THINKING INSIDE THE BOXES

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Strategy used to be about protecting existing competitive advantage. Today, it is about finding the next advantage. In fact, strategy starts to decay the day it is created. That's why corporations must develop strategies that address *tomorrow's* business realities.

Actions that companies take belong in one of three boxes: Box 1 = managing the present, Box 2 = selectively abandoning the past, and Box 3 = creating the future. Box 1 is about improving current businesses; Boxes 2 and 3 are about innovation, breakout performance, and growth.

Many organizations restrict their strategic thinking to Box 1, as leaders emphasize cost reduction and margin improvement in their current businesses. But strategy cannot be just about what an organization needs to do to secure profits in the short term. Strategy must include Boxes 2 and 3; it must be about what a company needs to do to sustain leadership in the long term. Dell's direct model in the PC industry, Wal-Mart's transformation of the discount retailing industry, and Southwest Airlines' revolution in the airline industry provide good examples of successful Box 2 and Box 3 initiatives.

Industries transform and change as a result of nonlinear shifts in technology and customer discontinuities. For instance, nanotechnology and genetic engineering are revolutionizing the semiconductor and pharmaceutical industries. Globalization is opening doors to emerging economies, most notably India and China, and billions of customers with vast unmet needs. Once-distinct industries, such as mass-media entertainment, telephony, and computing, are converging. Rapidly escalating concerns about security and the environment are creating unforeseen markets. Other, more subtle changes are important as well, such as the trend toward more empowered customers, the rising middle class in the developing world, and the aging population in the developed world.

As a result of these forces, companies find their strategies require almost constant reinvention because old assumptions are no longer valid, the previous strategy has been imitated and commoditized by competitors, or changes in the industry environment offer unanticipated opportunities. The only way to stay ahead is to innovate.

It is the responsibility of executives to make money with the current strategy. That is the challenge in Box 1. It is also their responsibility to make up for the decay and commoditization of strategy. That is the challenge in Boxes 2 and 3, but too many companies ignore these boxes until it is too late.

An effective illustration of nonlinear change is the history of the high-jump event at the Olympics (Exhibit 1). There have been four distinct “business models” in the high jump. Each has enabled athletes to achieve breakout performance.

Early on, the “scissors” style dominated. (It was much like hurdling.) Because all high jumpers used the scissors approach, winning depended upon being the best at that technique. The high jumpers were operating in Box 1. Had they been businesspeople, they would have been competing on cost, market share, and margins.

Someone changed the rules of the game one day by inventing the “western roll.” (High jumpers launched and landed on the same foot and kept their backs to the bar.) The western roll was the style for 25 years until someone changed the rules again, introducing the “straddle,” a.k.a. the “eastern roll.” (High jumpers launched and landed on opposite feet and faced the bar.) In the 1968 Olympics, former gymnast Dick Fosbury broke the Olympic record by three inches, creating a third, discontinuous change. (The “Fosbury flop” involved a straight approach, jumping with both feet and twisting the body 180 degrees, like a gymnast, looking away from the bar.) These nonlinear shifts exemplify Box 3 thinking. Each transformed the high-jump “industry.” In each case, the inventive high jumpers were not just managing the present, they were creating the future.

Because the future is uncertain, executives cannot predict it; they can only prepare to address its challenges and capture its opportunities. Executives need to address some key questions in this context. For example, how do we identify the nonlinear shifts and market discontinuities (e.g., fundamental shifts in technology, customers, competitors, lifestyle/demographics, globalization, regulations, etc.) that could transform our industry? How do we analyze the opportunities and risks, as a result of our understanding of market discontinuities? How can we create new growth platforms with a view to exploit the market discontinuities? What are our core competencies, and how can we leverage them in the growth platforms? What new competencies do we need? How do we build or acquire them? How do we allocate resources to support growth? How do we execute breakthrough strategies? What kind of organizational DNA must we have in order to anticipate and respond to changes on a continual basis? (For an elaboration of how to address these challenges, refer to *Ten Rules for Strategic Innovators: From Idea to Execution* by Vijay Govindarajan and Chris Trimble, Harvard Business School Press, 2005.)

When I have presented the three-box approach to strategy to Indian executives, on more than one occasion someone in the audience has pointed out the similarity between the three boxes and the three primary Hindu gods. (Some years ago I made a comparison between the three Hindu gods and the three boxes to an American audience. The metaphor was not particularly effective since the audience did not have the background in Hindu deities.) Though the Hindu religion recognizes 330 million gods, there are only three main Hindu deities (the “Hindu Trimurti”): Vishnu, the god of preservation; Shiva, the god of destruction; and Brahma, the god of creation. The correspondence between the three boxes and the three Hindu gods is clear. Vishnu/Box 1 = preserving or managing the present; Shiva/Box 2 = destroying or selectively abandoning the past; and Brahma/Box 3 = creating the future.

According to Hindu philosophy, creation-preservation-destruction is a continuous cycle without a beginning or an end. The three gods play an equally important role in creating and maintaining all forms of life. Further, Hinduism states that while changes in the universe can be quite dramatic, the processes leading to the changes usually are evolutionary in nature and involve smaller steps.

The three-box approach to strategic thinking argues that for an organization to sustain leadership over long periods of time, it must emphasize all three boxes. Innovation creates a new business (Box 3), which, at some point, becomes an established business (Box 1). Before the established business matures and dies, the organization must selectively forget the past (Box 2) and again engage in innovation. This is a dynamic and rhythmic process, one that never ends. Creating the future is akin to a marathon race that is best won by breaking the race into a series of mini-races, say, 400 meters, and focusing the organization's resources and energies on accomplishing the objectives in each 400-meter step.

Apple Computer offers a good example. Apple created the personal computer industry in the late 1970s and enjoyed record-setting sales. However, as their PC business started to slow down, Apple built a new growth platform by transforming the music-recording industry through a radical business model: mass customization of music in a cool, attractive product. Consider the iPod's innovative package: hand-held, portable, personalized, trendy, available in multiple colors; a rotating wheel to easily view and change songs and control volume; tie-ups with all major music producers to create an enviable library of songs on the Internet; download capability, allowing one to selectively download from iTunes ; and a simple pricing approach (every song costs 99¢). Apple went through many smaller trial-and-error evolutionary steps in creating the revolutionary iPod.

After introducing the first model, Apple regenerated the product by maintaining balanced efforts across Boxes 1, 2, and 3. The iPod has moved through several generations in the past five years (Nano, Video iPod), each new product destroying the old model but allowing Apple to remain in the lead. The results are instructive. Apple's sales were about $12 billion in 1995. Over the next six years, the company's sales gradually declined, leveling to about $5 billion in 2001, when it introduced the iPod. As of 2006 (a mere five years later), Apple's sales are about $14 billion! But the iPod concept itself will mature and die one day. Therefore, for Apple to maintain leadership in the future, it must continue to engage in "paradigm-shifting" innovation and transformation.

The challenge for large companies is to create their future while managing their present. Leaders can build lasting institutions if they can effectively manage the "preservation-destruction-creation" cycle.

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EXHIBIT 1