Quick takes

Larry Goodson

These brief summaries highlight the key points and action steps in the feature articles in this issue of Strategy & Leadership. *Larry Goodson, an* S&L *contributing editor, is a veteran strategy consultant based in St. Louis, Missouri. He is a Partner at LDGA Consulting, which offers Lean operations and strategy development services (ldgoodson@msn.com).*

Interview
Stefan Thomke: The power of experimentation in the digital era
Brian Leavy

Executives today, at all levels, and across all of the business disciplines, are well advised to update their training on the fundamentals of the experimental method – it should no longer be just the province of the technical specialist in engineering, R&D or data analytics. In the introduction to his latest book, *Experimentation Works: The Surprising Power of Business Experiments*, Harvard innovation expert Stefan H. Thomke pays particular tribute to the scientific method and "the engine that has powered" it over the centuries, the "humble experiment."

Strategy & Leadership: As a long-time leading advocate for the more extensive use of experiments in industrial research and innovation, your new book seems to have a broader, even more ambitious mission.

Stefan H. Thomke: The rapid and unrelenting rise of today's online businesses, like Google, Amazon and Booking.com, helped me realize that large-scale, controlled experimentation would revolutionize the way all companies operate their businesses and how managers make decisions.

S&L: You advocate that a "good" business experiment should follow "a clear set of principles," starting with a strong hypothesis. Why?

Thomke: Companies should conduct experiments if they are the only practical way to answer specific questions about proposed management actions, and to do so, you need a good hypothesis.

Building the experimentation organization

S&L: In your view, to successfully innovate, companies need to build a culture that invites experiments at a large scale, one with a "learning mind-set" that can value failure. How does this work in practice?

Thomke: In a culture with a learning mind-set at its heart, all experiments are seen as producing valuable learning, those that fail as well as those that succeed.

S&L: What are some of the other important attributes of effective innovation cultures?

Thomke: To successfully innovate, companies need to build a culture that invites experiments at a large scale, even when budgets are tight, and it's never been cheaper and easier to do so.

S&L: Developing a fully effective "experimentation organization" also requires "embracing a new leadership model." What are its traits?

Thomke: Instead of viewing leaders primarily as decision makers, the new leadership model encompasses at least three things:

1. Employees need to see how their experiments support an overall strategic goal.

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2. Putting in place systems, resources and organizational designs that allow for large-scale experimentation.

3. Being a role model.

Looking towards the future

S&L: Finally, you identify a number of developments you believe will require more and more businesses to develop "massive experimentation capacity." What are they?

Thomke: Three important developments are, first, customers will increasingly interact with your company through mobile devices. Second, in the context of innovation, companies will soon recognize that big data and business analytics need controlled experiments. Finally, perhaps the most significant, development is the rise of artificial intelligence (AI)—or more specifically, machine learning and artificial neural networks.

Why a culture of experimentation requires management transformation

Stephen Denning

Even before the current global coronavirus crisis, the world was in the midst of an era of life altering innovation. Technology had created the possibility of every person or product connecting with every other person or product instantly and at zero cost.

The coronavirus crisis: a massive forced experiment

Now the global coronavirus crisis has turned the possibility of digitization into a necessity. Firms are being compelled to reinvent on the fly much of what they do. While there is much talk of "getting back to normal," the reality is that the world will never get back to the way things were.

The need for a culture of innovation

In his latest book, *Experimentation Works: The Surprising Power of Business Experiments*, Harvard innovation expert Stefan H. Thomke says the reason some firms are not keeping pace with reinvention innovation is that most organizations lack "a culture of experimentation."

Thomke believes firms need "a new model of leadership," which cultivates curiosity, emphasizes data-informed decisions, experiments ethically, sets grand challenges and establishes systematic training and support for rapid experimentation.

How most big firms squelch experimentation

That's because the underlying management model of most big organizations is explicitly aimed at preventing the very kind of experimentation that Thomke is recommending. In this model the organization is run from the top, with an assumption that the top knows best. As business school professor John Kotter writes, people "are working with a system that is designed to get today's job done."

Why experimentation is necessary

Those management perceptions and practices focused only getting today's job done efficiently no longer make sense. Increasingly, a firm can only survive by obsessively understanding the customers' shifting needs and finding new ways of delighting them.

Thomke points out that in a digital world, technology has made it radically simpler and quicker and cheaper to carry out and evaluate multiple experiments.

The advent of business agility

Firms like Amazon, Facebook, Google and Microsoft have embraced a radically different kind of management. It involves three key elements that enable business agility:

- An obsession with delivering value *to* customers as the existential goal of the organization.
- A presumption that all work be carried out by small self-organizing teams, working in short cycles.
- An interacting network of teams rather than a steep command-and-control hierarchy.

This approach includes both operational agility – making the existing business better – and strategic agility – generating new products and services and so bringing in new customers.

The new normal: a network of teams

Creating a culture of experimentation involves more than adding a fix on top of an organizational structure with a vertical reporting dynamic. The whole organization needs to become an organic living network of high-performance teams.

Ecosystems boost revenues from innovation initiatives

Anthony Marshall, Anthony Lipp, Kazuaki Ikeda and Raj Rohit Singh

Ecosystem partnerships are driving a dramatic change in the nature of business as industries as diverse as banking, automotive and retail are converging in unprecedented ways—and at an unprecedented rate.

The IBM Institute for Business Value surveyed 1000 top executives in 19 industries and 29 countries between August and January 2019. Our analysis revealed that organizations with high engagement in ecosystems generate greater revenues from innovation initiatives. Moreover, organizations innovating in ecosystems seem to innovate more efficiently, with comparatively lower operational expense spending.

Platforms for value capture

Over the past several years, platform-centric businesses have become more valuable and often more innovative than others. Four of the five largest companies globally are now platform centric companies. As many as 90 percent of C-suite executives overall tell us that ecosystems are impacting their organization's focus or critical activities – and half say that the resulting impact on their organization will be high.

Learning from the best

The IBV study conducted a cluster analysis that revealed four distinct archetypes and how the most successful innovators in ecosystems differ from others:

- They lead with platforms for innovating in ecosystems.
- They create the structures that enable the transformation of ideas into desired customer experiences in ecosystems
- They establish effective, meaningful measurements for successful innovation in ecosystems.
- They approach innovation with a collaborative mindset and create an environment of openness that shapes innovative behavior.

Ecosystem innovators do things differently

Ecosystem innovators differ from the other three clusters across four innovation dimensions:

- Platform innovation. Platforms are an integral part of business ecosystems and enable frictionless interactions between economic agents.
- Structure innovation. Ecosystems are vital for organizations to broaden their market approach and shift their focus away from simply selling products to selling

outcomes and tailored experiences.

- **Process innovation**. Ecosystem innovators hold innovation initiatives accountable to clear financial and operational objectives.
- **Culture innovation**. More than any other group, ecosystem innovators foster a culture of openness, collaboration and participation.

Action guide:

Agile and flexible partnering arrangements will help the ecosystem respond quickly to changing market conditions. Establish Agile, cross–functional teams within the organization to complement the flexible partnering arrangements. Resist the urge to overemphasize internal organization structures and processes to manage the ecosystem.

Risk as strategy: defending against catastrophic turns of fortune

Joseph Calandro, Jr.

Due to the Covid-19 pandemic, stock markets across the globe are in turmoil and global economies are slowing. In January of 2020, in an article in this journal titled, "Disruptive technologies, 'Black Swans' and corporate innovation strategy," a colleague and I proposed a strategic preparedness approach which "applies to both the upside as well as the downside of such seemingly unlikely disruption.

One practical way to apply our approach is through hedging material balance sheet exposures when market volatility is low or contracting. For example, for firms with large equity and equity-like exposures – such as allocations to private equity – we recommend a volatility index (VIX) hedge, which is a way to protect a valuable S&P 500 correlated portfolio/position against a severe, unexpected loss.

Illusion of control

Modern corporate risk management functions generally tend to be based on one of four approaches: (1) quantitative analyses, (2) compliance-based analyses, (3) regulatory and/or rating agency analyses, or (4) some hybrid of the preceding three. A problem with this approach is that it can account for market risk, investment risk, interest rate risk, inflation risk, failure to match maturities risk, securities fraud risk, excessive promoters' compensation risk, but not the risk of Black Swan events.

The false assumption of control. The breadth of modern risk management processes, along with related governmental pronouncements and assurances, often give the illusion that "risk" in general is controlled.

Managing informed by past crises. Another cause of the "illusion of control" is the well-known human tendency to perceive the risks of the present informed by an "anchor to the past," particularly the recent past.

Uncertainty, strategy and risk

Uncertainty is inherent in strategy. A more strategic approach to risk management undertakes three core steps that inherently relate to corporate strategy:

Step 1. Managing significant asset concentrations that could impact a balance sheet and prevent successful strategic execution from both the asset- and liability-side.

Step 2. Monitoring the strategic environment for threats that could potentially target or "hit" a sizeable asset concentration.

Step 3. Finding economical ways to hedge or otherwise protect a balance sheet from the volatility swings in a crisis or catastrophe, which is an inherently strategic process.

Taking action that is different from what colleagues, peers, advisors and competitors see as standard practice can be stressful.

The risk differentiation advantage

Differentiation is core to effective strategy, so all strategists must “think different.” We believe that executives will increasingly become accountable for the performance of their firms during periods of extreme volatility expansion following a crisis, catastrophe or recession. A more strategic approach to risk could help a firm outperform its competitors during future crises and catastrophes.

Corporate turnaround failure: is the proper diagnosis transgenerational response?

John J. Oliver

Could there be a hidden cause of chronic failure in a corporation, where over many years multiple CEOs and new strategies can’t revitalize the firm after a long past painful stumble? In fact, some organizations exhibiting chronic underperformance may actually be suffering from the residual effects of a crisis event that occurred a number of years previously.

Public health medicine recognizes a syndrome called “Transgenerational Response,” which describes how a severe environmental trauma can create an inherited adaptive response that influences the development and health of future generations.

So, can a corporate crisis event create dysfunctional adaptive attitudes and behaviors that subsequently become embedded in the culture of a firm to the detriment of its long-term viability and performance?

Corporate DNA: it’s culture that drives performance!

Corporate culture is widely regarded as the collective cognition of implied assumptions and shared beliefs that differentiate one organization from another. It drives long-term performance, with firms being either open, or resistant, to the idea of innovation and of developing a strategic outlook, investments, systems, people and processes that deliver products, services and improved business performance valued by customers.

The cases of AIG and Yahoo- Critical Corporate Incident

These two firms were examined for “transgenerational response” trauma in 2017. Instead of just looking at the short-term view of how a crisis situation was managed, this approach specifically considers the attitudes and behaviors supporting innovation and risk.

Transgenerational response: further evidence from two cases

In 2005, AIG was charged with accounting fraud and bid rigging by the U.S. Securities and Exchange Commission. Two consequences of this deception were a $1.64 billion fine and the firing of long-term AIG CEO, a Critical Corporate Incident. Since 2005, seven AIG CEOs have been unable to manage a turnaround in the company’s fortunes. The average CEO tenure for the seven leaders is two years, far short of the average job length of 9.9 years for an S&P 500 CEO.

In 2008, Microsoft Corporation made a hostile bid to acquire Yahoo for US $44.6 billion. The subsequent failure of the deal was a Critical Corporate Incident for Yahoo, which struggled in an increasingly precarious position in its market. Arguably, the fallout from this hostile bid has affected subsequent generations of Yahoo managers who saw six CEOs take the helm. The average CEO tenure for the six Yahoo leaders was just 1.83 years.

A potential diagnostic in problematic corporate turnarounds

A plausible explanation for chronic corporate underperformance could be that a severe environmental situation or a Critical Corporate Incident has created an inherited adaptive cultural response that has influenced the development and health of the organization over multiple CEO tenures.

The long-term consequences of trauma

Corporate Crisis Incidents have the ability to foster dysfunctional adaptive responses in organizational culture and performance, and their effects and consequences may reach far beyond their immediate impact.

How CEOs can engage boards to become strategic assets

Benjamin Finzi, Maureen Bujno, Vincent Firth and Kathy Lu

How CEOs can orchestrate their relationship with their board to optimize its potential to become a strategic asset for the company, as distinct from its more traditional role as overseer of management, is a pressing issue in the current volatile, uncertain, complex, ambiguous business environment. In interviews with board members and corporate leaders, we're learning that one of most important needs they express is for the board to prepare to play a more strategic role. A strategic board, rather than one focused only on ensuring financial performance, will question what disruptive trends in the environment – such as, competitors, technology, social change – could endanger the company's business model.

Today's CEOs have challengingly complex, demanding and visible jobs, so they stand to benefit if their boards can work with them to maneuver through the whitewater of constant disruption.

Information asymmetry

One reason boards may be inherently reticent to play this more strategic role could be a data imbalance. One Chair-CEO said: "There's a huge information asymmetry. They're here for eight days, we're here for 365 days."

Research insights

We conducted more than 50 conversations with *Fortune* 1,000 CEOs, board chairs, directors, academics and external board advisors to ask them to share their experience and perspectives. There are six points of guidance from our analysis:

1. **Be open, transparent—and fearless.** As an example of how tension over differences of opinion can work creatively with the increased focus on sustainability, some boardroom discussions may turn to a focus on values that are not about maximizing shareholder value—stakeholder issues like workplace equity or community justice, for example.
2. **Tension can be beneficial - learn to walk this tightrope.** Helping facilitate attentive listening and full participation in the discussion of a contentious issue with their boards may be a new role for some CEOs, but it can result in a greater level of mutual respect, trust and support among all.
3. **Bridging from a series of board meetings to a more continuous board experience.** One Chair-CEO said: "There's a huge information asymmetry. They're here for eight days, we're here for 365 days."
4. **Curate information.** One CEO said: "When you read a two- to three-page summary instead of a deck of slides, you get a much stronger flavor of a CEO's position and what it is that the CEO wants to discuss."
5. **Should CEOs also be Board Chairs?** Some interviewees thought that for CEOs to leverage their boards' strategic skills more effectively, they needed to give up the chair role.

6. **CEOs should actively recruit board talent.** It takes a special set of skills to address the subtle and profound strategic risk of being rendered obsolete by constant disruption.

Facilitating dialog

Helping facilitate attentive listening and full participation in the discussion of a contentious issue with their boards may be a new role for some CEOs, but it can result in a greater level of mutual respect, trust and support among all.

Preparing for an uncertain future

The business environment is shifting faster than most companies can adjust, and success in these circumstances requires exceptional leadership. While there may be no absolute model for the "ideal" board, the reality is that, though each organization has different strategic needs, companies across industries need to be finding more inclusive and diverse board members who bring different perspectives as well as leading-edge experiences to the boardroom.