

## **The Strategy Paradox**

### **Why Committing to Success Leads to Failure (and What to Do About It)**

A review of [Michael E Raynor's](#) book on creating strategic flexibility.

#### **Summary**

I highly recommend Raynor's work as a complement to his joint work with Clayton Christensen [The Innovator's Solution](#), David G. Thompson's [Blueprint to a Billion](#), and other works that address developing flexible, innovative organizations, such as [Fast Innovation](#) by Michael George. You will regain confidence that spending more time with scenario planning and real options will put your corporate strategy at a more efficient risk-reward location in the production possibility space for your industry. Raynor also describes how to better align Corporate Venture Capital investments so that strategic flexibility allows your CVC to do more than just serve as another investment tool for investing shareholder profits.

#### **Commentary**

Most senior managers have engaged in the corporate strategy creation process at one time or another in their career. The experiences are often less than satisfying as apparently well thought out plans are often derailed by events that were unanticipated or discounted. The difficulty that companies face in developing an ongoing process that creates a succession of insightful strategies is reflected in the statistics of company performance. For example, David G. Thompson in *Blueprint to a Billion* extracts data from his research on the statistics of company success. Out of more than 7400 companies that went public since 1980 only 387 achieve \$1 billion in revenues. In summary, he notes that "... *only 5 % of American companies that have gone public since 1980 reached \$1B in revenues and these accounted for 56 % of employment in 2005 and 64% of market value.*" Only a small percentage of companies drive employment and market value. The rest are placeholders. Raynor suggests many of them could do much more by becoming proficient with strategic flexibility.

Recall that Richard Foster and Sarah Kaplan in [Creative Destruction](#) recount how the average life of a company on Forbes100 has declined precipitously since 1927 in performance relative to market average. Only 39 of the 100 companies remained in 1987. And only one of the two companies that outperformed the market through 1987 has continued to do so—GE. Disappointing performance against market averages was also noted for S&P 500 companies from 1957 through 1998. Accelerating change and complexity in our global economy is part of the problem. Part is also related to the difficulty in maintaining successful strategies and contingency plans, and in adapting corporate culture to match changing needs with increased flexibility. These must be balanced with maintaining a focus on managing resources, talent, and relationships that create sustainable competitive advantage and differentiation. Joseph Schumpeter's observation that capitalism actually thrives on creative destruction by eliminating inefficient and non-competitive companies presumes that companies cannot change fast

enough to meet new marketplace needs. Thus, the most effective way to reallocate underutilized resources devoted to a less-efficient company is to simply retire that company from our economic system and encourage others to redeploy those resources.

Raynor revisits tools that we have used in the past—scenario planning and real options—and then suggests a more effective way to apply these tools. First, he notes that commitment to a clear strategic direction is essential for a company to maintain competitive focus. That is why it is hard, for example, to get many groups responsible for technology roadmaps for infrastructure and service delivery excited about projections beyond 18 to 24 months. They want to be aware of potential surprises that might arise in the next 3 to 10 years, but they don't really want to spend any time or money to obtain that awareness. Given that the future is by nature evermore unpredictable as the time horizon extends, those potential disruptors are only possibilities. Spending more than a very minimal amount to maintain an ongoing scan<sup>1</sup> of these potential disruptors is generally outside the remit of most well-managed operational budgets. The significant downside of this tension between running a well-managed operation and dealing with accelerating changes in the competitive marketplace is that a company will tend to pick a more conservative strategy which results in less differentiation from competitors.

This tendency reminds me of [swarm behaviors](#) observed in nature when a school of herring, for example, is attacked by tuna. The herring appear to follow a few simple rules to reduce their risk of being eaten. First, they try to stay close to their neighbor but not too close. Second, they try to move towards the center of the chaotic “tornado-like” swirl of fish that forms. Managers are biased to pick strategies in the same herd-like fashion. This tendency is not surprising because companies are similarly biased to punish competitive shortfalls, even if only by reputation, so unless managers are brain-wired to live on the edge, they will naturally steer to the strategy map's conservative middle.

The numbers support this explanation. In Thompson's statistics, only 374 of 7,454 companies reached \$1 billion in revenues, while 2,019 disappeared from the public exchanges. That's a 5-to-1 ratio of dissolution to exceptional success. Because these public companies are most likely managed by smart people who seek good advice and use accepted tools for planning, it seems that these tools often don't work well. As a result, they are discounted, hedged, and even ignored.

Raynor believes the responsibility for scenario planning and creating real options to generate strategic flexibility falls on the Board of Directors and the CEO. That's because operating divisions must limit how much they invest in creating strategic flexibility (as opposed to contingency flexibility). The real options that the BOD and Corporate Office cultivate are either discarded, if not needed as the future unfolds, or exercised, if it becomes clear that some division of the company needs to change their strategy and the change should include exercising an available real option. Lacking a real option makes it

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<sup>1</sup> [SRIC-BI's SCAN Program](#) is one that enables companies gain early insights into potential social, cultural, technology, business and other trends to maintain a holistic picture of the possible disruptors of the broad array of businesses in the world today. Another is [The Map of Decade](#) project annually reinvented by The [Institute for the Future](#).

difficult to implement a strategic readjustment, while having an option makes it easier for the company to successfully adapt to the new environment.

Real options are typically created by forming partnerships, joint ventures, or limited investment in new companies. Each has its merits and shortcomings as described in the book.

Raynor uses examples from Johnson & Johnson, Microsoft, Bell Canada Enterprises, Sony, and Vivendi to show how these companies have successfully used (consciously or intuitively in the cases of J&J, Microsoft, and BCE) strategic flexibility. Unsuccessful examples include Vivendi and Sony: Vivendi's CEO gambled on one vision of the future that never came to pass. Sony, on the other hand, developed perfectly good strategies but not enough flexibility (Betamax, Minidisc, and now maybe the PlayStation 3). He also details Alliant Energy's use of strategic flexibility. He summarizes their formation of a five axis scenario space and how to reduce the complexity of analyzing the 32 scenarios that defines. This is particularly informative for those of us who have been encouraged to distill scenarios down to two axes and four quadrants of potential futures simply to reduce the complexity of analysis. This has always left me (and others I'm sure) feeling that the baby was probably tossed in bathwater of simplification. So it's no surprise that many scenario exercises are discounted.

The example companies Raynor discusses typically have more than one operating division. As a result, the scenarios and real options approach is more understandable because it benefits from leverage from both synergies across divisions where appropriate and the likely existence of a Corporate Venture Capital group that can develop investments and relationships to cultivate real options.

How this approach is used in smaller single operating unit companies and startups is less clear. The smaller the company, the more all resources are focused on a current strategy and tactical contingencies. Fewer resources (probably none) are available to develop real options. As Christensen and Raynor note in *The Innovator's Solution*, these smaller companies must have flexibility to find where the profits lie before they scale up operations. The primary solution for the smaller companies, especially entrepreneurial startups, is to cultivate very tight relationships with current and potential customers and to understand "*the jobs they hire your product to do*," as opposed to making contingent new investments or pursuing partnerships and alliances before identifying successful profit strategies.

Thompson in *Blueprint to a Billion* does, however, emphasize that small companies who partner with larger companies to create Big Brother alliances have much to gain. The big brother company is probably viewing the smaller company as a "real option" relationship or at least a tactical contingency. Thus, smaller companies should spend at least some time thinking about scenarios and real options to better determine who they should seek as marquee customers and big brother alliances. Whether these steps are part of creating strategic flexibility or simply "must do's" as part of a well-focused strategy, I believe that, after profit pools are identified, scenario planning with real options thinking should

be biased towards creating a perspective from the big brother partner's or alliance partner's point of view. This will help filter out those relationships that are more likely to meet the expectations of both companies.

One topic Raynor does not discuss is how these methods apply to developing government policies. Perhaps the number of stakeholders is too large or perhaps those stakeholders are too politically motivated to allow Raynor's disciplined approach to gain traction in the political arena. Given the scope of challenges facing the world, however, I would hope that some advisory groups are either using similar methods or implementing what Raynor suggests to create strategic flexibility. Recent books such as [Planet India by Mira Kamdar](#) and [The Coming China Wars by Peter Navarro](#) highlight the pervasive impact a rising East Asia will have on many important aspects of our lives. We should be using the best planning tools at our disposal to produce the most effective strategic flexibility we can to deal with the severe uncertainty of our global future.

In summary, I highly recommend Raynor's work. It will move scenario thinking and real options higher in your list of useful tools for developing strategic flexibility. For companies that support a corporate venture capital function, this will help address the sobering reality that most CVC's only survive about three years. Raynor suggests that CVC's die quickly because their investment focus does not really provide the corporation with strategic flexibility. Instead, the investments generally appear to be just another way to manage shareholder profits. This could be resolved, Raynor notes, by returning those profits to the shareholders to invest more in line with their individual financial objectives.

In short, if you want to know how to improve your strategic planning with scenario thinking and real options so you can better allocate risk and reward, you will find Raynor's book offers new insights worth exploring.

Michael L Olson, March 2007