CEO advisory

Leadership and strategy in the news

Craig Henry

Craig Henry, *Strategy & Leadership's* intrepid media explorer, collected these examples of novel strategic management concepts and practices and impending environmental discontinuity from various news media. A marketing and strategy consultant based in Carlisle, Pennsylvania, he welcomes your contributions and suggestions (craig_henry@centurylink.net).

Of strategies and strategists

When shrinking is the best strategy

Executives tend to shy away from divesting noncore businesses. They're reluctant to shed revenue, fear the market's reaction to a smaller company and don't want the challenge of stranded costs. They reason that the business could improve in time.

But sometimes, there are good reasons to divest. When strategically selected to clean up a company's portfolio and designed to command an optimal price, divestitures can generate significant shareholder value. They can also serve as a catalyst to improve the remaining business. When done well, they reduce complexity and provide fuel for the company to pump back into its core.

As part of our ongoing work with divestitures, my colleagues at Bain & Co. studied more than 2,100 public companies and found those engaging in focused divestment outperform inactive companies by about 15% over a 10-year period, as measured by total shareholder return. The results are even better for companies that combine focused divestments with a repeatable M&A model. They outperform inactive companies by nearly 40% over a 10-year period and generate more than twice the sales and profit growth.

From our experience working with companies across industries, we've identified four processes that enable successful divesting.

1. Actively manage the portfolio. Start with the basics of understanding how all of your businesses contribute to your core and regularly assess them for fit.
2. Don't race to sell the asset. Create a blueprint for making it attractive prior to selling – even better, begin implementing some of those initiatives prior to sale. We have found that 6 to 12 months is the right length of time to establish the blueprint and demonstrate progress. This allows you to improve the value of the business while you still own it, and also demonstrates to a potential buyer what is possible.
3. Show buyers how they can create value. Many sellers leave money on the table by shortcutting the divestiture process.
4. Make the remaining company future-ready. The deal's been made. It's now critical to carve out the old business, through a process that neither imposes risk on the business nor distracts the team. The best companies establish a separation management office to plan and execute the carve-out while controlling one-off costs and managing service agreement commitments.

James Allen, "Companies Hate to Sell Business Units. That's a Mistake", *Wall Street Journal*, 3 November 2017

When execution problems are really planning failures

Executives say that they lose 40% of their strategy's potential value to breakdowns in execution. In our experience at Bain & Company, however, this strategy-to-performance gap is rarely the result of shortcomings in implementation; it is because the plans are flawed from the start. . ..

Today's successful companies close the strategy-to-performance gap with a new strategy approach best described as "Decide-Do/Refine-Do". This agile, test-and-learn approach is better suited to today's tumultuous environment. It also helps bridge the chasms that exists at so many companies between great strategy, great execution, and great performance.

Here are five lessons we've gleaned from what we see the best companies doing:

1. Treat strategy as evergreen. The best companies see strategy less as a plan and more as a direction and agenda of decisions.
2. Value flexibility. When the road is obstacle-free, the value of maneuverability is low. Leadership is better off selecting a single path forward, even if it limits the company's ability to steer around potential roadblocks. In today's world, however, flexibility matters.
3. Think of strategy as a portfolio of options, not bonds. The traditional plan-then-do model treats the value of any strategy like a bond. Management forecasts the future coupon payments (or cash flows) associated with various strategies and then selects the one that has the highest discounted value. When volatility is high, however, strategic decisions should be treated more like call options. Leadership decides whether the small up-front investment is worth making as a call on potential profits. As long as the option appears "in the money," management can continue to invest; the moment the strategy becomes "out of the money," leadership can stop investing, cut its losses, and move on.
4. Create response mechanisms. In a world where the best laid plans can go awry, companies that react quickly and effectively come out on top.
5. Test and learn, then test some more. Agile planning can be thought of as a series of time-boxed sprints – or micro-battles, as my Bain colleague James Allen would say – with the objective of moving forward, testing the waters, learning, and refining the strategy based on the results.

Michael Mankins, "5 Ways the Best Companies Close the Strategy-Execution Gap," *Harvard Business Review*, November 2017

Aetna aims to transform healthcare

The winning companies in this digital age have an "attacker's advantage." This is the competitive edge generated by leaders who can detect subtle shifts in consumer behavior, markets and economic and social systems; who can spot an opportunity before others do and who can lead their enterprises decisively to execute on that opportunity.

Mark Bertolini, the CEO of the health insurance payer Aetna. . .sees how his company's strengths might combine with those of the pharmacy chain CVS to enable innovative approaches to healthcare delivery. CVS CEO Larry Merlo sees it too, and thus this week made a US$69 billion bid to acquire Aetna. The combined CVS – Aetna will be the first company to meld three discrete pieces of the healthcare system: drugstores, insurance, and pharmacy benefit management.

For several years, Bertolini has had to contend with constant turbulence in the healthcare industry, and with intense competition among insurers. He might have hunkered down to defend Aetna's insurance business. . ..Instead, he prepared an attacker's move. . .to chart Aetna's future as a health delivery company.

Aetna is rich with data about consumers' healthcare needs. Bertolini recognized the huge potential for using that data to individualize treatment plans and thereby improve healthcare outcomes. Putting that data to work, however, would require reaching consumers in new ways. He envisioned a trip to the doctor being akin to a trip to an Apple store: a curated experience in a physical place that is aesthetically and viscerally appealing. Such contact points would encourage people to take charge of their own health needs, keep them out of hospitals through preventive care, and improve their communications with doctors and other care providers.

CVS seemed a good fit. With its 10,000 U.S. stores, CVS can provide a point of entry and ongoing contact for consumers seeking a curated healthcare experience. Overlaps between Aetna's pharmacy benefits management and CVS's Caremark also create opportunities to lower costs.

Bertolini took other steps that show his drive to be a pioneer in healthcare. In November, for example, he announced a program to give away 500,000 Apple watches to customers in 2018 – extending a pilot program he started with Aetna employees. There is speculation that the promotion was simply meant to attract Apple users as customers. But it's tied to a much more strategic effort to increase the use of wearables and healthcare apps that can remind people to refill their prescriptions, take their medication, or make healthier choices – and lower costs for Aetna. As they developed apps together for the program, Aetna shared data with Apple about factors that drive health costs.

Ram Charan, "Why the Aetna-CVS Deal is a lesson for Leaders," *S+B Blog*, 7 December 2017, https://www.strategy-business.com/blog/Why-the-Aetna-CVS-Deal-Is-a-Lesson-for-Leaders

Technology and disruption

Transformation – Data is not enough

When J. Patrick Doyle took over as CEO of Domino's Pizza in 2010, the company's shares had been stuck at around $9 for three years. It was time to shake up the business.

Change started with accepting a simple fact: A tasty pie would take Domino's only so far without a seamless delivery experience. Domino's would need to rapidly expand its technological know-how – and fast. To get there, the company increased its software and analytics staff, which now accounts for half of the 800 employees at the company's headquarters. It set out to create a best-in-class mobile app that would allow users to order pizza with a simple text message or tweet and track their orders in real time. And it used new tools to improve two fundamentals of reliable pizza delivery: driver efficiency and order accuracy.

With a stock price that tops $170 and US same-store sales that outstrip those of its biggest rivals, Domino's has become proof that you don't need to be a digital native to harness the full potential of technology. That's because truly disruptive change, such as Domino's, takes more than data and coding. It requires companies to not only set their digital ambition and strategy, but also develop the right operating model, culture and IT systems – what we call the "inner game."

While efforts to boost a company's digital competence are widespread, they tend to be long on enthusiasm and short on results. Companies tend to focus on what we call the "outer game" of digital strategy – where to play, which products to pursue and how to bring digital technology to bear. While the outer game is critical, these initiatives generally fail if the company lacks the culture to innovate.

In contrast, companies thriving in this age of unpredictable, high-magnitude change invest in their inner games to support their outer games. Rather than treat digital competence as an end goal that they achieve simply by upgrading their website, they focus on building a more agile, responsive organization that can react quickly to market shifts. They make their cultures more adaptive and innovative, and bring in technology systems that can help them advance their strategies. Digital savvy is important, but technology is the means, not the end.

Greg Caimi and Elizabeth Spaulding, "The Inner Game: Why Culture Trumps Code in Digital Innovation," *Bain Brief*, 8 November 2017, http://www.bain.com/publications/articles/the-inner-game-why-culture-trumps-code-in-digital-innovation.aspx

Artificial intelligence: a tsunami of disruption

Just as electricity transformed the way industries functioned in the past century, artificial intelligence – the science of programming cognitive abilities into machines – has the power to substantially change society in the next 100 years. AI is being harnessed to enable such things as home robots, robo-taxis and mental health chatbots to make you feel better.

"AI is the new electricity," said Andrew Ng, co-founder of Coursera and an adjunct Stanford professor who founded the Google Brain Deep Learning Project, in a keynote speech at the AI Frontiers conference that was held this past weekend in Silicon Valley. "About 100 years ago, electricity transformed every major industry. AI has advanced to the point where it has the power to transform" every major sector in coming years. And even though there's a perception that AI was a fairly new development, it has actually been around for decades, he said. But it is taking off now because of the ability to scale data and computation. . . .

The U.S. and China lead the world in investments in AI, according to James Manyika, chairman and director of the McKinsey Global Institute. Last year, AI investment in North America ranged from $15 billion to $23 billion, Asia (mainly China) was $8 billion to $12 billion, and Europe lagged at $3 billion to $4 billion. Tech giants are the primary investors in AI, pouring in between $20 billion and $30 billion, with another $6 billion to $9 billion from others, such as venture capitalists and private equity firms.

"Why AI is the 'New Electricity'," *Knowledge@Wharton*, 7 November 2017, http://knowledge.wharton.upenn.edu/article/ai-new-electricity/

Looking for the Next New Thing in all the wrong places

Only about 7 percent of overall R&D spending by U.S. businesses goes toward basic science. Even many corporations lauded as innovators do not really support scientific research, choosing instead to concentrate on engineering projects. Google's Advanced Technology and Projects group, for example, reportedly gives projects two-year deadlines.

So when the denizens of Silicon Valley search for the next disruption, it seems they are looking in the wrong place. The world awaits the first Nobel

Prize to be awarded to a researcher from Google, Apple, Amazon, Microsoft, or one of our other modern high-tech firms. These corporations are a very long way from business models that foster Nobel laureates.

Compare today's tech leaders to those of yesteryear. As of this writing, Google is nearly nineteen years old. Bell Labs was just a dozen years old when one of its scientists was awarded the 1937 Nobel Prize in physics along with George Thomson for confirming experimentally Louis de Broglie's wave – particle theory of matter. Researchers at Bell Labs would go on to receive a total of eight Nobel Prizes. Five Nobels have also gone to researchers at IBM's labs, which were established in 1945 to pursue what IBM itself calls "pure science." Bell and IBM were not alone in those days; support for pure science or basic research was common at many other storied corporate labs, including those of Xerox, Kodak, DuPont, and even Exxon.

The problem is not that today's American tech sector lacks the money. . . .The collective market value of the top 100 tech companies is measured in trillions of dollars; only fifteen countries in the world have a GDP of over one trillion dollars. And the collective revenues of America's Fortune 500 equals two-thirds of the entire U.S. GDP.

But there is no evidence that any corporation, much less any corporation in the high-tech sector, is interested in returning to anything like the Bell Labs model.

Mark P. Mills, "Making Technological Miracles," *The New Atlantis*, https://www.thenewatlantis.com/publications/making-technological-miracles

Culture and innovation

How to succeed by "failing"

How could developing a "fail fast" culture help organizations unfreeze, survive, flow and flourish with the current levels of fear, ambiguity, uncertainty, volatility and instability in 21st century organizations?

In software development, the intention is to discover and detect where a potential problem might occur in the overall process, to speed it up and minimize time and costs. The focus is on iterating and steering the project to success as it develops, rather than creating a lot of software before showing it to the end user – to minimize the risks involved in their acceptance of it. This enables developers to test their products and get immediate customer feedback, to ensure that what is being developed is in tune, and aligned with what customer's think they might want, or want.

It is a useful and important agile concept that allows developer to reduce the time lag and costs in detecting the opportunity, problem or the failure, and relaying the detection back to the responsible developer to iterate and pivot the next phase of its development.

How can failure be perceived as feedback and learning?

Working this way teaches people the value of developing customer intimacy and an empathic understanding as to what constitutes value in their eyes. It is an ongoing learning process where feedback, whether positive or negative, enables people to adapt, respond and improve quickly.

Learning from this agile way of working, it is one way of taking the "emotional heat" out of "failure" as an emotional reaction, a visceral experience and perpetration against someone. . . .

According to Ed Catmull, president of Pixar and Disney Animation; "Mistakes aren't a necessary evil. They aren't evil at all. They are the inevitable consequence of doing something new (and as such, should be valuable; without them, we'd have no originality)."

Janet Sernack, "What is a 'Fail Fast' Organizational Culture?", *Innovation Excellence*, 12 December 2017, http://innovationexcellence.com/blog/2017/12/07/what-is-a-fail-fast-organizational-culture/

The value of formal leadership

Experts, academics and experienced innovators frequently espouse the virtues of eliminating hierarchies to make sure every idea is heard and to unlock innovation. As intuitively appealing as this view is, it does not stand up to scrutiny. In fact, a growing body of research, including studies by one of this article's authors, shows that the right hierarchy can help teams become better innovators and learners. We have also seen what happens when teams insist upon being flat. They often become unfocused, tumultuous and inefficient because their pursuit of perfect equality prevents the more expert team members from resolving conflicts and playing leadership roles in group learning and innovation.

Research on social species ranging from ants to zebras shows that hierarchies are important for group functioning. When a group has a chain of command, disagreements can be more easily resolved so that the group can take coordinated action. Coordinated action improves the odds of survival. Human beings also have a tendency to think and act hierarchically. In fact, hierarchies – distinct differences in group members' power and status – can be found in virtually every human group, from children on the playground to executives in the boardroom. Depending on the circumstances, hierarchies can be formally designated or emerge naturally. And while the idea of hierarchies may go against democratic instincts and beliefs, they can and do play useful roles.

IDEO, the product design and consulting firm, offers a useful example. In 1999, ABC News' "Nightline" chronicled the efforts of an interdisciplinary IDEO team to redesign the supermarket shopping cart. Since airing, the video has become a classic example of how innovation works. Initially, IDEO founder David Kelley expresses strongly negative views about hierarchy, saying, "In a very innovative culture, you can't have a kind of hierarchy." But as the story unfolds, a small group of senior IDEO people step in to direct how the product development team allocates its time. When asked why the intervention was necessary, one senior person explains that the process of finding creative solutions sometimes needs to be "very autocratic for a very short period."

In reviewing the empirical research on the role of hierarchies in learning and the innovation that results from learning, and through our own studies, we have found that a properly deployed hierarchy is an essential ingredient for helping a team engage in and get the most out of its efforts to learn and innovate. . ..

When those with more power in a group aren't needed to help with bounding, converging, or structuring, they need to get out of the way so that the team can do what teams do best – share, discuss, and integrate diverse perspectives and knowledge to come up with new ways of solving problems. In other words, the best hierarchies are invisible most of the time, operating in the background and only coming out of the shadows when power differences are needed to keep things moving along. Even well-meaning hierarchies become problematic when people at the top are too heavy-handed and interfere when their interference isn't needed.

Bret Sanner and J. Stuart Bunderson, "The Truth About Hierarchy," *Sloan Management Review*, Winter 2018

"The Hedgehog and the Fox" revisited

Understanding and staying within their circle of competence is even more important for specialists. A specialist who is outside of their circle of competence and doesn't know it is incredibly dangerous.

Philip Tetlock performed an 18-year study to look at the quality of expert predictions. Could people who are considered specialists in a particular area forecast the future with greater accuracy than a generalist? Tetlock tracked 284 experts from a range of disciplines, recording the outcomes of 28,000 predictions.

The results were stark: predictions coming from generalist thinkers were more accurate. Experts who stuck to their specialized areas and ignored interdisciplinary knowledge fared worse. . ..It seems that generalists have an edge when it comes to Bayesian updating, recognizing probability distributions and long-termism. . ..

As Tetlock's research shows, for us to understand how the world works, it's not enough to home in on one tiny area for decades. We need to pull ideas from everywhere, remaining open to having our minds changed, always looking for disconfirming evidence. Joseph Tussman put it this way: "If we do not let the world teach us, it teaches us a lesson."

"The Generalized Specialist: How Shakespeare, Da Vinci, and Kepler Excelled," *Farnham Street*, November 2017, https://www.farnamstreetblog.com/2017/11/generalized-specialist/

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