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CHAPTER 1

The Delta Model: The End of Conventional Wisdom

The Delta Model encompasses a set of frameworks and methodologies that we have developed in recent years to help managers articulate and implement effective corporate and business strategies. It grew from our conviction that the world of business has been experiencing transformations of such magnitude that the existing managerial frameworks have become either invalid or incomplete. A fundamental force in these transformations has been the emergence of the networked economy. The most obvious manifestation of this networking is the Internet. Networks have enabled a degree of bonding between customers, complementors, and suppliers that has changed the drivers of profitability and, consequently, the landscape of strategy.

Bonding: The Driving Force in Strategy

A firm owes itself to its customers. They are the ultimate repository of all the firm's activities. At the heart of management and, certainly, at the heart of strategy, resides the customer. We have to serve the customer in a distinctive way if we expect to enjoy superior performance. The name of the game is to attract, satisfy, and retain the customer. The conventional method for doing this is to offer a superior product – through some combination of cost, quality, features, and speed.

Classic strategy frameworks emphasize a product orientation. They pit competitor against competitor in a rivalry where the outcome is determined by who has the best product. Consequently, old economy companies are typically consumed by a product-centric mindset. There is often a product-silo mentality that permeates the organization. Companies in the old economy tend to commoditize the customers by offering standardized products, through mass distribution channels, making limited attempts to recognize and satisfy individual customer needs. Frequently, the point of contact with the client organization is the client's purchasing department through a conventional salesforce (its own or another's) commissioned to sell products or services. This institutes an arm's length relationship that inhibits any deep knowledge being nurtured and developed.

The physical nature of distribution channels themselves present barriers that block the firm from its final consumers. Michael Dell thought that he was simply reducing costs when he decided to skip the wholesale and retail channels and deal directly with the customers. However, we discovered that this new business model opened up a world of intelligence and information that could be put to use in offering customized solutions to key customers that could have not been generated under the old distribution scheme.

The intimacy and connectivity of a networked economy offer opportunities to create competitive positions based upon the structure of the customer relationship itself, independent of the product. A business can establish an unbreakable link, deep knowledge, and close relationship that we refer to as *customer bonding*. These bonds can be directly formed with the customer, or indirectly formed through the complementors that the customer wishes to access. Both are powerful sources of margin and sustainability. The bonds represent investments made by customers and complementors in and around the business' product. The investments include things such as learning how to use the product, incorporating customer-specific data, customized interfaces to the product, among others. These are external to the product itself and are enabled by a networked economy. With this understanding comes a recognition that competition based upon the product alone misses entirely a primary force driving profitability. Bonding emerges as a central force in shaping strategy.

We have observed that most companies, even those in consumer-oriented industries, lack the intimate customer knowledge needed to address this issue properly, or they are so absorbed in a product-centric mindset that it can be a challenge to relate to this kind of strategic thinking.

At the same time, we find companies so intoxicated by the new technology that they are lulled into a false sense that the technology is the strategy, rather than a powerful tool that can enhance bonding. The bright light of technology blinds them from the customer or complementor, and the value proposition is also product based.

Whether you are in the old or new economy, the customer and complementor should be at the center of your strategy. The Delta Model enables this positioning by providing a management framework that sets strategy which incorporates bonding.

Table 1.1 Contributions of the Delta Model

Contribution:	Goal:	Implication:	Method:
The Triangle	Opening the mindset to new strategic positions	The best product does not always win	Three distinct strategic options: ■ Best Product ■ Total Customer Solutions ■ System Lock-in
Adaptive Processes	Linking strategy with execution	Execution is not the problem, linking to strategy is	Execution is captured through three Adaptive Processes: ■ Operational Effectiveness ■ Customer Targeting ■ Innovation whose roles need to change to achieve different strategic positions
Aggregate Metrics	Measuring success	Good financials do not always lead to good results	Aggregate performance metrics need to reflect each of the Adaptive Processes and their role based upon the strategic position ■ Product performance ■ Customer performance ■ Complementor performance
Granular Metrics and Feedback	Discovering performance drivers	Managing by averages leads to below average performance	Business is nonlinear. Performance is concentrated, particularly when it involves bonding. Granular Metrics allow us to focus on underlying performance drivers, to detect variability, explain, learn, and act

The Delta Model: A Brief Overview

We believe that the Delta Model offers four major contributions essential for addressing the new economy. If taken as a whole, the total model constitutes a new approach and a new discipline for strategic management. The four contributions are the Triangle, Adaptive Processes, Aggregate Metrics, and Granular Metrics and Feedback (Table 1.1).

The Triangle: Opening the Mindset to a New Set of Strategic Options

Our foremost concern in defining the strategy of a firm or business is to decide on the relevant strategic positioning. This should capture the essence of how the firm competes and serves customers in its relevant marketplace.

There are three distinct strategic options, which offer very different approaches to achieve customer bonding. They are depicted graphically through a triangle (Figure 1.1). We have chosen the Triangle to display the different strategic positions not simply because it is a visual icon that is easy to remember, but also because it represents the letter Delta, which means transformation.

The *Best Product* (BP) positioning builds upon the classical form of competition. The customer is attracted by the inherent characteristics of the product itself, either due to its Low Cost, which provides a price advantage to the customer, or due to its Differentiation, which introduces unique features that the customers value and for which they are willing to pay a premium. The products tend to be standardized and unbundled. The customers are generic, numerous, and faceless. The central focus of attention is the competitor, who we are trying to equal or surpass. Competitive advantage rests upon product economics and the internal supply chain, which provide the engine for efficient product production. Innovation is centered on the internal product development process. The liability of this

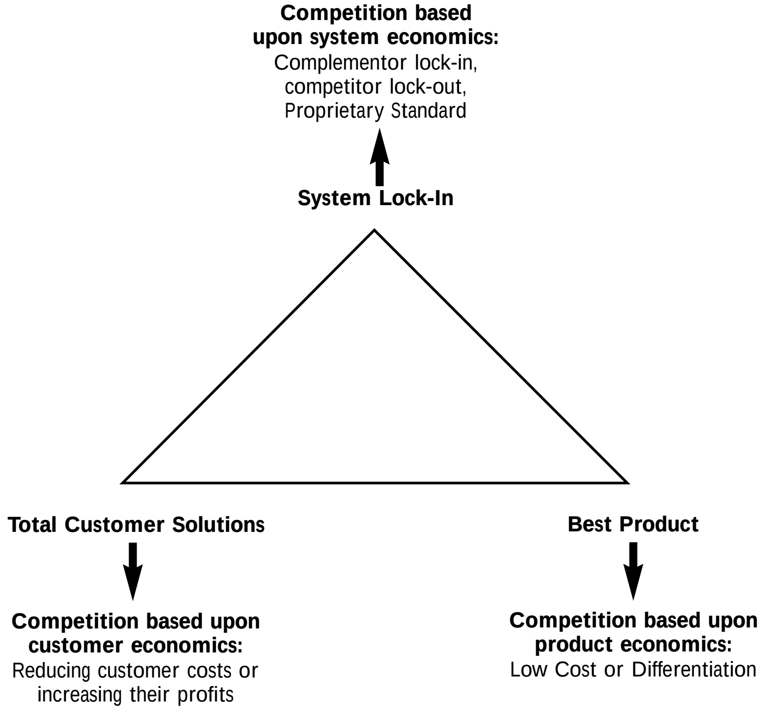

Figure 1.1 Business model: three distinct strategic options

approach is that it generates a minimal amount of customer bonding, hence making the incumbent firms most vulnerable to new entrants. Its obsessive concern with competitors often leads to imitation and price war, resulting in rivalry and convergence; the worst of all situations. In spite of the inherent limitations of this strategic position, it is by far the most widely adopted, and the default position for those businesses that do not deliberately consider other strategic options.

The *Total Customer Solutions* (TCS) strategy is a complete reversal from the Best Product approach. Instead of commoditizing the customer, we seek a deep customer understanding and relationship that allows us to develop value propositions that bond to each individual customer. Instead of developing and marketing standardized and isolated products, we seek to provide a coherent composition of products and services aimed at enhancing the customer's ability to create their own economic value. Instead of concentrating inwardly on our own supply chain, we seek to develop an integrated supply chain that links us with key suppliers and customers. Instead of focusing on competitors and imitating them, we redefine the ways to capture and serve the customer by putting together an overall set of corporate capabilities, also sourcing from proper external parties, that enhance our product offering. We are outwardly driven; customer economics is our guide. Strategy is not war with our competitors; it is love with our customers. What would you rather do, make war or make love? The innovation process is not oriented toward the design of standardized products; it is aimed at initiatives with our key customers for the joint development of distinctive products.

The *System Lock-In* (SLI) strategic option has the widest scope; it includes the *extended enterprise* – the firm, the customers, the suppliers, and most importantly, the *complementors*. A complementor is a firm engaged in the delivery of products and services which enhance our own product and service portfolio. The key to this strategic option is to identify, attract, and nurture the complementors. They are typically external, but may also be internal to the corporation, particularly in large and diversified organizations. These complementors are rarely detected and exploited effectively. That is why a System Lock-In strategy has to start with the full corporate scope – not just for one product or business – and has to continue with the identification and incorporation of all the key external players that can become complementors. The customer continues to be the central focus, but now we extend the enterprise to the fullest. We look at the overall system supply chain, not just the supply chain for our product, and harness the innovation percolating throughout the system as a whole. The richness and depth of complementors supporting your product or service lock your product into the system and lock-out the competition. De facto Proprietary Standards are one way to achieve System Lock-In. Microsoft is the most public example. Personal computer users are compelled to buy Microsoft's Windows operating system because it has the widest selection of available software applications. Over 100,000 applications are designed to work with Windows, whereas Apple's Macintosh operating system has one quarter that number. If you want to use the latest or most esoteric software, you had better have Windows on your computer. Correspondingly, if you are a software company that wants to reach the most customers, you had better write your application to work first (or only) with Windows because it is the operating system on the most computers. This creates a powerfully positive and self-reinforcing feedback loop – people choose Windows to gain access to the most applications, applications providers choose Windows to reach the most people. Once Microsoft achieved a slight edge, it became the clear choice. The system tolerates no meaningful second place.

Distribution channels are often a key consideration for System Lock-In positioning, particularly for old economy companies. By owning or restricting access to distribution channels, competitors can be locked out. Brands can be a means to this end. Coca-Cola creates higher turnover for retailers than lesser brands, motivating the retailer to give Coca-Cola more shelf space, which further enhances the brand, further improving its turnover, and so on. There are several routes to System Lock-In. A company that achieves this position exercises an enormous amount of power. However, a System Lock-In position is not always possible; there are necessary conditions. Foremost among these is that the value of the product to a customer should significantly increase as the product is used by others. Microsoft is valuable primarily because it is used by the majority of the PC users; the *Yellow Pages* is valuable because it is used by most shoppers; eBay is valuable because it is used by the vast majority of online auction buyers; and the list goes on. This leads to a self-reinforcing value proposition. After attaining it, there are additional challenges to a System Lock-In position: how to sustain it and exercise this power in an ethical way that does not create excesses of monopolistic behavior.

In a Best Product position the value proposition to the customer is the product and its attributes are independent of the customer. In a Total Customer Solutions position, the value proposition to the customer is enhanced by the interaction between the customer and the product, which leads to bonding with existing customers. In a System Lock-In position, the value proposition to the customer is enhanced by interaction with other customers, which leads to bonding with existing and new customers. Bonding reflects externalities beyond the product itself.

Value Creation by Each Strategic Option: Empirical Evidence

Economic returns differ markedly by strategic position. We collected empirical evidence from over 100 companies occupying a range of strategic positions. Our sample included the examples used in this book plus additional firms drawn from the Fortune 500 whose corporate-wide strategies could be clearly categorized as emphasizing one of the three alternatives in the Triangle. The Delta Model applies to companies pursuing different options in their different business units, but because such companies have blended the overall performance measures which then resist clear analysis, we pulled them from the sample. Moreover, our sample is selected from established (and hence old economy) firms with longstanding records of performance in order to avoid the speculative and volatile valuations that are a current part of the Internet marketplace at the time this book was written.

The acid test in terms of the merits of each option is the economic value that the companies are able to create for their shareholders. We use two common, and very popular, measures of performance: market value added (MVA) and market-to-book ratio (M/B).

Market value added measures the difference between a company's total market value of equity and debt and its book value, which is the total amount that investors of equity and debt have contributed to the company. This metric has received increasing currency as a key indicator to rank performance. In particular, *Fortune* magazine and *The Journal of Applied Corporate Finance* use it as the leading gauge of financial attainment. On this measure, System Lock-In businesses produce an MVA, which, on average, is over four times that of Best Product companies; Total Customer Solutions firms generate over 1.5 times the MVA of Best Product organizations. The results are shown in Table 1.2.

The market-to-book ratio compares the value that shareholders place on the business based upon their assessment of the expected future cashflows relative to the past resources that have been committed to the business. In other words, if a total of $1 million has been invested in a business that today is valued at $2 million, then the market-to-book ratio is 2. Obviously, the strategy and execution of the business has a multiplier effect that creates the additional value. The empirical data shows that the System Lock-In companies have an M/B ratio that is on average twice as large as

Table 1.2 Value creation by each strategic option: empirical evidence

		Market Value Added			Market-to-Book Value		
	Number of firms	Mean	Standard deviation	Index	Mean	Standard deviation	Index
Best Product	74	14.26	16.57	1.0	5.88	9.33	1.0
Total Customer Solutions	67	22.38	28.14	1.6	7.29	7.7	1.2
System Lock-In	16	57.15	48.67	4.0	11.98	5.86	2.0

the Best Product companies. The Total Customer Solutions companies have an average M/B that is 20% higher than that of the Best Product firms (Table 1.2).

We have found a significant financial premium for companies that can achieve a Total Customer Solutions position, and a further enhanced premium for those attaining System Lock-In. However, there are important caveats. This conclusion reflects the performance of companies that have successfully arrived at these positions, it does not account for those that have attempted and failed. There may be added risk and greater difficulty in reaching for the brass ring of System Lock-In or the annuities attached to Total Customer Solutions. Furthermore, while there are striking rewards that can draw you to new strategies, we are not implying that the strategic answer for all companies is the same.

The Various Dimensions of the Triangle – Beware the Product-centric Mindset

Table 1.3 provides a summary of the managerial differences among the three strategic positionings of the Triangle. Many companies implicitly follow the practices of the Best Product position. In fact, these actions are often praised as ‘best practices’ that should be applied by all companies. These include total quality management, reengineering, time-based competition, benchmarking, and so on. Best practices are a by-product of a product-centric mentality. Table 1.4 makes clear the consequences of adopting, without much reflection, a Best Product position. We are not suggesting that a Best Product strategy cannot be the most appropriate one, as there are excellent companies which are truly extraordinary in every conceivable dimension of performance which are part of that vertex of the Triangle. What we want to warn against is the passive adoption of this strategy without considering other alternatives.

Table 1.3 The various dimensions of the Triangle

Competitive Positioning	Best Product	Total Customer Solutions	System Lock-In
Strategic Focus	*Product* The business, its Industry and its competitors	*Corporation* The firm, its customers, and its suppliers	*The extended enterprise* The firm, its customers, its suppliers, and its complementors
Relevant Benchmarking	Competitors	Customers	Complementors
The Customer Value Proposition	*Product focus* Product economics	*Customer focus* Customer economics	*System focus* System economics
Product Offerings	Standardized products	Customized bundle of products and services	Portfolio of products and services extended by complementors
Relevant Supply Chain	*Internal supply chain*	*Integrated supply chain* Suppliers, the firm and the customers	*System supply chain* Suppliers, the firm, the customers, and the complementors
Relevant Channels	Generic channels, mass distribution	Targeted direct channel	Channels to complementors and customers
Impact on Brands	*Product orientation* Brand explosion	*Brands harmonized around the customer* Coherent portfolio of brands	*Brands harmonized around the system* System economics
Innovation Focus	Internal product development	Joint product innovation with customer	Open architecture, complementors as key investors
IT Role	*Internal support* E.g., SAP	*Customer and supplier support* E.g. e-business and e-commerce	*Total network support* E.g. e-system
Degree of Customer Bonding	*Very small* Depends exclusively on the product characteristics	*Potentially high* Reinforced by customization and mutual learning	*Potentially the highest* Reinforced by competitor lock-out and complementor lock-in

The danger of ‘functional silos’ is well known. The fact of the matter is that functions rarely act as silos. By their very nature they are obliged to exercise a high degree of synergy in an organization. If, in a functionally structured company, you are in charge of R&D, you are supposed to care for all the innovation issues across all the products in your company and it is hard to do otherwise; likewise, if you are in charge of finance, human resources, manufacturing, and so forth. Product-centric business units are the prevalent silos in today's organizations. These often represent parochial territory that prevent a firm from intelligently using all its capabilities and creatively serving the customer as effectively as it could.

If you look at Table 1.3 under the 'Best Product' column, you can immediately visualize the narrow cascade of responses that are associated with this option. The strategic focus is the single product; the relevant benchmarks are the competitors; the customer value proposition is dictated by the internal product economics; the product offering is standardized; the relevant supply chain is internal; the channels are generic and mass-driven; the product orientation leads to an explosion of disconnected brands; the innovation process is self-centered; the IT role, which is so critical to management today, deals with internal information. As a result, this brings a feeble degree of customer bonding and a rather conventional view of the business, which might limit creativity. It is a fundamentally inwardly oriented strategy, with its outside view centered on competitors. With this perspective in mind, you can see how this is totally divorced from a network-based Internet economy.

Contrast the Best Product option with the Total Customer Solutions positioning. You can envision the significant enrichment in scope and content that takes place. The strategic scope now looks across the corporation, not just a single product or business; the relevant benchmarks are of the customer's activities, not just the competitors'; the customer value proposition is dictated by the customer's economics, not just the product's internal economics; the product offering is often customized, rather than standardized; the relevant supply chain includes the customer, as well as the supplier; the channels are targeted and direct, not wholesale through mass channels; the customer solution orientation leads to a harmonization of brands; the innovation process emphasizes joint development with the customer, not just the typical stand-alone R&D center; the role of IT is to use the broadly available Internet protocols and infrastructure to inextricably link the customer to the firm, rather than to use proprietary internally oriented software. In the end, these actions create strong bonds to existing customers and generate assets and skills for the customer and the firm that are unique to that relationship. The firm benefits from innovation by the customer as well as from their own efforts. This is an outwardly oriented strategy, centered on the customer. In contrast with the Best Product strategy, this position is enabled, if not dependent, on the network-based Internet economy.

When we adopt the System Lock-In strategic positioning, we have to extend our perspectives even further. The strategic scope now covers the entire system including complementors that accompany, augment, or enhance your product, even though they may not be in the same ‘product’ industry; the relevant benchmarks necessarily encompass the complementor; the customer value proposition is focused on the system, not just on what the product does on its own; the product offering entails the portfolio of applications extended by complementors; the relevant supply chain also includes the complementors; the channels to customers and complementors are massive, direct and indirect because our share will dominate the system; the brand is harmonized around the system, a la Intel inside or Microsoft compatibility; the innovation process harnesses the creative juices of a multitude of complementors; the role of IT is to support the integration, efficiency, and compatibility of the complementors; the entire system benefits from a common network interface. In the end, the system is bonded to the product. It attracts new customers to the product as well as adhering to existing customers. This strategy is centered on the system, particularly the complementors.

A System Lock-In position can best develop when the industry is undergoing major transition, such as induced by new technology, deregulation, and globalization. In these situations, the traditional integrated competitors often become disaggregated into component pieces. New standards and exchanges then emerge to help reconnect the newly fragmented elements.

The Adaptive Processes – How to Genuinely Link Strategy and Execution

John S. Reed, the past Chairman of CitiGroup, once said:[1] ‘A CEO has just two jobs, decide what to do and making it happen. And, ninety percent of the job is making it happen. When you are running a company execution becomes everything.’ To guide managers in the ‘what to do’ question, the Triangle dramatically expands the sources of profitability to describe three distinct choices for strategic positioning: Best Product, Total Customer Solutions, and System Lock-In.

‘How to make it happen’ depends first and foremost on the proper alignment of the core activities of the business with the chosen strategy. Alignment is the operative term. Each strategic position of the Triangle generates a different set of tasks and activities. Our research suggests that the primary obstacle in execution is not working harder, with less error, faster, or smarter, but is failing to align the activities of execution with the specific requirements inherent in the desired strategic position of the business.

To accomplish this goal, we identified the three business processes that capture the essential tasks of execution. The core activities of the firm are embodied in three processes:

1. Operational Effectiveness (OE) – the production and delivery of goods and services.
2. Customer Targeting (CT) – the management of the customer interface.
3. Innovation (I) – the process of new product development.

Collectively we call them Adaptive Processes, to emphasize the changing nature of the tasks. Figure 1.2 represents the interactions that exist between the Triangle which is critical to define the changing role of each Adaptive Process and among the processes themselves, since each one influences the other.

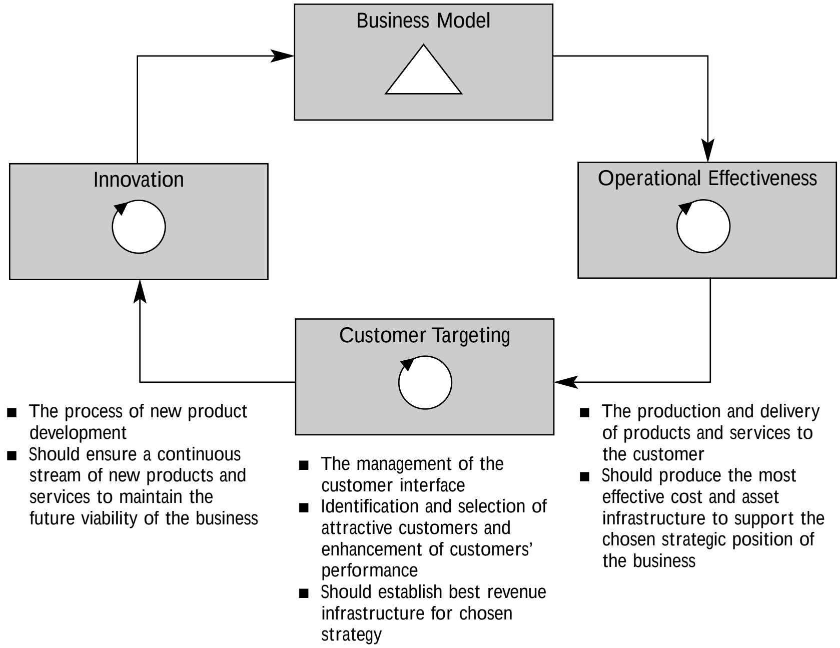

Figure 1.2 The Adaptive Processes: linking strategy with execution

Table 1.4 Role of the Adaptive Processes in supporting the strategic options of the Triangle

		STRATEGIC POSITIONING		
		Best Product	**Total Customer Solutions**	**System Lock-In**
ADAPTIVE PROCESS	**Operational Effectiveness**	*Best Product Cost* ■ Identify product cost drivers ■ Improve stand-alone product cost	*Best Customer Benefits* ■ Improve customer economics ■ Improve horizontal linkages in the components of total solutions	*Best System Performance* ■ Improve system performance drivers ■ Integrate complementors to improve system performance
ADAPTIVE PROCESS	**Customer Targeting**	*Target Distribution Channels* ■ Maximize coverage through multiple channels ■ Obtain low-cost distribution ■ Identify and enhance the profitability of each product by channel ■ Maximize product share	*Target Customer Bundles* ■ Identify and exploit opportunities to add value to key customers by bundling solutions and customization ■ Increase customer value and possible alliances to bundle solutions ■ Select key vertical markets ■ Examine channel ownership options ■ Maximize customer share	*Target System Architecture* ■ Identify leading complementors in the system ■ Expand number and variety of complementors ■ Establish channels to complementors, as well as customers ■ Consolidate high share with complementors
ADAPTIVE PROCESS	**Innovation**	*Product Innovation* ■ Develop family of products based on common platform ■ First to market, or follow rapidly – stream of products	*Customer Service Innovation* ■ Identify and exploit joint development linked to the customer value chain ■ Expand your offer into the customer value chain to improve customer economics ■ Integrate and innovate customer care functions ■ Increase customer lock-in through customization and learning	*System Innovation* ■ Create customer and system lock-in, and competitive lock-out ■ Design proprietary and open architecture – Complex interfaces – Rapid evolution – Backward compatibility ■ Facilitate complementor as well as customer innovation on our platform

Strategy is not effective if kept at an abstract level. The Adaptive Processes spell out in detail their unique supportive role for each of the three strategic positions in the Triangle. Figure 1.2 summarizes these roles.

What we find particularly alarming is that in practice most managers implicitly define each process according to a Best Product strategy. Namely, Operational Effectiveness seeks to establish an internally efficient cost infrastructure; Customer Targeting seeks maximum coverage through distribution channels; and Innovation seeks the speedy development of the firm's products aided by appropriate platforms and first-to-market expectations. As recognized in Table 1.4, the situation is starkly different when the Adaptive Processes support the TCS and the SLI strategic options.

In the TCS strategy, the key objective of Operational Effectiveness is the maximization of customer value, and this can only be achieved through consideration of the combined value chain of the firm and its customers. Customer Targeting is aimed at developing individual customer bonds, by structurally enhancing the interface with the customer and by creating assets in the customer's knowledge of your product or services. Innovation aims for the development of a composition of customized products jointly with the customer.

In the SLI strategic position the role of each process again changes. Now Operational Effectiveness is concerned with enhancing the overall system performance, often by consolidating strong partnerships with complementors. Customer Targeting attempts to consolidate a harmonized system architecture through a network of complementors and complementor interfaces. The ultimate goal of Innovation is to develop and appropriate an industry standard, facilitating a broad range of applications.

Once more, a primary objective is to raise the awareness of the product-centric mentality and to expand the alternatives open to managers. Rivalry and competition may not be the winning strategies.

Aggregate Metrics

Just as activities need to vary by strategy, so do the measures of success. Performance measurements and quantifiable indicators are essential for the development, execution, and monitoring of the desired strategy. The Delta Model aligns performance metrics to the strategic options selected, and recognizes that these metrics will be fundamentally different depending on the strategic position they intend to support.

There are two types of metrics. First, we need Aggregate Metrics to give us the overall, integrated view of the business and the firm's performance. Second, we need Granular Metrics that will allow us to decipher the fundamental performance drivers.

The Aggregate Metrics we will highlight are a direct by-product of the Adaptive Processes. Since these processes are the instruments for the execution of each strategic option, they also serve as guidelines to define the strategy performance. Table 1.5 provides a summary of a selected set of generic metrics according to Adaptive Processes and strategic options.

Table 1.5 Performance metrics for the business drivers of the Delta Model

		STRATEGIC POSITIONING		
		Best Product	**Total Customer Solutions**	**System Lock-In**
ADAPTIVE PROCESS	**Operational Effectiveness** *(cost drivers)*	■ Cost performance – Unit cost – Life cycle cost – Variable and total cost ■ Cost drivers ■ Quality performance ■ Degree of differentiation	■ Customer value chain – total cost – total revenue and profit ■ Customer economic drivers ■ Impact on customer profit due to our service vs. competitors	■ Description of system infrastructure ■ Total system costs/revenues ■ Complementor's investments and profits ■ Complementor costs of adhering to your standard ■ System performance drivers
	Customer Targeting *(profit drivers)*	■ Product market share ■ Channel cost ■ Product profit – by product type – by offer – by channel ■ Profit drivers	■ Customer share ■ Customer retention ■ Our profitability by customer – individual and by segment ■ Customer bonding – switching costs	■ System market share ■ Our share of complementors – % of investments tied to our proprietary standard ■ Our profit by complementor
	Innovation *(renewal drivers)*	■ Rate of product introduction ■ Time to market ■ Percent of sales from new products ■ Cost of product development ■ R&D as % of sales	■ Relative involvement in customer value chain ■ Percent of product development – from joint development – customized ■ Degree of product scope – current vs. potential bundling	■ Switching costs for complementors and for customers ■ Rate of product development ■ Cost of competitors to imitate standard

Of course, specific tailor-made metrics could and should be introduced in each individual business situation.

The Aggregate Metrics intrinsic to the Adaptive Processes stand in contrast to the conventional measures of success, which focus on financial measures, such as return on equity (ROE), return on assets (ROA), earning before taxes and interest (EBIT), and so on. Financial metrics are the ultimate manifestation of overall past performance and are critical, but they are poor predictors of future performance and provide few clues regarding the performance of the tasks of execution. Correspondingly, the Aggregate Metrics inherent in the Adaptive Processes reflect the top line performance of execution. Granular Metrics (discussed next) are necessary to understand the performance drivers and are indicators of future performance. While not yet broadly applied in industry, the idea of incorporating nonfinancial metrics is well established. The Delta Model provides an integrated framework that naturally gives rise to the appropriate metrics and describes how these change according to the distinct strategic positions.

Notice that the various processes assume metrics related to their defined charters: Operational Effectiveness is the depository of the cost drivers; Customer Targeting, of the profit drivers; and Innovation, of the renewal drivers. Also notice that the BP options are product oriented; TCS, customer oriented; and SLI, system oriented. However, most firms today only concentrate their attention on product-oriented opportunities. It is yet another manifestation of the pervasive product-centric mindset.

Granular Metrics and Feedback

To fully appreciate the necessity of Granular Metrics in a management framework for the new economy we should return to the fundamental force enabling new strategic positions – bonding. Bonding is remarkable because it is self-reinforcing. Where cost-based competition grows more difficult with each incremental improvement (and exhibits diminishing returns), bonding is an attractive force that naturally accelerates under its own power. There are a variety of popular terms used to describe this phenomenon ranging from increasing returns to viral effects. The essential characteristic is a positive feedback loop among market participants (end-users, suppliers, complementors) that is inherent in certain strategic positions. For example, eBay is the beneficiary of buyers wanting to shop at the market exchange with the most sellers, and sellers preferring the exchange with the most buyers. This is a positive feedback loop that creates a Dominant Exchange, leaving little room for competitors to occupy the same space. The same feedback can occur in the individual bonding to a customer. For example, customers using Schwab's One Source account learn how to use a range of its services, from checking and credit cards to charitable donation services. They also customize these services as they use them, such as adding money wiring or bill paying vendors. This learning and customization further induces the customer to invest even more in the Schwab service, further enhancing the unique bond between the customer and Schwab.

From feedback emerge three distinctive properties – nonlinearity, concentrations, and sensitive dependence. Nonlinearity is evident in the eBay exchange example; growth in users creates an exponential growth in the value of the exchange. If only four people used this exchange to buy and sell there would be the possibility of twelve different transactions (each user can buy or sell from the three others). Adding another user expands the number of possible transactions to twenty (possible transaction pairs equal n, the number of users, multiplied by n – 1, the number of users addressable by any one user). Six users expand the possibilities to thirty, seven expand the possibilities to forty-two, eight to fifty six, and so on. Contrast this to a conventional retailing relationship where each additional shopper visiting a store simply adds one more transactional possibility. Feedback creates an exponential (n^2), or nonlinear relationship. Nonlinear systems exhibit massive concentrations. Concentrations in cost, where a small portion of activities drives a disproportionate amount of effort; or in profits, where a small number of customers account for a vast majority of the earnings; or in collateral assets, where a small number of key complementors are central to the value proposition of the system. In a nonlinear world, managing by averages is at best misleading, and at worse dysfunctional. Furthermore, these concentrations are subject to sensitive dependence, as seemingly minor and detailed factors are magnified through a nonlinear system to yield huge consequences. Granular Metrics are necessary to succeed in this environment:

- They can identify the natural economic concentrations and inherent variability in business.
- They represent the performance drivers, which often occur at the detailed intersection of the three dimensions highlighted in the Delta Model: product, customer, and complementor.
- They enable a customized response at a customer and complementor specific level, which is so critical to secure bonding.

Granular segmentation is central to the effectiveness of the Adaptive Processes because it enables one to focus, detect variability, explain it, learn from it, and act. This in itself constitutes a response mechanism that is an important part of each Adaptive Process and is necessary in order to continually adapt strategy and to self-direct the day-to-day tasks of execution.

The forces of the new economy take us full circle, from bonding as strategy to Granular Metrics as the tools to manage bonding. Our research shows that a management framework must integrate the large with the small. There are profoundly new strategic positions for a business to consider, and execution must wrestle with specific details to realize these new sources of profitability.

How We Organized the Book

The book is organized to take the reader step by step through the Delta Model. This first chapter provides a brief overview of the integrated framework. Since a key message of the Delta Model is the need for an integrated plan of attack, this is a critical chapter to show how the pieces come together to yield more than the sum of its parts. Alignment of strategy with execution is a fundamental element of the Delta Model, and this is essential when attempting to reposition a business to take advantage of bonding and the forces of a networked economy. Incumbent firms are entrenched in the product-centric mindset, a legacy of the industrial era, and shifting position requires a change in activities, processes, and metrics.

Chapter 2 describes the Triangle and contrasts it with the most influential and current management frameworks, Porter's framework of Competitive Advantage and the Resource-Based View. The current frameworks for business strategy are rooted in the old economy and did not anticipate the changes to the competitive landscape wrought by the forces of networking. They are correct, but incomplete, and the Delta Model is a necessary complement. The networked economy has made bonding a pervasive force. Bonding is a continuum and leads to eight distinct ways of achieving the strategic positions in the Triangle.

In Chapters 3, 4 and 5, we describe in detail the strategic positions in the Triangle, and the eight ways to achieve them. Competing as a Best Product is achieved through Low Cost or Differentiation, the traditional options in strategy. We have observed three ways to achieve Total Customer Solutions: Redefining Customer Experience, Horizontal Breadth, and Customer Integration. There are also three ways to achieve a System Lock-In position: Restricted Access, Dominant Exchange, and Proprietary Standard.

In Chapter 6, we look at a case example to understand how to set a Strategic Agenda. Fifteen years ago Motorola was the leading corporation in the world for the semiconductor industry. By 1997, they had dropped to number 5 with a mere 6% of the market share. The case describes the transformation that is taking place within Motorola to recapture its leadership. The Delta Model is the driving intellectual force behind this strategic repositioning.

The case diagnoses the current situation, defines the new strategic position of the business, describes the mission statement, and the required Strategic Agenda. It demonstrates how the Delta Model can be implemented in a complex and high stakes situation.

In Chapter 7, we begin to link execution with strategy. We define the three Adaptive Processes and analyze extensively the changing role of each process to support each strategic position. Not surprisingly, we uncover that the common interpretation of the processes implicitly assumes that they are intending to support the Best Product strategy. This stands in stark contrast to the very different nature of the processes when properly pursuing a Total Customer Solutions or System Lock-In strategy.

In Chapter 8 we examine the Internet industry through the lens of the Delta Model. Most analysts admit that they do not know how many companies in the Internet industry will make money. At the same time, they all recognize the new infrastructure as a clear and persistent threat to the incumbent firms who do not adopt some e-business strategy. Whereas many categorize companies as ‘content’, or ‘B2B’ (business to business), or ‘B2C’ (business to consumer), or ‘infrastructure’, the more relevant dimensions from a strategy (and profitability) perspective are Best Product, Total Customer Solutions, and System Lock-In. We learn important lessons for the dot.coms and the incumbents.

With the strategy defined and the tasks aligned, in Chapter 9 we address the question of how to measure success, that is, metrics. The Delta Model presents a complete set of Aggregate Metrics that cover dimensions well beyond the financials. The alignment of the strategic position with the processes points to the proper design of aggregate measures.

Without denying the significance of Aggregate Metrics, they are not enough. In Chapter 10 we introduce Granular Metrics to close the loop on bonding. Complex businesses cannot be run with a handful of Aggregate Metrics alone, Granular Metrics are necessary to identify the natural concentrations of value, to reflect the underlying performance drivers, and to customize the bonds with individual customers and complementors. We show how companies integrate Granular Metrics into experimental feedback mechanisms as part of their Operational Effectiveness, Customer Targeting, and Innovation processes in order to respond to the market. The Delta Model can generate profound and deep change in a company, as is the case when attempting to move from one vertex to another vertex in the Triangle. This transformation brings us into unknown territory full of risks and uncertainty. Experimentation and testing are imperative when facing fundamental transformation, it enhances our knowledge and improves the odds of success. Failures are rife in the design of any grand plan, so you have to structure the business to learn systematically from them.

Chapter 11 describes the transformation of an entire industry. The Delta Model is particularly suited to the demands of the new economy, whether or not the Internet is central to the transformation. The transformation of the electric utility industry is being initiated by deregulation, although technological forces also play a role. This transition is similar to the one that has occurred in other industries including the computer industry, financial services, and telecommunications. Deregulation and technology apply a 10X force to the existing monolithic entities, fragmenting them and rotating the industry from a vertical to a horizontal structure. New companies enter each level of the value chain, competing with the fragmented residual businesses of the established participants. Standards and exchanges often emerge to facilitate the interoperability of the disaggregated parts. Each new business is best suited for very different strategic options, as is evident from the Delta Model.

Chapter 12 unifies the various frameworks of strategy. The most celebrated and influential frameworks of strategy – Porter's Competitive Advantage and the Resource-Based View of the firm – are insightful guides to developing strategy, but they are fundamentally incomplete. They fail to explain the new sources of profitability and do not serve as an effective guide to define superior strategic options in our new and complex environment. The Delta Model complements the perspectives of the existing frameworks, extends them to encompass new economic forces, and provides the integrative glue that results in a unified framework.

Note

1. MIT Tech Talk, April 29, 1998.

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