Understanding the Need for a New Approach to Strategy Development

<div style="text-align:right">1</div>

The important thing is to not stop questioning. Curiosity has its own reason for existing—Albert Einstein

Who still remembers Blockbuster? In the 1990s, Blockbuster was the market leader in movie rentals in the United States of America. It had a good understanding on how customers were renting movies, namely based on impulse. In addition, it had sound capabilities of renting videos to consumers through a large network of stores and generating revenues by charging a renting fee. Its strategy was developed using a traditional backward-looking analytical approach, resulting in a sound business model viable over many years. Still, in 2010 Blockbuster had to file for bankruptcy protection. So, what went wrong? The quick answer to that question is Netflix. But that is too short-sighted. Blockbuster failed to realize the changing environment and adjust its strategy accordingly.

Netflix took a different approach to strategy development (Shih and Kaufman 2014). Rather than relying on an analytical, backward looking methodology to strategy, it started by observing how customers rented movies and which pain-points they were faced with. They identified that a key pain-point faced by many movie renters was the late-fee charged by Blockbuster. Late-fees made-up a significant portion of the revenues in Blockbuster's business model. Netflix then tried to identify the causes of that late-fee pain. Why were customers faced with late fees? What were the reasons behind their inability to return the rented movies on time? And more importantly, how could this pain-point be addressed? The answer to the question was "lack of time to return the rented movies on time", which Netflix solved by offering a mail-based solution rather than an in-person solution.

Shipping large VHS cassettes was tedious and expensive. So, Netflix searched for an alternative. Although promising, live streaming via internet technology was not yet mature at that time. They looked for an alternative movie delivery medium and singled out DVDs as an emerging technology early 2000. Having solved the mail order size problem by replacing VHS cassettes with DVDs, Netflix was faced with another challenge. Not every household had a DVD player yet. Again, they

adjusted their strategy by focusing on those customers who had recently bought a DVD player.

Another challenge inherited from the generic movie-rental business model was that, although there are many movies available at any given point in time, only a small number of movies, the blockbusters, are actively sought out and rented. This often led to blockbusters being unavailable for rental and customers being unhappy. Rather than increasing the number of blockbuster movie copies available, which would have been very costly, Netflix prototyped a different idea, trying to match movie availability with customer preferences. If a requested blockbuster movie was not available for renting, Netflix suggested a second-best alternative, based on an in-depth understanding of the customer's preferences. To do so, they developed a movie rating database and used pattern matching algorithms, that is, artificial intelligence, to identify potential movie alternatives. Iterative learning allowed refining the algorithm over time and resulted in the ability to optimize the movies to be held in stock.

A further issue Netflix faced in their mail order business was the delay introduced by mail delivery. Rather than going to a rental shop and returning with the desired movie, customers had to wait for the postal service to deliver the ordered movie DVD. To address that drawback, Netflix introduced an optimized hub-based supply chain management approach that sped up rented movies delivery. By thinking out of the box, they came up with a subscription-based pricing model relying on their capabilities to forecast customer movie preferences. This means, they rented out movies based on identified customer preferences without the customers having to place any order, making the overall process much more efficient.

Further down the road, Netflix introduced video-on-demand, and most recently concluded that it needed to produce its own content, like House of Cards, Orange is the New Black, Narcos, or The Crown, to be able to differentiate from competitors. And one can be curious to see what will be the next strategic adjustment that Netflix will make to address changing customer needs and technological innovations.

Most of the strategic choices made by Netflix would not have been possible using traditional analytical strategy development frameworks. Successful strategy design methods need to be able to cope with a rapidly chaining environment. They have to be forward-looking rather than backward-looking. They also require a superior understanding of customer needs, their felt pains and sought-after gains. Research-based, inwards looking, analytical approaches fail to cope with the dynamics of both. A paradigm shift is needed. Before describing a solution to the faced strategy development challenges, let me start by characterizing what strategy is and is not.

1.1   Understanding the Concept of Strategy

Through time, three complementary types of approaches to strategy have emerged: the environmental approaches, the capabilities- or resources-based approaches, and the customer-centric approaches. Figure 1.1 illustrates the three approaches and how they complement each-other.

Fig. 1.1 Approaches to
business strategy focusing on
three complementary
elements
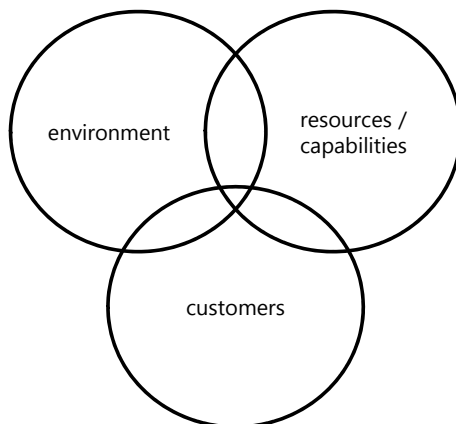
1.1.1   Traditional Definitions of Strategy

According to Porter (1985), strategy is about identifying and subsequently exploiting competitive advantages. Competitive advantage can either be achieved through cost leadership or through differentiation. More formally, developing a strategy means defining a particular configuration of the value chain, which is unique and sustainable over time, providing an offering that cannot easily be copied by competitors. Strategy is about choice, making trade-off decisions while competing (Porter 1996). Porter's definition of strategy is a combination of an environmental approach, such as his five forces model,[1] and a capability-based approach, for example, by focusing on the value chain concept. The process is analytical and focusing on convergent thinking.

Barney (1991, 2001a, 2001b) takes a different approach. He defines a strategy as a means of exploiting a firm's resources and related internal strengths to exploit environmental opportunities and neutralize external threats. The SWOT[2] analysis framework is at the core of developing such strategies. Success is based on effectively mapping resources to opportunities. Such strategies are called resource-based.

Mintzberg (1978, 1994, Mintzberg et al., 1988), another key strategy scholar, defines strategy as a stream of managerial decisions and actions, which are sometimes deliberate and at other times emergent. Strategic decisions are mostly based on managerial intuition and creativity, rather than analytical thinking. Mintzberg proposes a process-based approach, focusing on creativity and resulting in an integrated perspective of the firm.

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[1]These five forces are (1) industry competition, (2) potential new entrants, (3) power of suppliers, (4) power of buyers, and (5) threat from substitute products and services.
[2]SWOT—Strength Weakness Opportunity Threat.

A commonality of these definitions of strategy is that they fail to include customers and their needs as a central element. Satisfying customer needs is seen as a consequence of strategic decisions rather than their driver.

1.1.2   Strategy from a Designer's Perspective

Traditional strategy development processes are analytical, linear, problem-focused, and backward-looking. They aim at exploiting the known by applying analytical and quantitative approaches. The analysis is often outsourced to consultants. By contrast, designers foster creativity, iterate, focus on solutions, and are forward looking. They aim at transforming existing conditions into new ones, to achieve future improvements. They approach problem solving from the point of view of the end-user and call for creative solutions by developing a deep understanding of unmet needs. Designers help structure team interactions by cultivating greater inclusiveness, empathy, and align individual goals around shared results (Mootee 2013). They put real people, not statistics, at the forefront. They emphasize the importance of exploration into the unknown, by focusing on qualitative and empathetic approaches. They engage stakeholders in co-creation. This makes their approach a sound alternative for strategy development.

The design thinking framework formalizes strategy development by offering a *strategy design process* supported by a common language addressing four key questions:

(1) What customer needs, pain-points, and sought-after gains are currently addressed or nor addressed, and what customers are not served?
(2) How can the identified needs and pain-points be addressed in a way that customers are willing to pay for?
(3) What are the distinct capabilities and resources required to achieve a sustainable competitive advantage in delivering upon the promises made, that is, addressing the identified needs?
(4) How is the strategy ensuring that sustainable profits can be generated?

In contrast to other approaches to strategy, design thinking focuses on *generating value for the customers in a differentiated and sustainable way*. Strategy is about choice, what to do and what not to do, whom to serve and whom not to serve. It is about competing in a given environment by differentiating from competitors and delivering superior value to customers. Strategy is the destination a firm aims at reaching, rather than the path to that destination. Strategy design, the identification of the destination, is separate from strategy implementation, the path towards the identified destination, as illustrated in Fig. 1.2. Strategy design is not about planning. It is even much less about developing a business case. Some of the largest companies have turned to design thinking as a way to deal with disruption and sustained competitiveness (Mootee 2013).
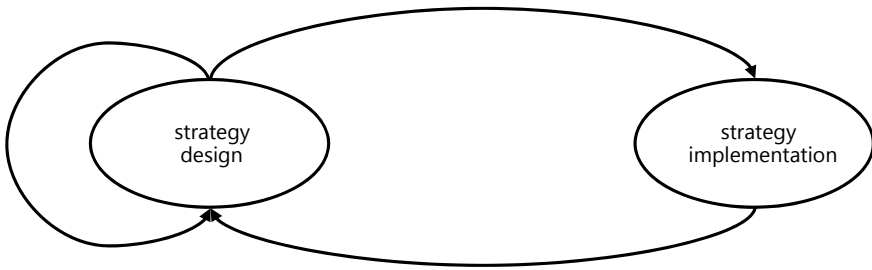
Fig. 1.2 Iterating between strategy design and strategy implementation

1.1.3   A Distinct Definition of Strategy

Strategy in this book is defined as the combination of a *strategic focus*, that is, a differentiating value creator, a *business model* describing how the firms aims at delivering value to customers and other stakeholders, and an approach to differentiate, focusing on the *competitive positioning* of the firm in the business environment.

$$strategy = strategic\,focus + business\,model + competitive\,positioning$$

The strategic focus defines the big picture or the foundation. The business model considers how the firms creates and delivers value by addressing customer jobs-to-be-done relying on capabilities and resources and collaborating with partners and suppliers. Competitive positioning addresses the competitive environment and defines how the firm intends to use its competitive advantages to succeed. But how can we design such a strategy?

1.2   Traditional Strategy Development Processes

To better understand the challenges faced by applying traditional processes to design successful strategies, let me review the most prominent strategy development approaches and identify their strengths and weaknesses in a rapidly changing business environment. The academic literature on strategy broadly distinguishes between two types of strategy schools, the *prescriptive school* and the *descriptive school*.

1.2.1   Prescriptive School

The oldest prescriptive school is the *design school*, advocated by Chandler (1962), Ansoff (1965), and Andrews (1971). Note that the prescriptive strategy design school is unrelated to design thinking and must not be mixed up. The prescriptive

design school focuses on matching internal capabilities to external opportunities. The core framework used is the SWOT analysis. Strategy development is the role of the firm's leader, the CEO or the chairman. Strategy design is separated from strategy implementation and kept simple and informal.

The second prescriptive school, the *planning school*, advocated by Steiner (1979), sees strategy development as an analytical and linearly convergent process. It mainly relies on strategic planning, which is how a firm's value chain is configured and resources are allocated, based on a set of strategic directions. In contrast with the design school, the planning school sees strategy development as a bottom-up approach involving line managers.

The third prescriptive school, mainly shaped by the work of Porter in his two landmarked books *Competitive Strategy* (Porter 1980) and *Competitive Advantage* (Porter 1985), is called the *positioning school*. It focuses on context, using frameworks such as the five forces model, rather than on process or on planning. It defines strategy as selecting from a constrained set of competitive positions and implementing the business logic behind them.

1.2.2   Descriptive School

The *descriptive school* towards strategy development places a higher value on the content rather than the process. It focuses on what the strategy represents rather than how it is derived. At least seven distinct descriptive schools can be identified.

The *cognitive school* defines strategy by looking at how people perceive patterns of data and process information. It focuses on what is happening in the mind of the strategy developer and how information is processed into insights.

The *entrepreneurial school* defines the strategy process as a visionary process that takes place in the head of a charismatic entrepreneur. The school stresses the innate nature of the key strategy development building blocks, that is, intuition, judgment, wisdom, experience, and insights. There exist three major sub-schools (Ott et al. 2017), those who strategize by doing—learning from experience, those who strategize by thinking—creating a holistic understanding, and those who strategize by iteratively doing and thinking.

Proponents of the *learning school* define strategy through what does and what does not work over time. They incorporate lessons learned into the overall strategy. The underlying principle of the learning school is that the world is too complex to allow a strategy to be developed all at once. Hence, the strategy of a firm emerges in small steps, as the firm's strategists learn.

Scholars stemming from the *political school* see strategy as the outcome of a negotiation process between powerhouses within the firm and with external stakeholders.

Strategy formulation in the *cultural school* is viewed as a fundamentally collective and cooperative process, involving various groups and departments within the firm. Strategy is seen as the outcome of a reflection on the corporate culture of the organization.

The *environmental school* defines strategy as the response to the challenges imposed by the external environment. The environment plays an active role in the strategy itself. It drives any strategic decision.

Last but not least, the *configurational school* defines strategy as the process of transforming an organization from one type of decision-making structure to another.

1.3   Challenges Faced by Traditional Approaches to Strategy Design

Four key challenges can be identified when trying to apply strategy development processes based on traditional strategy school thinking, whether prescriptive or descriptive, to the current fast-paced and ever-changing business environment:

(1) *Speed*—They are slow to execute.
    Traditional strategy development schools define sound approaches to the strategy development process. But they fail to cope with the fast-changing world, mainly due to their analytical foundations. They are slow, rigid, and often very ineffective.
(2) *Customer focus*—They tend not to focus on customers, their needs, their felt pains, and sought-after gains.
    Traditional strategy development approaches primarily focus on capabilities, those of the firm, those of competitors, and those defining the environment (suppliers, substitutes, etc.). They take an internal approach. They put the firm at the center of the strategy. But they fail to focus on customers and their jobs-to-be-done.
(3) *Complexity*—They are complex and hard to understand by the non-strategy trained manager or executive.
    Managers have a hard time navigating complex strategy frameworks, like Porter's five forces (Porter 1979), by themselves. It is an incorrect assumption to believe that successful managers are necessarily trained strategists.
(4) *Outsourcing*—More often than not, are large parts of the strategy development process outsourced to industry experts and strategy consultants.
    Consequently, the buy-in into the developed strategy is only half heated, resulting in a lack of follow-through.

Any good strategy development process requires guidance and simplicity, both in language and methodology. Successful strategy development requires decision makers to board a journey of discovery, exposing them to experiences that will align their beliefs with the outside world. The guidance and methodology may, and probably should, be facilitated by an independent method and moderation expert.

Yet the actual strategy design and validation work must be performed, or at least closely supervised, by those executives and directors who are ultimately responsible for its fate.

1.4 Design Thinking as a Solution

Any successful *strategy design process* addressing the identified challenges, should exhibit six key characteristics:

(1) Consistent with the strategy design school, the strategy design process should be *top-down*, starting with designing and validation a sound foundation.
(2) The strategy design process should follow an *agile*, just in time, sometimes also called lazy, approach, allowing for refinements and pivoting along the way.
(3) The focus should be put on *designing the future* rather than analyzing the past, notwithstanding learning from historical successes and failures.
(4) To ensure buy-in and subsequent successful implementation, the strategy design process should *integrate stakeholders* early in the design of the strategy, especially at the validation step.
(5) There does not exist not a one size fits it all approach to strategy design. Any successful strategy design process must allow for different types of strategies, that is, *customer centric* strategies, *innovation-oriented* strategies, *capabilities-based* strategies, or *cost-driven* strategies.
(6) And finally, the strategy design process must put the *targeted customers at the center* of any strategy design activity.

Design thinking is a method for solving wicked problems[3] (Churchman 1967), that is, problems with no upfront clear solution. It is based on abductive reasoning.[4] It aims at iteratively designing and validating solutions using a forward-looking approach and putting the customer at the center stage.

Strategy design is a typical wicked problem. It exhibits the four traits of openness, complexity, dynamism, and networking, as defined by Dorst (2015). The strategy design problem is an open problem, as its borders are unclear and permeable. There does not exist a single best solution. It is complex in the sense that it consists of many interrelated elements—like customers, competitors, suppliers, and regulators. Strategy solutions need to be dynamic, allowing to adapt to an ever faster changing environment. And solving the strategy design challenge requires

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[3]A wicked problem is a problem that does not have a definite solution and as such cannot be solved using linear problem-solving techniques. Solving wicked problems requires continuous reformulation of the problem.
[4]Abductive reasoning is a form of logical inference which starts by observing, followed by searching for the simplest and most likely explanation, refining it until the solution is considered sound.

considering a network of stakeholders constantly influencing each other, rather than focusing on a single individual or group. Design thinking, combined with the business model framework and game theory, is predestined as a solid approach to developing sound strategies. In addition, integrating stakeholders throughout the strategy design process is key to success. Strategy design must become a mindset, rather than a procedural exercise (Bradley et al. 2011).

1.4.1   Design Thinking Approach

Design thinking is an abductive approach to problem solving, combining the advantages of design and thinking. It finds its roots in architectural and industrial design. The underlying process can be characterized by a two-by-two matrix, as shown in Fig. 1.3. The first dimension looks at the thinking process, which can be divergent or convergent. The second dimension describes the time period considered, which either focuses on the past or on the future.

In contrast with other approaches, design thinking zeroes in as much on the problem specification as it aims at finding a solution. It also moves away from identifying the single best solution, targeting superiority rather than optimality. Figure 1.3 illustrates the four steps that define design thinking, as it most appropriately applies to strategy. It summarizes the tools to be used during each of the four steps, namely observing, learning, designing, and validating. Different design thinking approaches use different terminologies for the various steps or decompose the activities in distinct ways, but the underlying philosophy remains the same.

past/present	**(1) Observing** • Observing • Interviewing • Mind mapping • Answering five-why questions	**(2) Learning** • Classifying information • Determining analogies • Identifying personas • Documenting customer journeys and value chains
future	**(3) Designing** • Ideating • Brainstorming • Prototyping • Building mock-ups	**(4) Validating** • Hypothesizing • Experimenting • Running simulations • A/B testing
	divergent thinking exploratory analysis	convergent thinking confirmatory synthesis

Fig. 1.3 Four quadrants defining the design thinking approach, including possible tools to be used at each step

Chapter 2 explores design thinking in more detail and reviews different variations of design thinking processes from a historical perspective.

To avoid non-value-adding analysis, design thinking proceeds in an agile, just-in-time, way, moving to the next step as soon as enough insights have been gained. Whenever insights from a previous step turn out to be insufficient or incorrect, design thinking iterates back to the previous step and reconditions the missing or incorrect information. This allows proceeding in an agile way and avoids the use of unproductive labor whenever possible.

1.4.2 Delivering Value to Customers

Traditional strategy development processes primarily focus inwards on the firm and outwards on the competition, leaving customers as a residual. Design thinking supports building the strategy around the customers and their jobs-to-be-done. To be successful, strategy design must address four categories of questions related to customers (Brown 2009):

(1) *Desirable*—Are the offerings and associated value propositions underlying the strategy desired and sought-after by the targeted customers? Do they help satisfy a need, alleviate a pain, and/or provide additional gains to the targeted customers?
(2) *Feasible*—Can the firm deliver upon the promises made to the customers, both in terms of functionality and quality? Can the value proposition be upheld?
(3) *Viable*—Do customers consider the value of the offering worth paying for? Are customers willing to pay a price which will allow the firm to generate a profit?
(4) *Distinct*—Can customers distinguish the offering of the firm from that of its competitors? Do they value the uniqueness during their purchasing decision journey?

1.4.3 A Common Language

When individuals with diverse backgrounds, from marketing, product development, operations, legal and compliance, to finance, collaborate on the design of a new or the upgrade of an existing strategy, a common language is required. The business model canvas, introduced by Osterwalder and Pigneur (2010), provides such an easy to understand language, allowing for common fact finding, designing, and validating by all stakeholders involved in the strategy design process. Through its four major components, that is, customers, offerings, capabilities, and financials, it ensures a holistic approach to strategy design. Distinct levels of abstraction support the top-down approach.

1.4.4 Integrating Stakeholders

A strategy is only worth what senior management, executives, and members of the board of directors, believe it is. Having senior decision-makers on board is core to success. To achieve this needed buy-in, design thinking integrates all key stakeholders into the strategy design process from the beginning on. Senior managers are expected to participate, based on their experience, in the fact-finding steps (observing and learning steps). But more importantly, the designed strategy should be the outcome of a collaborative exercise between senior decision makers (designing step). Especially important is the active involvement of decision makers at the validation step. Participation in validating the assumptions ensures a higher degree of confidence and a commitment in the formulated strategy.

1.4.5 A Three Layers Process

The advocated strategy design process ensures success by decomposing strategy development into three layers, that is,

(1) the *foundation layer*,
(2) the *business model layer*, and
(3) the *competition layer*.

Each layer focuses on a specific characteristic of a strategy, starting with an operationalized version of the vision concept—the foundation. Based on the foundation, the business model supporting the strategy is designed. It defines the key elements of a successful firm. The third layer focuses on competition and differentiation. It puts the business model into perspective and ensures a positioning that provides a lasting competitive advantage. Each layer is described and discussed in a separate part of this book, part III focusing on the foundation layer, part IV on the business model layer, and part V on the competition layer.

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