-engineer their competitive offering to deliver maximum value at minimum cost. This is called value innovation and leads to companies deciding which value factors can be reduced or eliminated, raised or created entirely afresh.

Their examples include Formule 1 hotels (which are very cheap), Cirque du Soleil and Dyson vacuum cleaners. Yet Blue Ocean Strategy suffers from the same three problems as strategic intent and core competence

1. The theory has no intellectual validity: there is no control group, no systematic test of the theory. Attractive but selective stories of business success are just that: attractive, but selective. It is as valid to read a business leader's autobiography and try to follow those stories of success. Richard Branson, Jack Welch and many others are not shy about offering advice and giving insight into their personal brilliance.

2. The firms they studied did not use Blue Ocean Strategy and succeeded for many other reasons. Dyson's vacuum cleaner was not a product of analysing and designing value curves. It was the product of analysing and designing vacuum cleaners so that they work better. Theories are retrofitted onto past success.
3. Blue Ocean Strategy is not easily replicated by management. China Mobile CEO Wang Jianzhou talks about China's hinterland as a classic "blue-ocean market", but that is less a matter of strategic brilliance and more a case of regulatory permission and licensing arrangements. Legacy firms find it hard to create completely new ways of competing in new markets: Blue Ocean describes how new entrants compete more than it helps legacy firms.

Modern strategy is a revolution which is failing. It is long on hype and hope, but short on results or practicality. Simplistic formulas are good business for gurus, speech makers and consultants. They are attractive, but unhelpful, for managers. This leaves managers in an awkward spot. Orthodox, classical, strategy is clearly dangerous for all the reasons that the advocates of modern strategy point out. But modern strategy does not seem to offer the solution either. This appears to leave managers nowhere to go: no-one seems to have an answer to their pressing strategic challenges.

Perhaps managers are looking in the wrong direction. For a generation or more, managers have been dazzled by the brilliance of strategy gurus from Porter through Hamel to Chan Kim and beyond. As young managers they have paid a small fortune to learn the prescriptions at business schools. As senior managers they have

paid a large fortune to hire the gurus and the consultants to give them the answer. And the gurus and consultants have been very persuasive: like the medicine men of the nineteenth century Wild West they have promised to cure every corporate disease from a flagging share price to drooping morale. The shock is not that anyone offers the quack medicine: the shock is that managers want to buy it.

If gurus and consultants offer the quick fix, it is tempting to take it. If you follow the latest fashion, or if you hire McKinsey, then you cannot be faulted for effort even if things go wrong. If you have not explored Blue Ocean, or whatever the latest fad may be, then you are at risk if things do not go well. Fad surfing is easy and low risk. And in practice, the consultants may do some good anyway. They will use the latest fad as an excuse to work with you. Once they have started, consultants will do what is best for you, rather than be slaves to fashion following the latest fad or formula.

Using a formula, any formula, probably leads to the Hawthorne effect: just by doing something as opposed to doing nothing, managers are likely to improve performance. This should not be taken as proof that the formula works: it should be taken as proof that active management is preferable to passive management. The Hawthorne effect was noted after a series of experiments at the Hawthorne works outside Chicago over 1924 to 1932. Each time working conditions were altered, productivity rose. When conditions were returned to the original state, productivity rose again. Staff were responding to the attention they received, rather than to the changed conditions.

Managers have let themselves become too dependent on the fads, gurus, consultants, formulas and quick fixes. The strategic

revolution is to declare independence from the whole strategy industry. Originally, the strategy industry supported and helped managers. Now the industry has become a monster which is always looking for new clients on which to feed its insatiable appetite for revenues. The consulting partner's secondary objective is to help you: the primary objective is to meet the fees and earnings goals of the consulting firm.

Strategy frameworks which were originally intended to assist management thinking have become substitutes for thinking. When frameworks become formulas, they become prisons which stop managers thinking rather than help them. Both classical strategy and modern strategy can help if they are used properly: to help the creative process rather than as a substitute for it.

Strategy in practice

In practice, the strategic process is more creative and unpredictable than the formulas of modern and classical strategy imply. To tell managers that the strategic process is creative and unpredictable is liberating, but not helpful. Instead of abandoning managers in a bog of uncertainty, it pays to help in three ways:

1. Illustrate the variety of strategic approaches.
2. Show how managers can be creative.
3. Show how managers can evaluate a strategy.

Different types of strategic approach

There is no simple formula for creating a successful strategy. Different sorts of firms in different situations use different approaches. A critical difference is between incumbents and new

entrants. New entrants need new approaches and can afford to be radical. They cannot afford to compete in the same way for the same markets as the incumbents. The priority for incumbents is to protect what they have and perhaps grow incrementally. They will try to raise barriers to entry. For both incumbents and new entrants, competitive advantage can focus on the customer franchise, competitive weaknesses, product innovation or excellence or process efficiency and cost leadership. There is a huge range of ways to compete and succeed. The table below summarises the main types of approach:

	Incumbents: raise entry barriers, create multiple layers of advantage	New entrants: asymmetric warfare, new competitive space
Customer focused	Branding, inertia: P&G, Unilever	Exploit new market space: Facebook, Cirque du Soleil
Competitively focused	Network, scale economies: Utilities, phone companies, Microsoft, Google	Exploit segments ignored by incumbents: Komatsu, Canon
Product focused	Internal innovation machines: Pharmaceuticals, aero engines	Better mousetraps: Dyson, Freeplay
Efficiency/economically focused	Learning curve, scale economies Auto manufacturing, banks	Re-engineered costs: Discount airlines, Dell

The purpose of this framework is to show the variety of strategic approaches which can work. It is not intended to be a strategic formula which managers slavishly follow. The whole point is that there is no single recipe for strategic success. New entrants, in particular, need to find new ways of competing if they are to succeed against the incumbents. David did not beat Goliath by fighting on the same terms as the giant. He changed the rules of the game by using a sling shot instead of his fists: he was adopting asymmetric warfare and strategy without the help of any fancy theory. The prospect of death can be a great spur to creativity.

Within this framework, there is a deeper choice to be made. The choice is between root or branch strategy. Branch strategy is incremental: it is based on muddling through. Root strategy is about step change and challenging the fundamental logic of the firm and the industry. Most firms, most of the time, prefer branch strategy. They muddle through. The best predictor of next year's strategy is this year's strategy, with the odd tweak here and there. This is a much maligned approach, but it works very well in stable industries. The risks are low and it follows the first imperative of most firms: defend what you have. When a new entrant comes in with a root strategy, with asymmetric competition, the branch style firm often does not have the capacity to change. They continue to find that defending what they have is preferable to fundamental change. By the time the need for fundamental change is accepted, it is often too late.

How to be creative strategically

When managers are told to be creative they tend to break out in a cold sweat. It conjures up images of brainstorming sessions where you are asked to imagine what sort of car or dog you or your product would be if it was a car or a dog. Fortunately, you do not

have to think about cars or dogs to be creative. There are at least four ways in which to be strategically creative:

Copy an idea

Copying doesn't sound creative, but it is effective. Take someone else's idea and scale it up or copy it into another market. Ryanair essentially copied SouthWest airlines and imported the discount airline model into Europe. The idea was there for all to see: Ryanair had the wit to take the idea up. Ray Kroc bought up an idea for fast food developed by Dick and Mac McDonald: their restaurant at San Bernadino, which was based on production line methods, also inspired James McLamore (Burger King) and Glen Bell (Taco Bell). Copying is highly effective: the market research and feasibility has already been done which reduces both the risk and the investment. There are great ideas out there today, for anyone who has the courage to copy them and build them.

Solve a problem

Creativity is not just about blue sky thinking. It is, essentially, problem solving. The tougher the problem, the more creative the solution is likely to be. Dyson wanted to solve the problem of vacuum cleaners having dirty bags which reduced suction as they filled up. 5,127 prototypes later he had finally designed his world beating vacuum cleaner. Dyson's example shows that solving problems is not easy.

The tougher the problem, the more creative the solution has to be. For instance, when I first started work with P&G, Jurgen had been given his big break: he was to become a country head for the detergent manufacturer. His brief was simple: make the country profitable and become market leader. The brief was simple, the

solution was difficult. The market leader had about 60% market share with one product, Whizz. Jurgen's product (Sudso) typically had about 40% market share. Whizz benefited from economies of scale: manufacturing unit costs were lower and its advertising budget went much further. Because Whizz was the brand leader, the retail trade supported it better and normally offered it at a discount to Sudso, even although the trade bought both products at the same price. Every time Sudso tried something, Whizz could either outspend it on advertising, or beat it on price. Sudso lost money, Whizz made money.

Jurgen's solution was radical. He ignored the scale economies by launching a series of niche brands to attack Whizz. One premium detergent was for heavily soiled clothes and another for delicate woollens; a discount brand was launched to undercut Whizz; another offered fabric conditioning as well as cleaning. Suddenly, Whizz had nowhere to go: it could not attack all the brands on all price levels at once. So it was cannibalised by all the niche products. And if Whizz's owners launched their own niche products they would simply cannibalise Whizz further and destroy its scale economies.

Jurgen's solution worked, at great initial cost. It was creative problem solving that would not have come from following any of the strategic formulas of classical or modern strategy.

Experiment

Strategic innovation rarely follows an entirely logical path. The dot.com boom was an orgy of innovation, most of which failed. Webvan and Boo.com blew billions of dollars in developing faulty models for grocery and clothes retailing respectively. It took a long time to discover that paid search, not banner advertising, was the

way to monetise eyeballs in on-line search: Google emerged as the winner. Experimenting with large amounts of shareholders' money tends to be a way of losing money fast. Many of the best concepts start with a good idea, not with money. Dell started with a simple idea borne of desperation: build computers to order. At one stroke this removed the need for stocks, fire sales, sophisticated forecasting and large amounts of working capital. Many great business ideas are discovered, not designed. This implies that there is an element of randomness, of luck, in creating a world beating strategy.

Get lucky

Luck is important. For instance, Lloyds Bank decided to launch a bid for Standard Chartered which had global reach. Lloyds used its in-house investment bank, which managed to lose the bid by a wafer thin margin. Enraged, the CEO decided to abandon its investment banking and global ambitions: instead he focused on domestic acquisitions in the UK. It was a stunning strategy which led to Lloyds becoming one of the most profitable banks in the world. It was successful, but not what he had originally intended.

In aviation, Richard Branson set up Virgin Atlantic as a successor to the ill fated Laker Airlines which went bust. Virgin was also a discount airline with a very small upper class section for Branson and his music industry friends. It was not a sustainable economic model. But word spread about the fantastic (but small) upper class, and soon enough Branson found he had to expand it. Eventually, it became the main profit driver of the business and enabled him to succeed where Laker had failed, because he focused on premium traffic, not just discount traffic.

Of course, luck is not random. You have to seize the moment. Luck only comes to those who look for it. Equally, even the most creative and successful businesses find it hard to be lucky consistently. Few businesses and few lottery players hit the jackpot more than once. Google hit the jackpot with paid search: since then they have invested massively in a range of offerings from Google Maps, Street View, Google Earth, Google docs. These may enhance the core offering, but they are notable for not creating a revenue stream to equal the paid search business. Other breakthrough businesses such as eBay, Amazon, Dell and Skype have found a second breakthrough very hard. If there is a formula for innovative success, it seems to work at most once per firm.

How to develop a strategy

None of the strategic stories illustrated above fit into a neat formula. And that is the point about strategic formulation. You cannot start with a strategy manual at page one and then emerge at page 276 with a world beating strategy. This is good news for management. Managers are not slaves to someone else's formula. Managers have the freedom and responsibility to create their own future.

Strategy is a battle for ideas, and good ideas do not come from simplistic formulas. Good ideas come from seeing the world from different perspectives and challenging orthodoxy. Many of the best ideas do not come from management themselves: they come from customers, suppliers and staff. This means that the role of the manager is changing. Bosses do not have to be the brains of the business. Their job is not to do all the thinking for the firm, because in the knowledge economy no-one has a monopoly on knowledge or wisdom. The job of the strategist is to harness the wisdom,

knowledge and experience of the customers, suppliers and staff to discover the solution.

The process of strategy development is messy. Typically it will consist of four elements:

Multiple perspectives

This is the natural habitat of the business school case study and the strategy consultant's case interview method. Take a problem and look at it from every angle. Asking the right questions is the only way of finding the right answers. Some of the right questions include:

- Economic perspective: how do we make money in this market? Which market segments are most profitable for us? What are the economics and scale effects of this market?
- Competitive perspective: how do our competitors make money? Which segments are they strongest in? Which segments do they overlook?
- Customer perspective: what do customers really want? What is our value proposition, our competitor's value proposition and what does our customer value? How much does it cost to acquire, serve and retain different sorts of customers?
- Channel perspective: how do we and competition go to market? Which channels do we use? Are there alternatives? What are their economics?
- Resources perspective: what technology, capabilities, rights can we exploit ourselves, or with our suppliers and through alliances and acquisitions? Where can we best focus our limited resources or find more?

When you ask these questions, be patient. Experience shows that 19 out of 20 questions may lead to a dead end. They are a waste of effort. But the twentieth question may be the one that generates the insight. Most great strategies are built on one simple insight: finding the simple insight can be very difficult.

Multiple approaches

This is where the various strategy formulas are useful. Value curves, strategic intent, BCG grids, Porter's Five Forces, SWOT analyses and more will all give different insights as to what is possible and what needs to be worked on harder. Use them to provoke thinking, not as a substitute for thinking.

Endless iteration

No individual has a monopoly on truth or insight. But the chances are that each person holds one piece of the strategic jigsaw which you are putting together. This process of talking through ideas takes time and effort. Within it, there are two traps. In many firms the process of strategic debate is not about finding the best way forward for the firm. It is about finding a consensus which minimises the risk for all the managers involved in the process. Consensus building rarely leads to breakthroughs. The purpose of the discussions is not to find a consensus: it is to find the insight that takes the firm to the next level of performance. Use of consultants and strategy formulas is another way of minimising risk, building consensus and avoiding insight. In these discussions, many managers will want to prove how clever they are by finding all sorts of problems, objections and challenges to any ideas. These challenges are politically and emotionally draining. These managers are very good at killing good ideas and preventing insight or

progress. But they can also be used to test, push and develop an emerging idea even further.

Rapid testing of ideas

Some ideas can be tested through market research, although this can be a huge bear trap (see the chapter on marketing). The bear trap is that consumers often say what they think they ought to say, and their comments are constrained by what they know. They will not imagine the future for you. Innovative market research can avoid these bear traps, but the best research of all is marketplace experience.

Conclusions

Great strategy is normally very simple, but achieving simplicity is very hard. The simplistic formulas of the past are both flawed and dangerous. When managers ride the wave of orthodoxy, they sink or swim with the fortunes of the industry. Very few firms show that they can consistently swim against the fortunes of their industry. To become leaders, firms cannot follow orthodoxy. They have to be different in a relevant way.

Strategy differs greatly between new and established firms. New firms have to fight asymmetric battles: they cannot afford to fight on the same terms as the more powerful incumbents. These breakthrough strategies are often discovered, not designed. They come from seeing and solving a problem, from playing with products, from listening to customers. They succeed with a mix of luck and courage from the founders. Established firms are more risk averse. Instead of breakthrough strategies, they focus on defending what

they have and then growing incrementally. They muddle through, reacting to threats and opportunities as they emerge.

Whether strategy is breakthrough or incremental, it does not rely on the simplistic formulas and formal processes of consultants and gurus. It is not about a few brilliant brain boxes designing the future on a PowerPoint presentation. The role of the manager is no longer to be the brains of the business. Managers need to liberate and harness the talent of the customers, suppliers and staff to discover and implement strategy. This is a world which is far more exciting, and dangerous, than the top down world of tired strategic formulas.

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