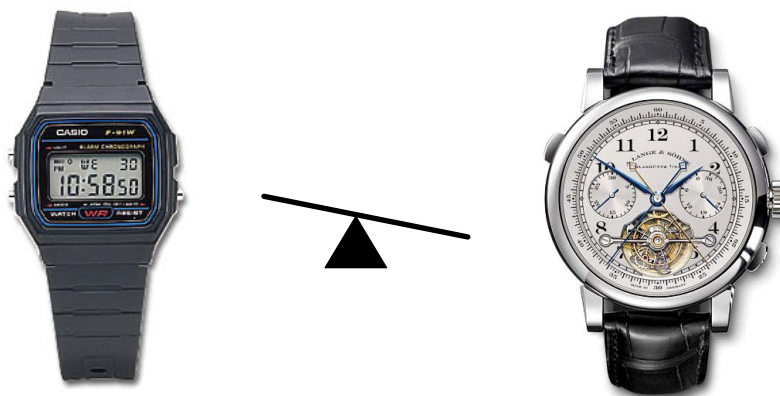


## Optimum And Ideal

*“A sailor without a destination cannot hope for a favorable wind.” — Leon Tec*

Place yourself in a store for a second, and think about how you are in the middle of making your decision to spend your money on something. What is going on in your mind? What are the calculations you are making?

These are the sorts of questions that providers of products and services have to think about a lot. As we work with these companies and study what makes one thing successful and another not, we quickly see some very clear patterns of what distinguishes one from the other. The first thing we see is that people buy things because they are trying to *do* something. They are trying to achieve a *function* or a *benefit*; get a *job* done. This job might be a very tangible one – like buying the ingredients for tonight’s meal, or taking out an insurance policy – or it could be intangible – for example buying branded items because the brand ‘says something’ about us. Most often these days, we buy things because they do a combination of tangible and intangible jobs for us. When we buy a pen or a watch, we can buy a particular make or model because it simply delivers the tangible function or ‘benefit’ of telling us the time, or we can also say that the watch should also deliver some intangible benefits like status, or aesthetics.



The next most obvious thing we take into account when we see a range of candidate items that meet our functional needs is ‘how much do they cost?’ Thus begins an intricate series of trade-off decisions in our mind. All of us have this benefit-versus-cost trade-off very clearly planted in our minds – the more I pay, the more benefits I expect, and vice versa.

There is also, often, a third thing that we bring into this trade-off calculation, and that involves thinking about other negative aspects of what we are about to purchase. These negative aspects cover a broad range of things from things simple things like how long we have to wait (‘convenience’) through to things like how long will it last, through, increasingly, to what impact will it have on the environment and/or the surrounding social infrastructure. Collectively, we can think of all of these negatives as the ‘harmful’ side-effects that unavoidably come along with the thing we buy.

When taken together, these three aspects– benefits, costs and ‘harms’ – get built into our purchase decisions as a simple equation that overall defines something we all know of as ‘value’. Value, in this equation may be seen as the sum of all the useful tangible and

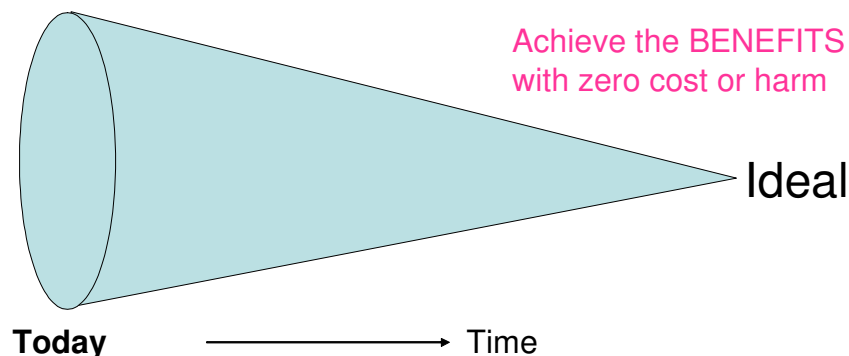
intangible benefits a product or service offers us, divided by the sum of all the costs and other 'harmful' things we didn't want.

So far so good. If we had to make this calculation from scratch every time we went to purchase anything however, we would never make a decision. So what happens is we tend to simply look out for changes relative to the set of expectations we already have in our minds. This means, if say, we are in the process of buying a new car, our expectations for the new vehicle will be compared to our current vehicle. If we are thinking of moving to a different bank, likewise we compare the offering of others to what we currently get from our current provider.

We will make a decision to move from what we have to something new providing the overall 'value' justifies the likely difficulties of making the change.

In simple terms, people will, on average, purchase things that offer a relatively higher level of 'value' than what they bought before. What this means when we now look at millions and millions of customers buying millions and millions of products and services is that over time 'value' as a whole must increase. Thinking about the equation we just defined, this means that customers will inherently therefore get more benefits, less cost and less harm. As a provider of the products and services that we want people to buy, it is therefore our obligation to move in these same directions. Very simply, if we don't, then someone else surely will. Our job and the job of organisations, therefore, is to be increasing value at a rate greater than our competitors are doing.

Well, hopefully all of this sounds pretty obvious. We can start to make things a lot more interesting for ourselves, though, if we start exploring what this 'increasing value' direction means when we travel to its ultimate conclusion: If, over time, benefits go up and costs and harms go down, then in the end what we will end up with is customers receiving all the benefits they want at no cost and without any negative harmful side-effects. We might think of this end point as an 'ideal' goal.

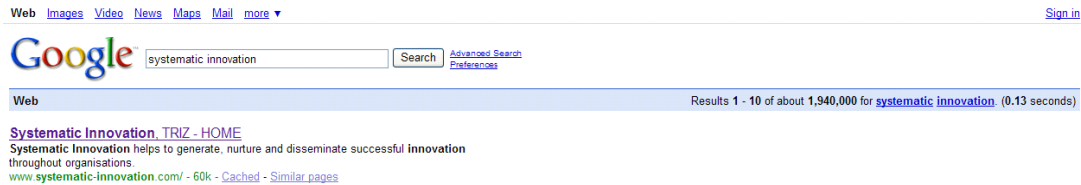


We might also think of it as an impossible to reach goal. What business could possibly survive in such a scenario? Sure, providing our customers with all the benefits they want is logical. Ditto eliminating any harmful side effects. But zero cost? How can I expect to pay my wage-bill every week if I am expected to give things away to my customers?

Of course, the 'ideal' destination is designed to be a theoretical one. But at the same time, it carries with it some enormous implications for the way we design our businesses. Particularly if the businesses we are in involve IT and services.

Take Google as an example. Here is an extraordinarily successful business. One of the reasons they've grown so quickly is because they have given their customers a good version

of that 'ideal' solution. Think of it as 'free, perfect and now'. Or how about – given the speed that everything seems to change these days - 'free, perfect and yesterday'. How many of the people reading this article use Google? How many of us expect to pay for that privilege? The question is absurd. It is that way because as users of search engines, Google has been thinking about giving us all the benefits we want (we want to achieve the job 'find relevant information'), it does the job effectively instantaneously ("1,940,000 hits in 0.13 seconds") and finding ways to give us those things without a need to charge us money. As far as you and I as users of Google are concerned, they have given us pretty much our 'ideal' solution.



But, of course, that still leaves Google with the critical problems of how to pay the wages each week. Their answer to this question is – as elsewhere – to find 'someone' who does not yet expect the 'free, perfect and yesterday' ideal; someone that will be prepared to pay in order to acquire the benefits they need. The answer to that question today is the advertiser. A big part of Google's revenue stream is expected to come from people wishing to sell something to a Google user.

So far so good. Now for a really, really important thought. Google already gives it's users that 'free, perfect and now' ideal. Advertisers have to pay. But in exactly the same way that search engines must move towards the ideal, the same must happen to advertising on a search engine. Imagine for a minute that you are someone who is looking to place some advertising on one of the available search engines. Because Google is now the world's most popular search engine, the company is able to charge a premium for the privilege of advertising there. There are other competing search engines of course, and these too are trying to get more users and more advertisers. So how do these companies compete with Google? Very likely one of the strategies they will try is offering a more attractive advertising rate. Less users seeing the advert maybe, but lower cost. And there's that cost-benefit trade-off again. Inevitably what it results in is – and here's the critical idea – as competitive pressures drive different players to discriminate their offering from others, sooner or later advertisers too will come to expect that ideal 'free, perfect and yesterday' solution from each of the search engine providers. When that happens – and it is very definitely a 'when' and not an 'if' – Google and others will have to find another way of paying the wages every week.

Here then is a great model to describe at a meta level of the world of business works; things move along an unstoppable treadmill towards an 'ideal' state. Different parts of the value network will move at different rates, but sooner or later they will all get what they want. Very simply because if we don't give it to them, someone else in this rapidly globalising world will.

Lest we all use this moment as one of great doom and gloom, let's bring in a couple of important additional ideas. Firstly, the race towards 'free, perfect and now' happens quicker in some industries than others. In the petrochemical industry for example, we only have to look at the price of a barrel of oil today to see that it is making no great shift towards the dimension of 'free'. The industry is competitive, of course, but the current drive is towards more benefit and less harm rather than lower cost. The industry competes internally on who can provide the best fuels with the fewest harmful side-effects. Minimising internal costs are important, but don't necessarily have to be passed on to the customer. We are only likely to

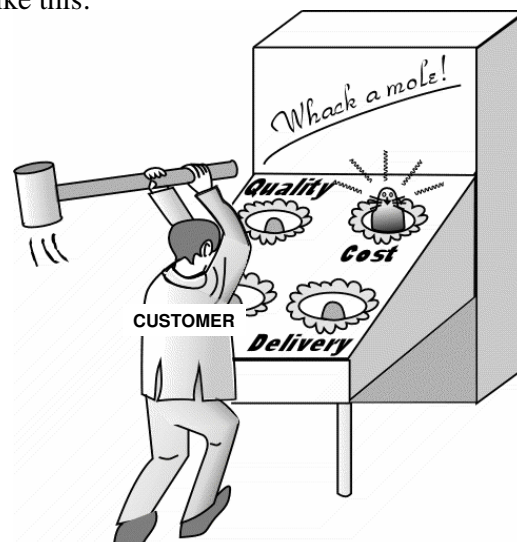
see more significant drives towards 'free, perfect and yesterday' at such times when – thinking beyond purely petrochemicals – alternative energy supply methods are able to deliver comparable levels of 'ideality'. The time when (again 'when' rather than 'if') solar energy, say, reaches a comparable level of ideality in the hearts and minds of customers will be the time when the petrochemical sector will really find itself in their own real 'free, perfect and yesterday' race.

Second is the thought that although we have been talking about this 'ideal' solution as some kind of a final destination, in actual fact, whenever something gets close to that definition, our definition of what 'ideal' actually means tends to shift. Think of Google again. When you first started using it, chances are that you thought it was pretty much perfect in terms of the job that it did for you. You wanted to find information about something; Google found it. End of story? Well, yes, except now you've been receiving that 'perfect' result for some time, your definition of what perfect has probably moved on. Why do I have to have ten hits per page? Why can't I have everything on one page? Why can't I just have the one hit that I really need? Neither Google nor any of the other engine providers has thus far thought about these new issues as they continue to think about what 'ideal' might mean.

'Ideal' in this sense is, paradoxically, both a fixed end point and a moving one. As soon as one perfect horizon is reached, whether Google or anyone else likes it or not, another more distant horizon will sooner or later begin to emerge.

This thought in turn ought to introduce several others leading back to our discussions in the previous two parts of the series. Let's use banking and financial services as a way of examining some of these points.

The banking sector is clearly another one that is currently feeling the extreme effects of globalisation. What makes one bank stand out from any other bank when customers are now so easily able to compare that bank with a thousand others? If I look at my own personal experience, I've been with my bank for close to 40 years now. They actually came to my school when I was 9 years old and gave us a talk on money and saving (in itself quite an innovative idea), and as a result of that I started a savings account with them. Overall they've offered me a very competent service ever since that account was opened. Occasionally I look around to see if there's anything I ought to change to, but so far in all those 40 years nothing has hinted that it is worth the hassle of changing from where I am now. Even the banks that tell me they will take care of all that hassle haven't been able to tempt me. Why is that? Could it be because every single bank out there is playing the same basic game? One gives a half-point more interest on my chequing account, but then offsets that with a bigger penalty if I go over-drawn. Another offers to donate a percentage of its profits to charity, but at the same time, it's a new bank and I'm not convinced that they're as competent at managing my funds as my current bank. All banks are playing the same old trade-off and optimization game. The game looks something like this:



If you've ever found yourself playing the same game with your bank (or any other product or service provider come to that), it's because within the bank they're playing exactly the same trade-off and optimization game. 'Balance' is a really important word in the banking industry. It is an industry – like many others – built on intricate algorithms that allow managers and strategists to balance - or 'optimize' – their risk, revenue and returns.

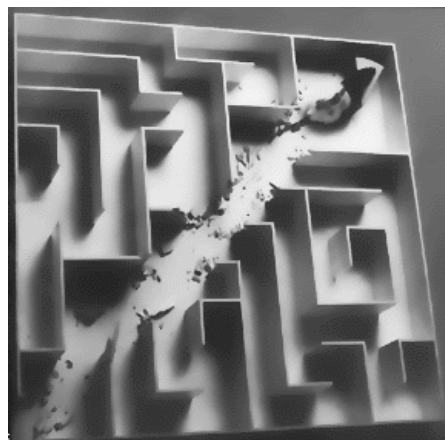
Hopefully it should be clear at this point that 'optimum' and 'ideal' don't have that much in common with each other. Banks and other institutions have tended very much towards the former business model historically. After a few decades of doing this kind of 'optimization' job, the net result is that a) we have some pretty sophisticated algorithms developed, b) customers become increasingly unable to distinguish one bank from any other.

'Optimum' means moving trade-offs and compromises from one place to another, and therefore knowing our customers well enough to know where we should put the 'sweet spots'. In India at the moment for example, the speed at which one bank can offer customers a new credit card is one way for one bank to stand out from another. A 'same day' credit card is a definite sweet spot. But, of course, it won't be for long, because all that is happening is that the bank has shifted the risk trade-off from one place to another – more customers arrive due to the speedy service versus higher risk that some of those customers will default on their payments. There has been no innovation here, no jump to a more ideal solution.

Banking has been very lazy when it comes to thinking about giving their customers 'ideal' services. This perhaps explain why some of the fastest growing financial institutions in the UK and US at the moment are players who have entered from outside the traditional players. Supermarket chain, Tesco, for example, now offers a genuinely more 'ideal' service for many potential customers because it is able to leverage benefits, costs and harms across different sectors. Customers, for example, are now able to pick up literature about insurance while they are queueing to pay for their groceries, in some cases 24 hours a day. What bank offers anything like that capability? I haven't changed my account to Tesco yet, but if I ever change from my current bank, the chances are the company that I change to will not be one of the traditional banks, but rather a supermarket or some other intruder who has been thinking about what my 'ideal' solution looks like and sets about designing a genuinely more ideal overall service.

Banks might think they are in a safe 'optimum' environment. They, like many others, tend to look for 'optimum' solutions. The supermarkets – an even more highly competitive industry due to the low margins – have had to adopt much more 'ideal' thinking in order to satisfy their shareholders. Hence they get to be the ones that intrude on the traditional territory of banks. We will no doubt see more of these kinds of breakthrough industry intrusions in the coming years as more and more companies come to realise the difference between 'optimising' what they currently do and looking at what the customer 'ideally' wants.

As a final thought this month is this image:



We like this image because it offers an excellent metaphor for both what we've been talking about this month and also for innovation in general. The mouse in this picture represents us as innovators. The cheese that the mouse is trying to get to is what we might now think of as our customers' 'ideal' solution.

Next come all of the walls that make it difficult for us to get to that ideal. These walls represent all of the trade-offs and compromises that stand between us and that 'free, perfect and yesterday' destination. Just about the whole of the innovator's job is to find ways of advancing through the maze that the walls form. Optimization is about polishing the walls and floors in the place where we are now, making life as comfortable as possible for ourselves. Innovation is about knocking the walls down and moving to where our customers want us to be.

We talked a lot about the importance of identifying and solving trade-offs, compromises, conflicts, conundrums, contradictions in last month's article. This month we have seen that there is a higher purpose and direction to doing that job. We solve contradictions in order that we can make jumps towards 'ideal' solutions. These jumps are the things that make customers go wow. The 'wow' comes because when those customers make their usual cost-benefit trade-off comparisons with what they 'expect' they discover that the game has changed and the value equation has shifted.

If we're smart, this is the job that as business leaders we need to take on in earnest. Next month we explore the idea in a bit more detail and then move forward to explore whether there are some predictable jumps that allow us to accelerate our progress through the maze. Is the future predictable? In terms at least of where things will evolve, we hope we can convince you that, yes it is. Very much so in fact.

Darrell Mann  
[Darrell.Mann@systematic-innovation.com](mailto:Darrell.Mann@systematic-innovation.com)