Let's Get Persian

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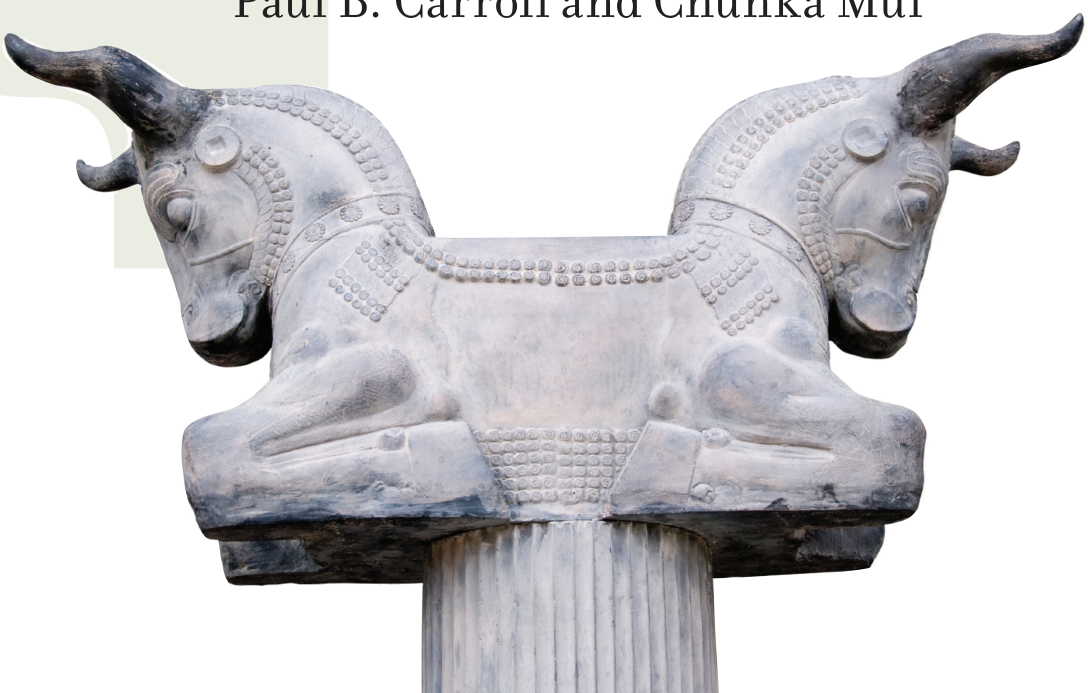

Herodotus, the Greek historian, reported that the ancient Persians always made important decisions twice—first when they were drunk, and then again when they were sober. Only if the Persians reached the same decision, drunk and sober, would they act on that decision. The approach apparently worked—the Persians dominated the much of the Middle East and Central Asia for three centuries.

Our two years of research into major business failures finds that companies would benefit widely from being more like the ancient Persians.

We usually draw a chuckle when we say this in front of audiences. As you can well imagine, people say things like, "Maybe we should hit the bar and continue the discussion there." In fact, businesses usually make their important decisions in a state that, while not drunken, is what psychiatrists call "hot." "Hot" because, while business is generally thought of as highly rational, there is actually a lot of emotion involved, especially in major moves. People feel an urgency to act, so they may gloss over potential problems with major strategy choices. People get intimated by the stakes or by pressure from peers and bosses to proceed with a strategy, based on the idea that "we have to do something." People may be afraid to voice objections, lest they seem ill-informed.

Our research into the 750 biggest business failures of the past quarter-century found that executives don't need to go drinking to revisit decisions. Executives just need a cold, dispassionate environment that will let them reconsider their options carefully.

The Persian approach has been used by some very successful executives, including Alfred P. Sloan, the creator of General Motors. Sloan once looked around a table at a meeting of his senior team and saw that they were quickly reaching consensus. "So, I take it we're all agreed," he said. Everyone nodded. "Then," Sloan said, "I suggest we postpone this decision until a later date, so we can have time to develop some disagreement and come to a better understanding of the issues."

In addition to using what might be called a second-chance meeting to review important decisions in an unbiased light, businesses should also take advantage of other means of introducing constructive contention into their decision-making, because disagreement, managed correctly, turns out to be crucial in avoiding errors. Our research found nine additional ways to introduce disagreement and manage that disagreement so it keeps everyone on their toes without harming the camaraderie of a management team:

1 | Informal devil's advocacy
2 | Escalation systems
3 | Bets
4 | Staring into the abyss
5 | Finding history that fits
6 | Deciding (ahead of time) how to decide
7 | Smoothing out management ruts
8 | Constructing alarm systems
9 | A formal devil's advocate review

We'll look at those nine methods, one by one, starting with the relatively simple and concluding with a formal process that, we believe, should be used by every company before any major decision is made. These nine approaches are in use and have demonstrated successes, but are often overlooked because business literature typically looks at success stories and says, "Here's how to be like those guys." Almost no books look at failures and say, "Here's how *not* to be like *those* guys." So, approaches that are designed to play defense, rather than offense, are too often ignored.

The stakes are huge. The failures we investigated involved bankruptcies of 423 U.S. companies, with assets totaling $1.5 trillion and annual revenue of almost $830 billion. The failures also included companies that took write-offs totaling $380 billion and that reported losses from discontinued operations of $30 billion. Yet we found that almost half of those enormous failures need not have happened. Some 46% of the failures occurred because of strategies that could have been spotted at the time as weak—in other words, not because of bad luck or poor execution, even though conventional wisdom these days seems to be that good execution can make any idea work. If the executives who launched the failed strategies had gone Persian, or had found other ways to introduce constructive contention into the strategy process, they could have seen the problems.

After all, it wouldn't have taken Blue Circle much reflection to realize it had gone too far afield when it decided that it should move beyond its core cement business and make lawnmowers, on the theory that cement is used in homes and that homes, well, have lawns. Long before Blue Circle, one of the world's largest cement companies, went into bankruptcy proceedings and was then sold, *somebody* at the company knew lawn mowers were a bad idea. Probably many somebodies.

Taking a sober look at the misconceived strategies could have saved investors tens of billions of dollars and saved hundreds of thousands of jobs—including those of many of the executives involved.

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Before we begin...

There are two things worth noting before we launch into our list of nine additional ways to bring constructive contention into decision-making:

1. **What we call devil's advocacy begins in a storied tradition.** The term comes from the Catholic Church, which used devil's advocates as part of the process of canonizing people as saints. Late in the process, someone would be appointed to argue the devil's point of view, laying out any evidence that would suggest someone shouldn't be canonized. The church used these advocates for 400 years, before abolishing the practice in the 1980s. We find it illuminating that, since the office was eliminated, the rate of canonization has increased by a factor of 25.

2. **Devil's advocacy and the other approaches we offer are in no way intended to stifle innovation.** We'll say that again: We have no interest in helping arm naysayers so they can head off useful ideas. We realize that we don't live in a perfect world, so no strategy will be without flaws. In fact, we have spent much of our careers helping companies find ways to be more innovative, so our bias is toward action. As a result, all the approaches we lay out are designed as an overlay to existing processes. We leave the decision-making power where it already is, meaning that executive teams aren't going to be slowed down by having to answer lots of extraneous questions and check off lots of boxes on process review lists. We also have worked to ensure that our approaches don't harm the camaraderie of a team. As you'll see, all we're trying to do is bring to the surface the flaws in a strategy that sometimes get overlooked, so that companies don't pull another Blue Circle.

Studies have found that chief executives who make a serious strategic error, such as a misjudged acquisition, typically lose their jobs within two years. We'd like to help those CEOs keep their jobs.

1 | INFORMAL DEVIL'S ADVOCACY

Often, this will occur naturally. Someone will have the sort of personality that lets him challenge an emerging consensus. Perhaps he feels strongly about an issue and wants to make sure he's heard. Maybe he's going to have to implement the strategy and just wants to be sure everyone understands all the obstacles he faces.

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Better yet is to focus on building a culture where challenges come naturally, without damaging the internal conversations. This is something Jack Welch did exceptionally well as the longtime CEO of General Electric. One executive, who joined GE as part of the acquisition of RCA, told Welch: "What passes for conversation around here would be seen as a mugging by RCA people."

The best example of the power of informal devil's advocacy may be the Cuban missile crisis. After the Kennedy administration botched every major decision about the Bay of Pigs invasion, President Kennedy appointed his brother Bobby to be a devil's advocate in the missile crisis. While the civilians had accepted the judgments of military leaders before the Bay of Pigs, Bobby continually challenged the generals in the missile crisis. When one said a detailed analysis concluded that the U.S. could bomb the Cuban missile sites without fear of retaliation from the Soviet Union, Bobby got everyone in the room to put themselves in the Soviets' shoes. The group realized the Soviets would have to strike back or lose all credibility on the world stage. Just imagine what might have happened without Bobby's devil's advocacy.

2 | ESCALATION SYSTEMS

Because informal devil's advocates will sometimes censor themselves, worrying that saying certain things could put their careers in jeopardy, it's worth putting in place systems that give people lower in the organization a chance to voice concerns. Rosabeth Moss Kanter tells a great story about an executive at a fabric manufacturer who took over a group and demonstrated that he was open to any new ideas. Someone from the production line approached the executive and, in a heavy foreign accent, said he had an idea that might solve a problem that had long bedeviled the company: An important type of fiber would sometimes snap, causing millions of dollars of production delays each year. The executive promised to try the idea, and it worked.

"That was a great idea," the executive told the worker. "How long have you had this idea?"

"Thirty-two years," the worker replied.

The idea of escalation systems is at least as old as the suggestion box. Some companies have updated it, taking advantage of the ease of electronic communication. Microsoft goes further, occasionally holding anonymous polls to ask workers whether, for instance, a piece of software will really be delivered when the team leader says it will.

As the fiber manufacturer shows, though, the design of these systems is crucial because people need to believe that they will be heard and that there will be no repercussions. IBM, for instance, long benefited from an "Open Door" policy. Instituted by founder Tom Watson Sr., the policy literally meant that anyone could walk into his office to complain. Over time, however, the system was subverted. As IBM grew, "Open Door" concerns had to be submitted in writing. As IBM became more and more successful, its willingness to tolerate dissent declined. By the late 1980s, "Open Door" issues were simply referred back to the manager of the person who complained—even though the manager was often the subject of the complaint. The system's usefulness died.

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3 | BETS

Our friend Gordon Bell, a computer-industry pioneer and a prominent investor, sometimes does an unusual thing when he's talking with an executive team. He'll zero in on a number and say to the CEO, "Wanna bet? A side bet, you and me, for $1,000. I bet you don't make that number." If the CEO gulps, Bell knows he doesn't have the courage of his convictions.

While executives take their fiscal responsibilities seriously, there's something about betting your own money that can provide a real gut check. Bets can also force people to be very precise about their assumptions. Before the Bay of Pigs debacle, the Joint Chiefs of Staff told President Kennedy the plan had a fair chance of success. Kennedy took that statement as an endorsement—but what they meant is the plan had a one in four chance of working. By contrast, being specific about odds, timing, etc. can lead to the sort of result we saw at a consulting client. The client assumed that a revenue stream from a certain kind of information would go away as the information became more readily available for free online, but when pressed to be more specific revealed a wide range of assumptions about how quickly the problem would develop. Some said six months, some six years. Once they debated the issue, they all wound up on pretty much the same page and could act on the group assumption.

Some companies are also finding it useful to set up “prediction markets.” These markets, which have shed light on which candidates would win political races and which movies would win Academy Awards, are set up like pseudo stock markets. People buy and sell, say, the right to collect $1 if Barack Obama wins the presidency. If the market price for that right is 52 cents per share, then the market is saying that, at that moment, Obama has roughly a 52% chance of victory. Studies have found that these markets are consistently more accurate than traditional polls, and companies are starting to use them on business metrics. Hewlett-Packard, for instance, found that a prediction market produced better forecasts of printer sales than its traditional process did.

4 | STARING INTO THE ABYSS

For all sorts of psychological and anthropological reasons, people tend to view the future as a variant of the present. Even when people know their limitations, they still have a hard time getting around them. Just ask Kodak, which was so accustomed to selling prints that they couldn’t imagine a world in which teenagers snapped lots of pictures, then sent them around via cellphone to their friends, who viewed the pictures, chuckled and deleted them—all without the image ever touching paper. Kodak actually did a detailed study of the threat from digital photography in 1981 and was extremely accurate about the first decade of that threat, but then underplayed that threat because it couldn’t imagine a world where prints didn’t dominate. While competitors Agfa and Fuji limited the damage, Kodak went on one long slide.

To avoid having that sort of Kodak moment, it’s important for executives to step outside their bodies every once in a while and go through exercises that can force them to stare into the abyss. One exercise is to have people grab a blank sheet of paper and imagine that they were designing their worst competitor—one that had lots of capital, lots of expertise and great interest in attacking the

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incumbents in the market. Once people see their worst nightmare on paper, they can take a more realistic look at their potential vulnerabilities. Another exercise is scenario planning. What if national health insurance happens? What if global warming quadruples the number of hurricanes in the Atlantic each year? What if. . . ? A colleague who was a strategist at General Motors some years back got the top executive team to ask itself, What if the internal combustion engine went away? The team initially dismissed the idea as goofy but was eventually willing to consider an alternate formulation of the idea: What if gas prices go through the roof? The CEO then shifted money in the research budget to allow for that possibility. GM's Volt is a direct result of that research. GM is still in a world of hurt, but at least it's much better prepared for high gas prices than it would have been.

5 | FINDING HISTORY THAT FITS

Another off-the-charts-smart friend, Alan Kay, likes to say that the right context is worth 80 IQ points. That idea has certainly worked for Kay, who is sometimes called the father of the personal computer and who has made breakthrough innovations at Xerox, Apple, Disney and elsewhere. The problem is that companies often have an incomplete understanding of the context in which their strategy will play out.

The first part of the problem is that companies tend to try to draw lessons just from successes, when they really need to look at successes *and* failures. Looking just at successes is like interviewing the winners at a roulette table and assuming that following their strategies will lead to similar winnings—even though the game is stacked against you. Unum, the largest provider of group disability insurance in the U.S., made this mistake when it bought Provident in the late 1990s. Unum looked at various ideas on synergy and concluded that buying Provident, the largest provider of individual disability insurance, would be complementary. Unum somehow ignored the fact that it had tried on its own to get into individual disability insurance some years earlier and had found the market impossible. The individual market was not only completely different from the group market but had some dynamics that induced companies, including Unum, to seriously underestimate the risks. Unum got out of the individual market when it tried on its own, and it got out of the market again after buying Provident—but not until the Provident acquisition cut Unum's stock market value by more than half.

The second problem is that people tend to look at history by doing a situation analysis. That provides a snapshot in time—what a company's market share is, who its competitors are, what margins are, etc. But a situation analysis doesn't explain how the company got to its current position, even though understanding the trends that produced the current snapshot can be much more important. To help companies grasp the relevant trends, we have drawn on the work of Harvard professors Richard Neustadt and Ernest May, whose book *Thinking in Time* focuses on the world of public policy. They tell a powerful story about how a Soviet brigade was located in Cuba in the late 1970s, just as the U.S. Senate was considering approving an arms-limitation treaty. Opponents of the treaty seized on the news and said the Soviets couldn't be trusted. The treaty died. Only later did an investigation find that the brigade had been stationed in Cuba since the early 1960s and that prior administrations had known about it. Had the relevant history been understood at the time of the treaty debate, the brigade would have been a nonevent.

6 | DECIDING (AHEAD OF TIME) HOW TO DECIDE

Companies often find it hard to get enough consensus to undertake a major initiative. So, when a CEO realizes that something is going wrong, he doesn't take the time to fully investigate, for fear of having the organization bog down in self-analysis. Rather, he comes up with a plausible solution to the problem and begins building support for that solution at the same time the dimensions of the problem are being probed. The idea is that the analysis of the problem will shape the eventual solution. In practice, however, the CEO often invests so much in selling the solution to his team that the analysis gets shunted aside.

The solution is to agree ahead of time on what an executive team will do when a major obstacle arises. The team needs to agree on a formal investigation *before* the consideration of numerous potential solutions.

7 | SMOOTHING OUT MANAGEMENT RUTS

When Lou Gerstner became CEO of IBM in 1993, he banned what IBMers called "foils"—cellophane sheets that were used to show slides on overhead projectors. This was big stuff. IBMers were so addicted to foils that one CEO had a projector build into his mahogany desk. IBMers weren't sure how to think without foils—which was precisely Gerstner's intention. He wanted to break habits, to force people to articulate things about the business, about customers, about competitors that would stand up to scrutiny when described in one word on a slide but that would fall apart when someone tried to defend them in oral argument.

Similar approaches can be useful, breaking management out of ruts that would produce the same old decisions—and the same old mistakes. In considering mergers, Pitney Bowes has outlawed PowerPoint presentations, in favor of prose documents, to force people to really develop and defend their thinking, rather than just write something like “increased scale” as a benefit on a slide. Some executives we know will occasionally ban spreadsheets from a meeting to change the dialogue.

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8 | CONSTRUCTING ALARM SYSTEMS

Once a strategy is put in place, a company can’t just file the document and forget about it. A strategy is based on numerous assumptions on how the market will play out, and companies need to have all those assumptions articulated so they can adapt if the assumptions turn out to be significantly wrong. Companies need to do periodic reviews to check key assumptions against emerging reality. This is precisely what Kodak didn’t do following its 1981 investigation of the prospects for digital photography. Kodak liked the report’s assurance that its business would be largely unaffected by 1990 and didn’t pay attention as digital’s quality improved, as prices came down, as individual printers improved, etc.—in other words, as all the factors that limited digital’s capabilities gradually disappeared.

9 | A FORMAL DEVIL'S ADVOCATE REVIEW

In setting any major strategy, we believe a company owes it to itself to step back and do a formal version of devil's advocacy. The effort need not be terribly time-consuming or expensive and can catch an awful lot of mistakes.

There are five key attributes to a formal review:

1. There needs to be a clear and limited charter. In the competitive world of the executive suite, people are always trying to make rivals look bad. So, to be accepted, a review can't be about coming up with a better idea. The review can only focus on the idea at hand, and whether it will work. The review also can't be about whether the strategy is perfect, just whether it's the best of many imperfect alternatives.

2. The review needs to be organized for success. The main point here is that asking an investment bank or a consultant for a second opinion isn't devil's advocacy—even though that's how many companies have approached due diligence historically. The bankers and consultants we know are often terribly smart, but they have financial incentives that might color their own judgment about whether or not a proposed strategy is wrong-headed. The banker, in fact, doesn't get paid unless a deal is done, so he has every incentive to keep things going. The formal review needs to be led by a credible person who has had little or no involvement in forming the strategy and who has no financial incentive to see it carried through. That leader may be a retired executive. He may be a truly independent board member. He may be an outsider.

3. The focus needs to be on the strategy, not on the process that produced it. The issue isn't whether every box was checked off in the decision-making process. Almost always, it was. The issue is whether questionable assumptions were made as part of an attempt to sell the organization on a strategy. The strategy has to be evaluated on its own to see if it stands or falls.

4. The review needs to deliver questions, not answers. The idea isn't to make everything perfect; that's the job of day-to-day management. The review is there just to challenge assumptions and show where management needs to do more probing.

5. The review needs to come to closure. This doesn't contradict the statement about delivering questions, not answers. Rather, this statement means that there needs to be some mechanism for not only delivering a report to senior management but prompting action on its findings, and revisiting that report from time to time to see if the issues raised are adequately addressed.

* * * * *

None of these 10 methods will guarantee against all failure. Business will remain a contact sport. Companies will win. Companies will lose. But, at the least, the sort of constructive contention we're advocating will help head off a significant percentage of ill-judged strategies and avoid a lot of wasted investment.

That these methods work is well-demonstrated. When Tom Watson Jr. succeeded his father as CEO of IBM in the mid-1950s, he rebuilt the culture around the idea of contention. Operating executives were assigned a staff counterpart. Major decisions only went ahead if the operating executive and the staff executive agreed—and woe to the executives who couldn't agree or who took too long to decide. Far from bogging IBM down, the contention system positioned IBM for three decades of dominance. When Fortune magazine put Watson on its cover, the headline read, "The Greatest Capitalist in History."

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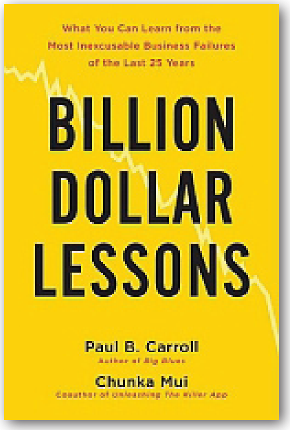

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