

DEEP

RICH HORWATH

"... the most valuable book ever
written on strategic thinking."

—JAMES FLOYD, director, worldwide
operations, McDonald's

DIVINE

THE PROVEN METHOD
for BUILDING STRATEGY,
FOCUSING YOUR RESOURCES,
and TAKING SMART ACTION



CHAPTER 1

HOW DEEP CAN YOU DIVE?

Be not the slave of your own past. Plunge into the sublime seas, dive deep and swim far, so you shall come back with self-respect, with new power, with an advanced experience that shall explain and overlook the old.

—Ralph Waldo Emerson, writer and philosopher

Immersed in the sea of crystal blue water, I checked the tank's pressure gauge and verified what I had just noted. I was out of air. Unable to take another breath from the tank, I quickly ascended until my scuba mask crashed through the surface of the water into the warm Caribbean breeze. Yanking the regulator from my lips, I gulped in a huge mouthful of life-sustaining air. I then put in my snorkel and swam to shore. My inability to breathe had provided me with a forceful reminder of the importance of intelligently using one's limited resources—in this case, oxygen.

And so it is with strategy. Each day we rely on strategy to determine how we use our limited resources to better our organization's place in the competitive landscape. Many firms never get to the point of "taking their last breaths," and so they continue to slowly leak resources that dooms them to mediocre existences. It seems

that without the watchful eye of urgency, the discipline to intelligently allocate our resources—time talent, and money—is washed out with the receding tide.

All managers have these resources to varying degrees within their organizations, and they must decide how to manage each. So, technically, all managers are strategists. The reality, however, is that not all managers are good strategists. Herein lies the pearl of great opportunity: the deeper you can dive into the business and resurface with strategic insights, the more valuable you'll become to your organization. Effective resource allocation drives profitability (more resources invested in the right activities) and productivity (fewer resources invested in the wrong activities). The result is a high-performance organization in which all levels of management are encouraged and equipped to shape its strategic direction.

ARE YOU STRATEGIC?

I was thrown out of college for cheating on the metaphysics exam; I looked into the soul of the boy sitting next to me.

—Woody Allen, writer, director, and actor

Until now, looking into someone's soul was about the only way we've had to guess whether or not someone is "strategic." In many organizations it is assumed that senior executives are strategic and lower-level employees are not. As you might imagine, solely using someone's title to determine his or her strategic ability is as accurate as using a Hollywood star's popularity to determine his or her knowledge of political issues.

Research on leadership by the American Management Association has shown that the most important competency for a leader is the ability to develop strategy.¹ Unfortunately, when researchers

examined leaders at all levels in organizations, they found only 4 percent to be strategists.² According to the Institute of Directors in London, the wide gap between the importance of strategic thinking and the percentage of leaders who actually are strategic can be attributed to the fact that 90 percent of executives at the director and vice president levels have had no training to become competent strategists.³ Organizations tend to invest training and development resources in the tangible operational areas of sales, customer service, and communication while neglecting the critical area of strategic thinking. Consider your organization. When was the last time you and your colleagues were provided with developmental programs specifically geared toward strategic thinking?

TIME TROUBLE

The worst enemy of the strategist is the clock. Time trouble, as we call it in chess, reduces us all to pure reflex and reaction, tactical play.

—Garry Kasparov, former world chess champion

We all know the popular maxim that the most precious commodity is time. Time is the one resource that can't be renewed. Entire industries have been built around providing people with more time by outsourcing the less desirable tasks that can eat away at it: for example, cleaning services, lawn maintenance, and concierge-type services. Most of the ramifications of a lack of strategic thinking relate to wasting time. What follows are just a few examples from recent research:

- “Our research suggests that 85 percent of executive leadership teams spend less than one hour per month discussing their unit’s strategy, with 50 percent spending no time at all.”⁴

- “Our findings on managerial behavior should frighten you: Fully 90 percent of managers squander their time in all sorts of ineffective activities. In other words, a mere 10 percent of managers spend their time in a committed, purposeful and reflective manner.”⁵
- “Eighty percent of top management’s time is devoted to issues that account for less than 20 percent of [a] company’s long-term value.”⁶
- “The main problem identified by the majority of senior executives was strategic thinking. ‘Our senior executives tend to get carried away by details and lose their strategic perspective. It is a major challenge to get our decision makers to think in strategic, rather than operational, terms.’”⁷

A lack of strategic thinking not only prevents individual managers from maximizing the critical resource of time but also can stop the entire firm’s progress in its tracks. A study was conducted of five hundred companies to better understand what causes successful organizations to struggle financially for extended periods of time. The researchers found that 87 percent of these companies suffered one or more “stall points,” a term for the start of a prolonged financial decline. The effects of these stall points can be devastating. The study further reported that “On average, companies lose 74 percent of their market capitalization as measured against the S&P 500 index in the decade surrounding a growth stall.”⁸

When the researchers pored through data to uncover the cause of stall points, they found that 70 percent were attributed to poor choices about strategy. While it’s convenient to blame the economy for one’s misfortunes, the data clearly show that most financial decline is well within management’s control. Today, the reality is that battles in business are waged with one weapon—the mind. How sharp is yours?

Academicians and executives alike echo the urgency of improving strategic thinking skills. Just listen to the following thought-leader comments:

- “There are no substitutes for strategic thinking. Improving quality is meaningless without knowing what kind of quality is relevant in competitive terms.”⁹
- “The ability to think and plan strategically for the future is the most important single skill of effective executives.”¹⁰
- “Although companies find it difficult to change strategy for many reasons, one stands out: strategic thinking is not a core managerial competence at most companies.”¹¹
- “At the speed of business today, it’s essential to turn technical pro’s (e.g., engineers, scientists, clinicians) into strategic thinkers who grasp a company’s core functions.”¹²
- “In the environment we’re in, good execution and good operations aren’t enough to fix a business with a flawed strategy. So you need to spend time understanding what businesses you think you are going to work, what business models seem to make sense. Strategy is more important than ever before.”¹³

If we heed the advice of these thought-leaders about the critical need for enhanced strategic thinking, exactly how do we get there? After all, strategy is an abstract concept we can’t just reach out and touch, and that makes the process of thinking about it much more difficult. We can begin by defining strategic thinking as the generation and application of business insights on a continual basis to achieve competitive advantage.

Just as intelligent allocation of limited resources is at the heart of strategy, insight is at the heart of strategic thinking. Insight is the difference between

Strategic thinking is the generation and application of business insights on a continual basis to achieve competitive advantage.

taking a business-as-usual incremental approach and pursuing dynamic game-changing initiatives that separate winners from losers. Too often in the “action is everything” world we live in, we are hamsters running on a wheel. Day in and day out, we run faster and faster, doing the same things in the same ways we’ve always done them. Trouble is, we’re often doing the wrong things: things that drain critical resources from those few effective tasks that really will make us successful. If we think of our business as a Ferrari and strategy as the steering wheel, insights are the key to the ignition. A business without insights is like a Ferrari without the key: it looks sensational on the outside, but it isn’t going anywhere.

Insights also act as the bridge between experience and expertise. Take the United States Postal Service, for example. It has been in business since 1789, which means it has 220 years of experience delivering things. It also happens to misdirect, damage, and lose numerous items each year. FedEx, on the other hand, has been in business for just 38 years, yet it has revolutionized the industry, becoming the most versatile mover of goods in the world, with on-time delivery rates of 99.8 percent!

Experience without expertise means nothing. Just because someone has forty years of experience breathing doesn’t necessarily mean they’re getting better at it. And unless you are actively generating *insights* about your business on a continual basis, you are



DIVE MASTER PRACTICE

How do you generate new insights about your business? What insight-generating tools do you use? Where do you keep track of your insights on a regular basis? What are the three most important insights you’ve learned during the past month?

simply not taking full advantage of your experience. Insights are the bridge connecting experience to expertise, and strategic thinking is how we build that bridge of insights every day we're in business.

As we saw in the USPS example, experience alone can be a very deceptive predictor of success. This is often apparent in the importance placed on experience in the hiring process. While experience is often touted as the best indicator that a candidate will be successful, in fact, eighty years of data show that experience is only the *fifth* best predictor of job success.¹⁴

For example, several years ago three vice chairmen were vying for the CEO position at Pfizer—the largest pharmaceutical company in the world. Two of the candidates each had more than thirty-five years of pharmaceutical industry experience, while the third had only four within that industry. Yet the board chose Jeffrey Kindler, a lawyer with just four years of pharmaceutical experience. Of Kindler's selection, Pfizer board member Stanley Ikenberry says: "We had a general feeling that the external environment for pharmaceutical companies is changing rapidly. Jeff is a very strategic thinker."¹⁵

Think of experience like cholesterol: there is the good kind and the bad kind. Active experience is the good cholesterol (HDL); passive experience is the bad cholesterol (LDL). Active experience involves continually taking on challenges that are just outside your competence or current ability level. Active experience means monitoring your progress and generating insights as to how to close the gap between where you are and where you want to be.

In contrast, passive experience involves going through the motions of the activity with no focus on concrete steps for improving performance. It means charging through each day without ever stopping to gain the insights from your efforts. Think of all the sales reps, marketing managers, senior executives, church choirs, and weekend golfers who pile up years of experience without ever getting better. The price you pay for not transforming passive

experience into active experience is obsolescence. As author David Mayer writes, “When emphasis is placed on experience and experience counts more than such essentials as empathy and drive, what is accomplished can only be called the inbreeding of mediocrity.”¹⁶ Don’t be discouraged, however. There is a bridge above the perilous waters of obsolescence that can take you from passive experience to expertise. That bridge is insight.

The Nobel Prize–winning German economist Reinhard Selten describes that bridge in this way: “I run business decision-making experiments both with experienced managers and with university students. Overall, the students do much better. It’s always the same story: People are guided too much by little-understood experience and make the wrong generalizations. Less experience can be advantageous when it forces you to think harder.”¹⁷

The natural reaction of managers with twenty-plus years of experience in their fields is to dismiss these data as not real world. But look again at Selten’s comment that “People are guided too much by little-understood experience” and it begins to make sense. If time isn’t invested in strategic thinking—that is, in generating insights about experience—then that experience is indeed being wasted. It’s certainly not being transformed into expertise. As Gus Pagonis, former head of logistics for the U.S. Army, says, “I can think of no leader, military or business, who has achieved success in his or her position without some profound expertise.”¹⁸

Albert Einstein defined insanity as doing the same thing over and over and expecting different results. Insanity in business is using the same assumptions and outdated tactics year after year and expecting dramatically *better* results. Yet, isn’t that what most of us do? Companies continually forecast sizeable increases in revenue and sales without providing their teams with new ways to think about the business and generate insights. A simple but often-overlooked premise in business is that *new growth comes from new thinking*.

Expecting new growth without new ways—concepts, tools, and frameworks—to think about the business is like a farmer expecting to grow new crops without first planting the seeds. For anyone under the impression that working harder at doing the same things in the same ways will generate new growth, please hop into a time machine and transport yourself back to 1960. It is crucial that everyone—especially those who have their heads buried in the sand of business by busyness—identify new ways to think about their work.

The Chinese philosopher Chuang Tzu wrote: “When people wish to see their reflections, they do not look into running water; they look into still water. Only that which is still can hold other things still.” Taking time to reflect and evaluate why we’re doing what we’re doing and how to become more effective will both provide answers and evoke deeper questions. Sure, we can continue to use a blizzard of activity as an analgesic, numbing us to the pain of knowing we’re potentially wasting our time and talent in the wrong activities, the wrong work, the wrong job, the wrong company, or maybe even the wrong vocation. Or we can stop and look into the still water and find out what’s really there, and then make some important changes in our work and in our lives.

The ability of executives to think strategically has the most relevance in today’s dynamic business environment. Strategic thinking (defined, remember, as the generation and application of business insights on a continual basis to achieve competitive advantage) is different from strategic planning. We can define strategic planning as the channeling of insights into an action plan to achieve goals and objectives. A key distinction between strategic thinking and strategic planning is that the former occurs on a regular basis, as part of our daily activities, while the latter usually occurs annually. One of the reasons management scholars such as Henry Mintzberg of McGill University and Richard Rumelt of UCLA have lampooned strategic planning is that in many cases, it is an annual pilgrimage disguising the inherent flaws in the process. Professor Rumelt says:

“Most corporate strategic plans have little to do with strategy. They are simply three-year or five-year rolling resource budgets and some sort of market share projection. Calling this strategic planning creates false expectations that the exercise will somehow produce a coherent strategy.”¹⁹

Unlike the additional work that is created by the process of strategic planning, we can understand strategic thinking as using a new lens to view all aspects of the business at all times. It’s not about *adding* more work. It’s about *enhancing* the view of the work and improving one’s ability to perform it. As professor Mintzberg puts it: “Strategic planning is not strategic thinking. Indeed, strategic planning often spoils strategic thinking, causing managers to confuse real vision with the manipulation of numbers.”²⁰

Over time, strategic planning has erroneously become the umbrella for strategy development. Strategy development consists of a five-phase process, from discovery through implementation; strategic planning is merely one of those five phases. As such, strategic planning is therefore an event that occurs on a periodic basis. Strategic thinking, on the other hand, is an ongoing mind-set that can be developed by practicing its three disciplines—which I introduce toward the end of this chapter—and by continually seeking the insights into your company that lead to competitive advantage.

THE FOUR TYPES OF STRATEGIC THINKERS

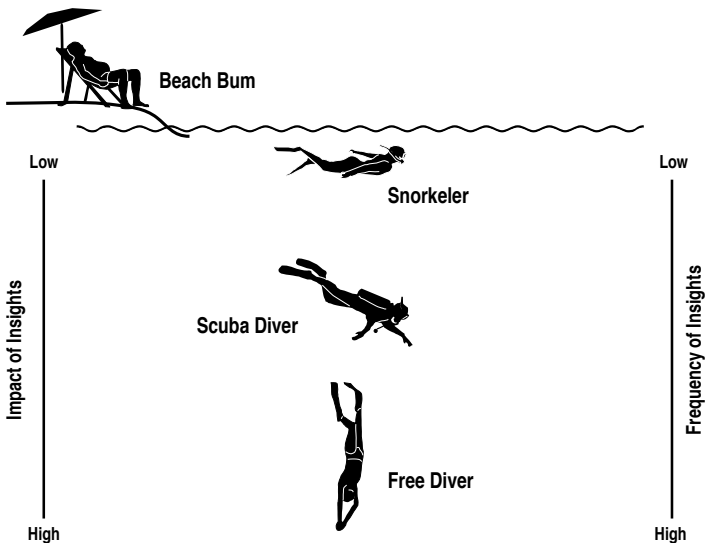
You’ve likely noticed during your daily encounters with bosses, colleagues, direct reports, customers, suppliers, and other individuals that strategic thinking comes in varying degrees, ranging from brilliant to nonexistent. To help you refine your idea of strategic thinking, I have taken the results of research I conducted among senior managers from 154 companies and have identified four types of strategic thinkers. These will help you better understand how to think strategically and will give you insight into individuals in your

organization. Two criteria to consider as you evaluate an individual's ability to provide strategic insight are what I call the "Impact of Insights" and the "Frequency of Insights."

I use the analogy of underwater diving to explain the types of strategic thinkers I've researched. Just as there are four types of divers, so too are there four types of strategic thinkers (as shown in Figure 1.1).

1. **Beach Bums:** They sit on the shore and make no attempt to enter the water. This type of manager doesn't contribute insight into the business. The research shows, on average, that 9 percent of managers are Beach Bums.
2. **Snorkelers:** They swim on the surface of the water, equipped with a diving mask and swim fins. This type of manager offers tactical solutions to issues, but the solutions don't have a significant positive impact on the business. As

Figure 1.1 The Four Types of Strategic Thinkers

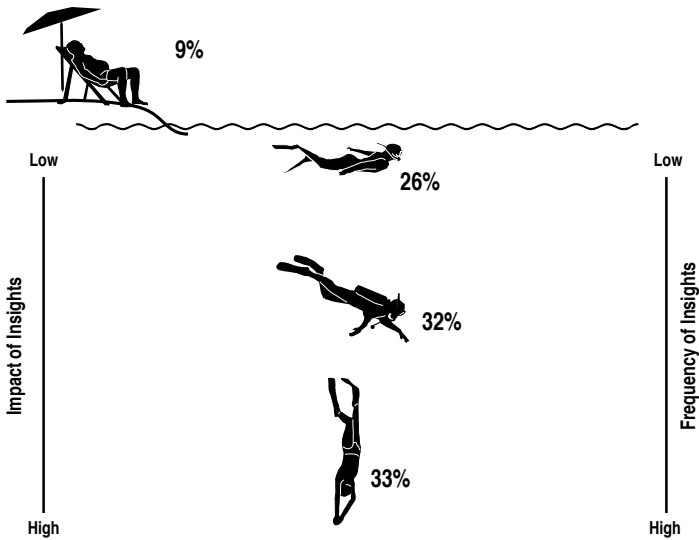


the name indicates, they tend to do surface thinking and seldom get to the heart of an issue. Research indicates, on average, that 26 percent of managers are Snorkelers.

3. **Scuba Divers:** They swim underwater wearing a diving mask, swim fins, a wetsuit, and a portable apparatus containing compressed air. This type of manager can produce strategic insights for solutions but requires instruction and assistance to do so. These managers can provide ideas that advance the overall success of the business, but they need a setting such as a group strategic planning meeting to contribute. When these managers are thoroughly prepared with the proper data and market research prior to a meeting, and are then led through the meeting with frameworks and models, they can generate highly effective insights. However, because they generate insights only when heavily equipped, the insights are infrequent and tend to occur only in a meeting environment. Study results show, on average, that 32 percent of managers can be classified as Scuba Divers.
4. **Free Divers:** They dive underwater without the assistance of a portable breathing apparatus in an attempt to attain great depths. This is the type of strategic thinker leaders aspire to be. These managers generate effective insights about the business on a regular basis. Although they use a customary portfolio of questions, frameworks, and models to guide their thinking, they are able to summon the appropriate tool and combine it with the right data to continually generate insights that transform the business. The research indicates that, on average, only three of every ten managers are Free Divers (see Figure 1.2).

At first blush, it would appear that the only things standing in a manager's way of becoming a Free Diver are adequate knowledge

Figure 1.2 Average Percentage of Managers as Each Type of Strategic Thinkers



and mental models to think strategically on a regular basis. While these do account for a large portion of the cases, a subtler reason also exists. Strategic thinking, and the actions taken to follow through on it, requires an appetite for risk. Strategy calls for focus and the trade-offs that inherently follow, but many managers decide they would rather play it safe. In most organizations, sins of commission—taking a risk and failing—are punished much more harshly than sins of omission—not taking a risk and missing out on a great opportunity. With both political (your reputation within the company) and career (not wanting to jeopardize your next promotion) ramifications to consider, many managers consciously opt out of strategic thinking. And that is a shame. As Roberto Goizueta, the successful former CEO of Coca-Cola, points out: “If you take risks, you may still fail. If you do not take risks, you will surely fail. The greatest risk of all is to do nothing.”



DIVE MASTER PRACTICE

Consider your daily activities. How often do you have the opportunity to come up with insights that change the course of your work? What level of effect do those insights have on your business? What type of strategic thinker are you currently—a Beach Bum, a Snorkeler, a Scuba Diver, or a Free Diver? Consider your colleagues in the department. What percentage are Beach Bums? Snorkelers? Scuba Divers? Free Divers?

THE STRATEGIC THINKING ASSESSMENT

If a management team is willing to take calculated risks and is intent on becoming more effective strategists, a first step is to assess their baseline strategic thinking skills. As the old medical adage goes, prescription without diagnosis equals malpractice. You wouldn't trust a physician who walked into the exam room where you were waiting, took one look at you, and wrote a prescription without asking any questions. By the same token, asking questions to assess your team's baseline strategic thinking skills is an important starting point.

I developed the Strategic Thinking Assessment as an objective way to evaluate a manager's strategic thinking skills by using a list of fifty questions. The questions are grouped under ten strategic thinking skills (see Figure 1.3), five questions per skill.

A brief explanation of the ten strategic thinking skills follows:

1. Strategy: mastering the three criteria of great strategy (acumen, allocation, and action—which I describe in detail later in the chapter)



Figure 1.3 Ten Strategic Thinking Skills

2. Insight: generating new ideas about the business
3. Context: understanding the current situation
4. Competitive Advantage: creating distinct offerings with superior value
5. Value: determining the benefits/costs of the offerings
6. Resource Allocation: deciding where to focus capital, talent, and time
7. Modeling: visually capturing the essence of business issues
8. Innovation: creating new value for customers
9. Purpose: developing mission, vision, and values
10. Mental Agility: the ability to improvise, adapt, and excel through adversity

The Strategic Thinking Assessment has been administered to hundreds of executives around the world to shed light on their individual thinking skills and the level of support they receive from their organizations in their efforts to think strategically. At the writing of this book, the average score is 58 out of 100 points. Considering so few resources have been invested in educating and training managers to become more effective strategists, this low score is not surprising.

The following are sample questions taken from the assessment:

1. Successful business strategy is about:
 - A. Being better than the competition.
 - B. Having the “right people on the bus.”
 - C. Being different from the competition.

2. One method of influencing competitive advantage is to:
 - A. Reduce prices to drive out competition.
 - B. Change the customer’s value preferences.
 - C. Benchmark competitors and excel at best practices.

3. Context is defined as:
 - A. The specific problem in a given business situation.
 - B. The circumstances in which an event occurs.
 - C. The combination of strengths and weaknesses an organization possesses to balance with opportunities and threats.

4. For my business, purpose in the form of a mission, vision, or values statement:
 - A. Influences my daily activities.
 - B. Doesn’t exist.
 - C. In reality has little, if any, effect on my business.

5. The three value disciplines are:
 - A. Revenue growth, gross margin, and return on capital.
 - B. Customer intimacy, operational excellence, and product leadership.
 - C. Operational effectiveness, low-cost leadership, and innovation.

As data from the Strategic Thinking Assessment indicate, there is a big difference between tossing the word *strategic* around in the conference room and knowing what it really means.

THE THREE DISCIPLINES OF STRATEGIC THINKING

Strategic thinking rarely occurs spontaneously.

—Michael Porter, professor, Harvard Business School

By now you know that strategic thinking is the ability to generate and apply insights on a continual basis to achieve competitive advantage. Knowing the definition by itself, however, does not move you closer to practical application. When working with an intangible concept like strategy, it's often helpful to affix it to a more concrete framework. My research indicates that strategic thinking consists of three disciplines (as shown in Figure 1.4):

1. Acumen, which helps you generate key business insights
2. Allocation, which focuses resources through trade-offs
3. Action, which requires executing strategy to achieve goals

These “three As” provide a simple yet comprehensive framework for applying strategic thinking to the real-world business issues you will face. They provide you with the mental strength, agility,

Figure 1.4 Three Disciplines of Strategic Thinking



and confidence you need to successfully traverse the competitive landscape.

You may wonder why I chose the word *discipline* to describe the three As. In an age when it is easy to be swept away by the tidal wave of urgent but unimportant things in the form of e-mails, voicemails, and tactical firefighting, discipline is often the only thing that can keep us on track. Discipline is what makes us ask why. Discipline is what makes us challenge last year's assumptions. And discipline is what prevents us from wasting precious hours, days, and weeks on things that simply don't matter. Study the habits of chess grand masters, classical musicians, and world-class athletes, and the one thing they all have in common is discipline. Strategic thinking is no different. If you want to elevate yourself to the pinnacle of enduring business success, you must master the three disciplines of strategic thinking.

The remainder of this book is devoted to the practical application of the three disciplines of strategic thinking to your business. Prior to the in-depth look at the three disciplines in chapters 3 through 5, I provide an overview of strategy in chapter 2 to create a foundation for understanding this fundamental concept at the core of strategic thinking.



PEARLS OF INSIGHT

- **Strategic thinking is defined as the generation and application of business insights on a continual basis to achieve competitive advantage.**
- **New growth comes from new thinking.**
- **Strategic planning is the channeling of the insights generated by strategic thinking into an action plan to achieve goals and objectives.**
- **There are four types of strategic thinkers:**
 1. Beach Bums are managers who don't contribute insights to the business.
 2. Snorkelers are managers who offer tactical solutions to issues, but their solutions don't have a significant positive impact on the business.
 3. Scuba Divers are managers who can produce strategic insights for solutions, but they require instruction and assistance to do so.
 4. Free Divers are managers who, on a regular basis, generate insights that have a significant impact on the business.

○ **There are ten strategic thinking skills:**

1. Strategy: mastering the three criteria of great strategy
2. Insight: generating new ideas about the business
3. Context: understanding the current situation
4. Competitive Advantage: creating distinct offerings with superior value
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