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THE THREE BOX SOLUTION PLAYBOOK

Tools and Tactics for Creating Your Company's Strategy

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GETTING STARTED

Strategy, for any organization, is about leadership in the future. Just because your organization is a leader today does not mean it will be a leader in the future. For every industry, the only constant is *change*. Therefore, to earn its leadership in the future, your organization must adapt to change. This is what we call innovation.

Think about all the projects your organization is executing today. How many of them will ensure that you are a leader in the future? One way to answer this question is by putting all the projects your organization is executing into three boxes:

Box 1: Manage the present. This box includes projects that are about improving the efficiency of your current business model—the customers you serve today, the value you offer to those customers, and the way you deliver that value. It includes product as well as process innovations, all within the frame of the current business model. We call Box 1 the *performance engine*.

Box 2: Selectively forget the past. This box includes two categories. First, an organization needs to identify and divest businesses that do not fit its vision for the future. Second, it must abandon the practices, ideas, and attitudes that are no longer relevant in a changed environment and that would otherwise interfere with a focus on the future.

Box 3: Create the future. This box includes projects that will drive innovations to respond to such developments as technological disruptions, customer discontinuities, nontraditional competitors, and regulatory changes. Such projects may require the creation of new business models outside your organization's current Box 1 business model.

Boxes 1 and 2 are as important as Box 3—and you'll need to balance all three boxes to succeed and grow. However, with the increasing rate of change—technological discontinuities, opportunities to convert nonconsumers to consumers, nontraditional competitors, and regulatory changes—many leaders find themselves at a crossroads to transform themselves and build new growth engines. To do this, you'll need to create new business models and other innovations. This tall order requires you to overcome organizational inertia, make uncertain bets, manage trade-offs, address conflicts, and, most importantly, foster a healthy partnership between the new businesses and the core businesses.

In other words, you need to pursue and execute on Box 3 ideas. That's our mission for this book—to help you do exactly that—while also helping you to manage the present and forget the things that could hold you back from pursuing the future.

A Deeper Dive into Box 3

Box 3 innovations are nonlinear. They create new business models by dramatically (1) redefining your set of customers, (2) reinventing the value you offer them, or (3) redesigning the end-to-end value chain architecture by which you deliver that value. For example, a business school's

THE THREE BOXES OF THE NEW YORK TIMES COMPANY

In 1995, the New York Times Company's business model was the publication of a print edition of the newspaper that served two sets of customers: highly educated readers and *Fortune* 500 companies that advertised in the newspaper to reach these influential readers. Its value proposition was premium content created by numerous Pulitzer Prize–winning journalists. The value chain architecture included the printing presses and the distribution infrastructure. Here's how company executives could have done the three-box exercise:

BOX 1: MANAGE THE PRESENT. The paper's Box 1 projects included both process innovation projects and product innovation initiatives within the bounds of its current business model. For instance, in 1994 the newspaper initiated a pagination program that enabled editors to electronically design a newspaper page, including news text, graphics, and ads, thereby avoiding part or all of the manual pasteup of the various elements on a page. This change was a Box 1 process innovation. Adding a new section in the newspaper would have been a Box 1 product innovation within the company's current business model.

BOX 2: SELECTIVELY FORGET THE PAST. In 2001, the New York Times Company sold its magazine group segment, which consisted of golf properties, such as *Golf Digest*, *Golf Digest Woman*, *Golf World*, and *Golf World Business*. This Box 2 move freed up resources to shape Box 3.

BOX 3: CREATE THE FUTURE. Betting on the emergence of the internet as a technological disruption, the New York Times Company embarked on a Box 3 innovation project—internet media—called New York Times Digital (NYTD) in 1995. Unlike the Box 1 business model, NYTD's business model was to provide an online product and distribution channel. Should the internet grow into something big, Box 3 was how the company would earn its leadership in the future.

For the New York Times Company to build NYTD, it also had to forget the Box 1 definition of one set of its customers, the highly educated readers. It had to forget that news was created in daily cycles and that Pulitzer Prize–winning journalists were its most critical capabilities. For publishing news online, it had to abandon the printing presses. Yet, these aspects were critical to maintain Box 1 leadership.

move to offer an MBA through entirely online channels would be a nonlinear innovation. It would serve a broader customer base and democratize access to high-level intellectual content while delivering the product in a fundamentally different way. Let's look at some more examples.

Redefining Your Set of Customers

In the late 1970s, when Xerox was the market leader in selling big copiers to corporations, Canon successfully designed personal copiers at a price point significantly below Xerox's big copiers to appeal to a new set of customers: small businesses and individuals. At that time, Canon's personal copiers made 8 to 10 copies per minute and ranged in price from $700 to $1,200. In contrast, Xerox's high-speed machines made 90 to 120 copies per minute and had a price range of $80,000 to $129,000.

Reinventing the Value You Offer Customers

Tetra Pak, a Swedish multinational, was in the business of packaging for liquid food items. Unlike traditional players that offered containers to customers, Tetra Pak changed the value proposition by offering total systems: filling equipment, packaging materials, and distribution equipment, such as conveyers, tray packers, and film wrappers. Customer value was transformed from the traditional model, namely, liquids poured into containers, to Tetra Pak's model, that is, containers made at the point where beverages were ready to be packed.

Redesigning the Value Chain Architecture

The traditional value chain in the personal computer industry used to be categorized as *build-to-stock*, where PC manufacturers designed and manufactured several components, assembled them with preset options, and warehoused them. These assembled computers were then sent to specialized computer retailers, resellers, and other intermediaries who eventually got the PCs into the customers' hands. Dell dramatically redefined this value chain by creating the *build-to-order* model. It outsourced components to component suppliers, used its telephone network and online methods to get a customized configuration requirement from customers, assembled the components, and delivered the final product to customers.

As you'll see, Box 3 innovations are about closing what we call the possibility gap. This is the difference between the growth ambition of the company and what it can actually achieve by increasing the performance (the performance gap) of its core Box 1 business. Unlike Box 1 innovations, which are linear and incremental—that is, they seek to fill a performance gap between one's current revenue and growth goals—Box 3 innovations create the future by adding new growth through radical changes in one or more of the aforementioned business model constituents.

The Box 3 Journey

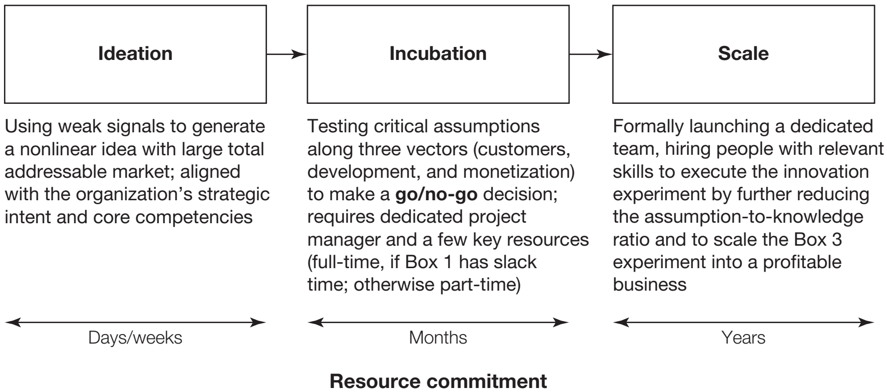
The radical approach represented by Box 3 requires a more creative and iterative process if it is to succeed. This process involves three stages, all of which we'll cover in detail throughout this book (figure 1-1).

Ideation: At the ideation stage, a team uses *weak signals* from within its industry to imagine the industry's future and generates nonlinear ideas by redefining one or more of the three aforementioned attributes—customer, value proposition, and value chain. These Box 3 ideas are then tested for attractiveness and strategic fit and, hence, as worthwhile ideas to incubate. Part 1 of this playbook is about ideation.

Incubation: At the incubation stage, your team tests critical assumptions about a Box 3 idea. For example, will customers be

FIGURE 1-1

Box 3 innovation journey



interested in the offering? Can we build the offering? And if we do, can we make money? With reasonable confidence along these three dimensions, the idea can formally be moved to the scale phase. Part 2 of this book discusses incubation.

Scale: In this phase, your company constructs a dedicated team and doing innovation execution, a way to implement Box 3—different from Box 1—as an experiment. Ultimately, scaling is what gets Box 3 to deliver profits back to the company. Part 3 in this book guides businesses in how they can take their innovations to a successful level of growth.

Major Barriers to Box 3 Innovations

Box 3 innovation is difficult. As you make your way through the ideation, incubation, and scaling phases of Box 3, several traps lie in wait to undermine your efforts:

Complacency trap: The more a firm succeeds in the Box 1 performance engine, the more it views success as a validation of the past. The complacency trap conditions a business to suppose that success in the future requires doing nothing more than what the business has done in the past.

Competency trap: Favorable results from current competencies encourage an organization to invest more in those competencies, providing little incentive for the organization to invest in new competencies. In established companies built around a spectacular success, such as IBM, with its industry-defining mainframe computers, business leaders naturally want to create a workforce whose skills dominantly reflect the legacy success. But reliance on a single, established competency is a trap.

Cannibalization trap: This trap persuades leaders that new business models based on nonlinear ideas will jeopardize the firm's present prosperity. So, like antibodies attacking an invading virus, they protect the Box 1 business by resisting ideas that don't conform to the models of the past.

Box 3 innovation by its very nature carries a high execution risk. Leaders misjudge the Box 1 risk of obsolescence to be much lower than the Box 3 execution risk. This outlook is similar to knowing you must commit to daily exercise for long-term health while the disadvantages of *not* exercising are so minuscule on a daily basis that they go unnoticed. Only in the long term will the accumulated problems show up. Additionally, organizations are often paralyzed by the fear of failure when trying something new.

Box 3 innovation requires a change in mind-set for established organizations because they are used to predictable processes that yield predictable results, and the managers in core businesses are held accountable for results. Also, during the execution of a Box 3 idea, there will invariably be natural conflicts, not because Box 1 is resistant to change but because Box 1 and Box 3 have different jobs to do despite competing over resources, time horizons, and overlapping customers. These are very challenging issues, and to solve them, you *must bring the organization along*.

PROCESS

Before jumping into Box 3 innovations in earnest, you'll want to step back and assess your company. What is its primary business model? How large is your growth gap? Answers to these questions, and understanding the current direction and capabilities of your company, will help you answer the most important question of all: Why do you need to pursue Box 3 innovations?

Assessing Your Organization's Primary Business Model

Your primary business model is Box 1. Ask yourself these questions to assess its scope. Doing so will help you internalize the concept of a business model and will provide a useful baseline against which you can contrast other business models and through which you can ultimately discover new ones.

1. Who is your customer?

   ____

   ____

   ____

   ____

2. What value are you offering to your customer?

3. How have you designed the value chain to deliver that value to your customer?

4. What competencies are required to deliver that value?

5. Who are your competitors?

6. What are the current revenues and profits from your Box 1 projects?

Assessing Your Organization’s Ambition and Box 1 Leftover Growth

Next, estimate how much growth you can expect from your Box 1 business (the *performance gap*) in a given time frame and your organization’s growth ambitions during the same time frame, and then compare the two.

1. What is your ambition for the revenue your organization will bring five years from now?

2. How large is your performance gap? What are the likely revenues from your Box 1 projects in five years? (In other words, how much growth is left in Box 1 to achieve your organization’s revenue ambition?)

3. How large is your possibility gap? That is, how great is the difference between your ambition and your performance gap?

Explaining Why Box 3 Is Needed

Rarely is your company's growth ambition lower than Box 1's expected growth rate (the performance gap). Therefore, you must initiate Box 3 breakthrough innovations to close the possibility gap.

There are many examples of companies that have completely disappeared when confronted by a disruptive technology. For instance, Blockbuster, a provider of in-home rental and retail sales of movies and game entertainment, employed more than eighty-four thousand people worldwide at its peak in 2004.[1] However, the company was unable to cope with nonlinear innovations, such as mail-order service, automated kiosks, and on-demand services, from companies like Netflix and Redbox. It eventually filed for bankruptcy in 2010.

While there are other examples like Blockbuster, we recommend you *resist* the temptation to jump to the doomsday narrative—that is, "If we don't invest in Box 3 innovation, we will be disrupted and reach a fate similar to Blockbuster's." Such a narrative pits Box 3 against Box 1 and minimizes Box 1's importance.

Your leadership team needs to form a narrative for pursuing Box 3 initiatives as opportunities to grow your company, as opposed to protecting against complete annihilation of Box 1. Let's look at the following reasons for pursuing both Boxes 1 and 3 for growth ambitions and some examples of companies that are doing just that.

When Box 1 Is Insufficient

Sometimes, Box 1 alone is insufficient to achieve a company's ambition and investors' growth expectations. There are several reasons that a company needs to pursue Box 3 in addition to Box 1:

- **Our company needs a Box 3 leveraged bet to drive additional growth.** Nvidia is a visual- and accelerated-computing company that develops graphics processing units for use in PCs, mobile devices, and supercomputers. With one architecture across various large markets, the company enjoys immense leverage. Nvidia's Box 1 has been serving graphics chips in the gaming market. Nonlinear Box 3 innovations in the last few years have focused on serving new customers in data centers with new value: deep-learning accelerators to speed up artificial-intelligence computations. In its second fiscal quarter 2018 results, reported in August 2018, Nvidia's gaming revenue grew 52 percent year over year; data-center revenue grew 83 percent year over year.[2]

- **Our company needs higher-risk, high-growth Box 3 projects to drive additional growth.** Google, the world's largest search engine provider, invested in a Box 3 initiative in the autonomous-driving space. In 2016, it spun out Waymo as a separate company. Waymo is widely recognized as one of the leaders in autonomous driving.

- **Our company's Box 1 is firing on all cylinders today, but Box 1 growth is likely to slow or stagnate in the near future.** Over the last few years, Walmart, one of the largest retailers in the world, has been steadily investing in Box 3 online retail and e-commerce initiatives to drive additional growth. Furthermore, in May 2018, Walmart rolled out Jetblack, a chat-based personal shopping service targeting time-strapped mothers in New York City.[3] Jetblack allows members to text when they run out of cereal or need a last-minute gift recommendation, for example, and provides same- or next-day delivery with free returns.

- **Our Box 1 is in a decline or, worse, is a burning platform.** Electrolux was in decline in 2002. The European manufacturer of household appliances served midrange customers, but people's priorities were changing. Customers were gravitating to either the low end of the market or the premium end. As a result, the CEO took on a multiyear Box 3 initiative to target premium customers by building new competencies, such as customer insight teams and industrial design.

- **Our Box 1 simply cannot address the emerging industry dynamics, because of current business-model limitations.** In 2002, Timberland was competing in the footwear industry, where the fast creation of new subcategories was the norm. The company churned out new offerings twice a year, but when the company recognized a trend toward specialty shoes, Box 1 processes were inadequate to address it. Timberland embarked on a Box 3 project that would be free from the month-to-month pressures of Box 1. The company ultimately created specialty shoes for trail runners, who had different needs from road runners. People who ran on the road cared most about minimizing the strain on joints, whereas trail runners wanted to avoid falling. It took Timberland five years to launch the new offering for trail runners.

- **Newer opportunities, such as emerging markets, require a Box 3 move.** To target nonconsumers at the bottom of the pyramid in India, General Electric made a Box 3 move to completely reimagine its electrocardiogram (ECG) machines and make them ultra-low-cost, portable, and battery-operable.

When Box 3 Innovation Makes Better Sense Than Box 1 Innovation

Sometimes, innovation is possible in both Box 1 and Box 3 projects. But for the following reasons, good strategy favors Box 3.

- **In our investment-constrained environment, Box 3 innovation is cheaper than Box 1.** In 2002, Lucent Technologies, a network equipment business, was hit hard by the dot-com bust. Technological innovation was very much embedded in Lucent's DNA. And although the company had forecast revenues of $40 billion during the boom, reality was that its revenues were under $10 billion. In the battle for survival, Lucent was forced to consider newer models of growth. The services market seemed attractive since the company already had a services team to repair and maintain the equipment constituting its core business. Expanding the team beyond Lucent switches to the entire telecom network was a cheaper Box 3 move than were incremental investments in new technologies in Box 1.

- **We have a Box 1 that limits Box 3 from taking shape and is taking the business in the wrong direction.** Tata Consultancy Services (TCS), one of India's largest information technology (IT) services company, had become successful in the thriving sector of offshore call centers at the start of the millennium. Despite the business's growth, TCS decided to discontinue its call-center service after a few years. Experience showed that the average tenure of a call-center

> operator ranged from three months to a year, according to TCS's former CEO Subramaniam Ramadorai. This high workforce churn, with as many as a half million workers cycling through the company annually, caused an intense drain on management energy. Closing down the call-center service allowed TCS to free up resources for Box 3.

Now that you've laid the groundwork, articulate precisely why you need Box 3 (fill in the following statement). This critical step helps all key stakeholders see the value of, and urgency for, Box 3 and recognize that Box 1 is also an integral part of the answer to future growth.

Our company needs Box 3 innovation now because . . .

Creating an Inventory of Box 3 Projects

Finally, create a list of Box 3 projects already under way in your organization, and identify their stage (ideation, incubation, scale). For each Box 3, ensure that there is a nonlinear difference, relative to Box 1, across one or more of the three dimensions: customer, value proposition, and value chain. That is, a Box 3 project is not an incrementally larger, faster, or better version of a Box 1 project but rather is a significantly new take on at least one of the three dimensions.

Box 3 project:

Stage:

Dimension	Short description	Nonlinear difference between Box 3 and Box 1? (Yes/No)
Customer		
Value proposition		
Value chain		

After completing the application exercises, review "The Path Ahead" table at the end of this chapter to map your next step, depending on where you are in your Box 3 journey. In each chapter, we will guide you through the relevant concepts, processes, and exercises.

IDEAS IN PRACTICE

In the mid-1990s, as the newspaper industry was facing challenges from the internet, the New York Times Company (NYTimes) had to make several tough strategic decisions. These decisions focused on the creation of a Box 3 innovation, the digital product NYTD, which has been very successful. Even though one-fifth of the newspapers in the United States have shut down in the last fifteen years—roughly more than eighteen hundred newspapers since 2004—the New York Times Company has been more successful.[4] It more than doubled its market cap between March 1995 and November 2019, with a meaningful revenue contribution from digital-only subscriptions.[5] Let's wind back the clock and imagine how the Times tried to develop its future path.

The Box 1 Business Model of the NYTimes

In 1995, the business model of the NYTimes could have been described as follows:

Customers: The company had two primary customers: the highly educated readers of the printed paper and the *Fortune* 500 companies that advertised in the printed newspaper.

Value offering: The NYTimes offered premium content at a premium price for subscriptions and especially for advertising.

Value chain: The chain that delivered value to its customers had several components. The company purchased 276,000 metric tons of newsprint through long-term contracts from its suppliers. Pulitzer Prize–winning journalists gathered the facts and wrote the news articles. The articles were processed through electronic news-editing terminals and sent to high-resolution image setters. The papers were printed in a New York

City production facility and were produced and distributed to individual customers by a facility in Edison, New Jersey. City and Suburban Delivery Systems, a company-owned wholesale distributor, delivered the product to retail outlets.

Competencies required to deliver value: Among the capabilities necessary for delivering value to NYTimes customers were the top-notch journalists who, by 2019, have delivered seventy-nine Pulitzer Prizes to the newspaper; the extensive printing, production, and distribution facilities. Finally, there were the 12,300 full-time employees. Overall, 3,600 of these employees were represented by sixteen unions; there were collective bargaining agreements with six production unions and six non-production unions.

Competitors: Competing with the NYTimes were newspapers of general circulation and, to varying degrees, national publications such as the *Wall Street Journal* and *USA Today*.

Revenues and profits or operating margin: In 1995, the company had approximately $2.1 billion in annual revenues; $208 million in operating profit, with a 10 percent operating margin.

The Possibility Gap of the NYTimes

Next, the NYTimes assessed its possibility gap, which eventually would be serviced by Box 3 projects. To make this assessment, the company looked at its revenue ambition for the next five years. Its revenue had grown at a compound annual growth rate (CAGR) of 5.8 percent over the past five years. Let's assume the company's growth ambition was 8 percent CAGR over the next five years, to a total revenue of approximately $3.5 billion. It then would have to figure how much growth remained in its Box 1 to reach this five-year ambition. The estimated necessary growth constituted the company's performance gap.

Box 1 revenue was expected to grow at a CAGR of 4.9 percent (performance gap) over the next five or six years, to about $2.8 billion in 2001. The possibility gap was 3.1 percent (8 percent growth ambition minus the 4.9 percent leftover growth for Box 1).

The Need for a Box 3 Innovation

Building on the preceding information, how did the NYTimes articulate its need for a Box 3 innovation? The company understood that its Box 1 growth was slowing. The newspaper's circulation had been declining by more than twenty thousand copies per year since 1993. With newsprint prices rising significantly and forecast to grow by more than $76 million by the end of 1995, the company had to offset the cost by selling more advertising and implementing cost controls. The company's possibility gap was 3.1 percent. Thus, the NYTimes needed to bet on a higher-growth and maybe higher-risk Box 3 that was in line with the future of the industry as a new source of revenue.

Considering the emergence of the internet, the NYTimes leaders knew they had to explore newer ways to reach their readers and provide better ways for their advertisers to target those readers. In fact, the previous year, the NYTimes had experimented with an online service, called @times, which shared information from the *New York Times* on America Online (AOL). The trial had been widely successful, as @times was then one of AOL's most frequently accessed services. The leaders reasoned that if the internet took off, it could be big and the NYTimes could lead rather than follow this trend.

The Box 3 Idea of the NYTimes

The NYTimes leaders came up with the idea of creating a digital version of the newspaper. This was a Box 3 idea. It redefined not only the consumer set that the company was targeting but also the value proposition and the way that value was delivered to the consumers.

Dimension	Short description	Nonlinear difference between Box 3 and Box 1? (Yes/No)
Customer	General consumer worldwide, not just limited to the United States	Yes
Value proposition	Nonpremium content at low cost, with some paid premium content	Yes
Value chain	Produced and distributed online	Yes

The Path Ahead

Depending on where your organization stands with its Box 3 development, you will want to start moving forward at the appropriate place. The following table shows the most pertinent chapters for you to consult next for your Box 3 challenges:

Your present status	Book segments to consult
You have no Box 3 ideas; you are starting from scratch.	Chapters 2–5
You don't have enough Box 3 ideas.	Chapters 2–5
You have a Box 3 but are not sure it is the right one.	Chapters 2, 3, 4, and "Selecting Ideas" section of Chapter 5
You have a Box 3 but have not yet made a go/no-go decision.	Chapter 6
You have a Box 3 but are still trying to determine product-market fit.	Chapter 6
You have a Box 3 but are not executing it fast enough.	Chapters 7–9
You have a Box 3 but are running into conflicts with Box 1.	Chapter 8
You have a Box 3 but are not achieving results.	Chapter 9