Focus on: Flexibility

harvard management update

Dear Reader:

I was playing a chasing game with a bunch of six-year-olds the other day and smashed my foot into the corner of a door. Nothing's broken—thanks!—but there's quite a bit of black-and-blue and a whole lot of stiffness. As painful as it's been, my injury has put me in mind of two valuable lessons: the first from my mother (Don't run in the house!), the second from the writers whose work appears in this issue of *Harvard Management Update*—remain flexible! My foot doesn't have much flexibility at the moment, so my ability to move quickly is severely hampered. The same happens in organizations. Without flexibility, companies and managers can slow down, sometimes to a dangerous degree.

The issue of flexibility manifests itself in every article of *Harvard Management Update* this month. Not surprisingly, you'll see some overlap in ideas between several of the articles in this issue. But read closely, as each author has a distinct take on how companies and managers can achieve and maintain flexibility.

In our cover story, "Five Steps to Thriving in Times of Uncertainty," business writer Peter Jacobs considers the ideas of management researchers Michael Hitt of Texas A&M University and Katsuhiko Shimizu of the University of Texas, San Antonio, as well as several other experts and executives, to offer a prescription for building and maintaining **strategic flexibility**. "To thrive today, managers must find ways to increase their units' and their organizations' ability to read and react to industry and market disruptions," Jacobs writes. In a time when no industry is fully immune from the unforeseen, this article contains critical lessons for all managers.

We continue with a similar theme in "How Resilient Is Your Company?" on page 5. Booz Allen Hamilton consultants Gary L. Neilson and Bruce A. Pasternack describe the 10 traits of resilient enterprises, those that are steadfast enough to weather turbulent times **yet flexible enough to change when change is necessary**. Consider how your firm stacks up.

In our Debriefing of Robert Mittelstaedt, dean of the W. P. Carey School of Business at Arizona State University and author of the book *Will Your Next Mistake Be Fatal?* (page 10), writer Lauren Keller Johnson delivers Mittelstaedt's advice to managers for combating the **inflexibility** that has been known to settle in on companies enjoying a run of success. Why look for alternatives when you're winning? Because all winning streaks end—usually with unexpected abruptness.

Finally, we get personal in "Who Will Advance Your Cause?" on page 12. Writer Loren Gary works with Eileen Shapiro, coauthor of *Make Your Own Luck: 12 Practical Steps to Taking Smarter Risks in Business,* to cook up a recipe for using empathy to sort out your allies from those who may stand in your way. The key is **to adopt a more flexible way of looking at the world** so as to see it as others see it.

Enjoy the issue.

Paul Michelman
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Focus on: Flexibility

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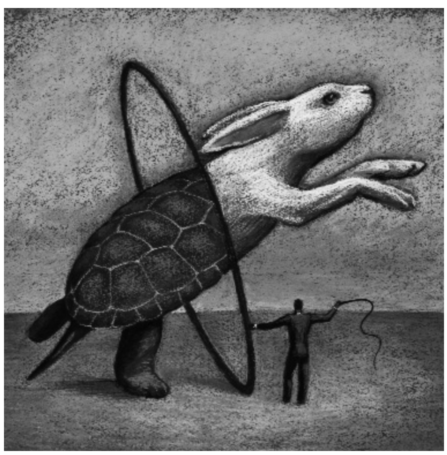
harvard management update

Five Steps to Thriving in Times of Uncertainty

by Peter Jacobs

IN TIMES OF RAPID CHANGE and heightened uncertainty, seemingly solid business strategies can derail with astounding speed. An unforeseen competitor enters the market with a cheaper product; consumer tastes shift rapidly to a new technology; world events conspire to throttle your access to key resources. The possibilities for strategic disruption seem endless.

For a company to thrive today, its managers must find ways to increase their units' and the organization's ability to read and react to industry and market changes. Their goal: to boost the company's strategic flexibility by learning how to see potential disruptions earlier and respond faster.



For most companies, this does not come easily, note Katsuhiko Shimizu of the University of Texas, San Antonio, and Michael Hitt of Texas A&M University.

In a 2004 *Academy of Management Executive* article, Shimizu and Hitt bring into clear focus the barriers companies face in building strategic flexibility and identify several steps managers can take to overcome them. Their ideas, combined with the insights of other experts and top executives, provide a valuable framework for increasing your company's strategic flexibility.

The critical ability to confront change and uncertainty

Shimizu and Hitt define strategic flexibility as an organization's capacity to:

- Identify major changes in its external environments.
- Quickly commit resources to new courses of action in response to such changes.
- Recognize and act promptly when it's time to halt or reverse existing resource commitments.

The dynamic competitive landscape of recent years has made speed a critical component of each of these capabilities.

Consider Polaroid. The former king of instant photography took years to acknowledge and respond to the advances of digital imaging. By the time the company finally did, it was too little, too late.

Whether Polaroid was blind to industry changes, opted to ignore them, or lacked the resources to respond effectively is unclear. However, the company exemplifies what Hitt suggests is a kind of strategic rigidity. Whatever its corporate strategy may have been, Polaroid seemed steadfastly committed to that strategy even while technological advances rendered it irrelevant.

It's easy enough to scoff at Polaroid's apparent incompe-

continued on page 2

Inside

tence, but how prepared is your company to deal with the unforeseen?

Five steps to maintain strategic flexibility

Because managers at every level are subject to psychological and organizational biases, maintaining strategic flexibility is seldom a simple task. The following steps, however, will help.

1. Measure and monitor outcomes.

At Dow Corning Corporation, the senior management team reviews the strategic performance of each major corporate initiative at least quarterly. "In reality, monitoring is even more fluid because we meet frequently to review and evaluate project performance against designated targets," says Scott Fuson, Dow Corning's chief marketing officer. "Dow Corning is involved in dozens of diverse markets where everything changes constantly, so close monitoring is essential to keep projects on track and within budget."

It is also important, Shimizu and Hitt note, for organizations to think hard about what they measure. For example, if your goal is to capture market share from a rival, you can't just measure total sales because the market might well have grown and, with it, your rival's sales as well. Similarly, if you are shifting focus to new growth initiatives, you can't rely on metrics meant to monitor the success of fully mature businesses.

To further boost organizational adaptability, Fuson advises companies to keep projects affordable and flexible, committing resources to new initiatives one stage at a time—especially at the beginning. "If monitoring suddenly indicates a major change in direction is likely to significantly improve project outcome but the budget is already stretched to its limit, the whole initiative could be at risk," he explains.

2. Have someone play devil's advocate.

Leaders need to be aware of their own cognitive biases, lest they get stuck in a too-rigid way of looking at the world. Designating a trusted associate—or, better yet, more than one—to assume the role of devil's advocate within your team is an excellent way, Shimizu and Hitt note, to uncover our biases.

What about nonteam decisions? Hitt finds that, for lack of time, managers often make key strategic decisions themselves. But even then, he says, sharing your thinking with colleagues and seeking their feedback can help you keep a truly open mind.

The main obstacle to devil's advocacy is our natural reluctance to being viewed as a naysayer. The authors point to General Motors as a telling example. When Roger Smith manned GM's helm, anyone who voiced a problem was quickly dubbed as negative and not a team player. Debra Meyerson, an associate professor at Stanford University's School of Education and (by courtesy) its Graduate School of Business, and author of *Tempered Radicals: How Everyday Leaders Inspire Change at Work* (Harvard Business School Press, 2003), says companies need to encourage people to voice their views even if they disagree with the dominant perspective. "Organizations can't learn if everyone thinks and speaks in the same tongue," she says.

3. Pursue external perspectives.

Listening with an open mind to the thoughts and ideas of those with differing viewpoints, whether from outside a particular business unit or outside the company altogether, is another effective way of countering management biases. Typically unnoticed, biases such as a tendency to overlook negative feedback or to act too swiftly grow entrenched over time, especially if management turnover is low. Shimizu and Hitt say obtaining fresh external insight is

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therefore important at every organizational level. Consider the following steps companies can take to help make it happen:

- **Routinely appoint outside board members.** New external directors are obliged to learn about the company and, in the process, tend to question policies and practices long taken for granted.
- **Limit top executives' tenure.** "Arrival of a new outside CEO," the authors say, "provides an opportunity for an organization to revisit old assumptions and correct mistakes in past strategic decisions." For example, despite their outstanding performance, the last two CEOs of Toyota stepped down after four and six years, respectively.
- **Rotate managers routinely.** Many organizations rotate certain managers and executives as part of their training programs, but other companies leave the same people in the same positions for years. Stale thinking and inertia inevitably result. Conversely, cross-training not only broadens an organization's knowledge and skills but it also energizes and motivates participants.
- **Exploit partner alliances.** Alliances with other firms have become popular strategic moves, usually as a way to mutually capitalize on complementary resources. However, such alliances can also be excellent sources of fresh ideas, insight, and learning.
- **Create ad hoc advisory groups.** A CEO or business unit leader will often assemble an informal group to help analyze and assess the potential outcomes of important strategic decisions—for example, whether

MAKING YOUR ORGANIZATION CHANGE-READY

To achieve strategic flexibility, organizations must embrace change as an inevitable and essential part of an organization's growth.

But few corporate leaders do. Indeed, even in unpredictable business climates, managers tend to focus almost all their energy on successfully executing the current strategy. What they also should be doing is preparing for an unknown future.

The essential first step in this effort is to ensure the company is change-ready at all times—that is, to ensure that the people within the organization are prepared for and capable of shifting what they do, how they do it, and with whom they do it.

If such a mindset is not already in place in your company or unit, there are certain steps you can take.

Challenge complacency

It's difficult to motivate people to change when they are satisfied with their current situation. Explain why change will inevitably be necessary and provide the relevant information to make employees understand.

Give your employees a voice

Employees who can freely express their ideas—and who think you will listen to them—will feel more empowered to act. Encourage open discussions about the change program, and work to understand resistance by exploring people's concerns. When people believe their voice matters, they are more apt to mobilize for change.

Encourage participative work

Develop more participative approaches to how everyday business is handled, specifically:

- Bring decision making down to the lowest levels possible.
- Keep the lines of communication open.
- Share information freely.
- Familiarize yourself with the issues faced by frontline employees.
- Focus on building collaboration through cross-functional teams.

Drive fear out of your group

Fear encourages people to avoid risks, become internally focused, and stop communicating. It also costs organizations real money in terms of reduced productivity and diminished quality of work. Aim to reduce fear, but do not deny the challenges that come with change. Employees at all levels in the organization must feel free to identify problems and suggest solutions. They must also feel free to experiment and try new things without fear of retribution if they fail.

—Siobhan Ford

Adapted from Harvard Business Essentials: Manager's Toolkit—The 13 Skills Managers Need to Succeed *(Harvard Business School Press, 2004) and* Harvard ManageMentor.

and what the firm should outsource and to which vendor. Leaders must be clear on their expectations for what the group will provide and in what form. Advisory-group participants are most often managers chosen to reflect a broad cross section of expertise.

Shimizu and Hitt concede that their suggestions involve some disadvantages and risk. New executives and managers, for instance, might reshape currently effective strategies simply to add their own distinct mark. The learning curve for anyone in a new job also must be a consideration.

"Be careful about external viewpoints," cautions Steve Odland, chairman and CEO of Office Depot (Delray Beach, Fla.). "Those who don't fully understand your organization can lead you off track and destroy your brand proposition. Strategic inconsistency can confuse customers and, ultimately, destroy shareholder value. Maintaining balance is therefore critical."

"Those who don't fully understand your organization can lead you off track and destroy your brand proposition."

4. View decisions as a portfolio of options.

Organizations usually have multiple projects and initiatives under way simultaneously, and it's critical that leaders not let one or two dominate their attention. As markets shift, seemingly less significant initiatives may quickly become the most valuable.

One way to maintain a balanced perspective, Shimizu and Hitt note, is to periodically review the organization's projects and initiatives as a portfolio of options. Doing so makes it easier to reallocate resources from one project to another offering even greater promise given the state of the market.

Smaller organizations tend to have fewer initiatives under way simultaneously but can easily expand their decision portfolios by including small variations and experiments.

5. Analyze outcomes and apply learning.

Flexibility stems from the ability to learn. But do companies learn all they can from the strategic initiatives they undertake? Probably not. Managers tend to overlook the negative and emphasize the positive. However, only by carefully examining what has led to negative outcomes as well as positive ones can managers maximize their learning experience.

If a corporate acquisition performs poorly, for example, but management learns a lot from the experience, the company can divest the asset and apply its newfound knowledge to make future acquisitions more successful. Or, if the company's executive team senses the problem stems from ineffective integration, it can postpone divestiture until it better understands the problem.

Determining the specific value of such learning may not be possible, but companies ought to consider it as part of every project's return on investment. Often, it will change their perspective significantly.

A good example, Shimizu and Hitt note, is Cisco Systems. The company has grown considerably through a series of successful acquisitions. The authors found Cisco makes a concerted effort to learn as much as possible from each acquisition, and takes great care to avoid the departure of key personnel who possess significant knowledge about the acquired company, its industries, and its markets. These employees can become powerful teachers, helping organizations to see their business and their markets in a new light. The ability to adopt such new perspectives is, of course, a critical element in building strategic flexibility. ◆

THE IPOD IN THE BIGGER PICTURE

Companies cannot allow themselves to make strategic decisions in isolation. When Apple Computer decided to aggressively enter the personal digital entertainment market with its iPod and iTunes, management carefully evaluated the potential impact on the firm's core computer business and focused on how to leverage its potential benefits.

"Apple's strategy has been to use iPod to promote home entertainment networks powered by its big-ticket computers and laptops such as iMac and PowerBook," wrote Terril Yue Jones in the *Los Angeles Times* ("King of Music Players," November 25, 2004).

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How Resilient Is Your Company?

Most resilient organizations share these 10 traits. How does your company measure up?

by Gary L. Neilson and Bruce A. Pasternack

OVER THE PAST DECADE, *the concept of "resiliency" has gained a great deal of momentum in management circles. Depending on who is doing the describing, a "resilient" organization is one that is steadfast enough to weather turbulent times yet flexible enough to change when change is necessary. Indeed, by some definitions, resilient organizations are characterized by their ability to change before change becomes crucial.*

In this adaptation from their new book, Results: Keep What's Good, Fix What's Wrong, and Unlock Great Performance, *Booz Allen Hamilton consultants Gary L. Neilson and Bruce A. Pasternack discuss the core attributes of the resilient organization. Our goal in publishing this piece is not to deliver a formula for how organizations can achieve resiliency but rather to allow you to compare your company's condition with the ideal state as described by the authors.*

Understanding where your organization is or is not living up to the authors' standards of resiliency may be an essential first step toward building a healthier company.

—Paul Michelman, editor

* * *

Ten traits of the resilient organization

The hallmark of the resilient organization is the seamless manner in which decision rights, information, motivators, and structure integrate with one another to drive the organization and its performance forward. This seamless alignment is what enables these organizations to demonstrate the following 10 winning behaviors that together drive results.

1. Entertain the inconceivable.

Resilient companies benchmark themselves—not against others in their industry but against the theoretical limits of the human imagination. They take the view that anything that can be conceived can be done. These organizations reach beyond best in class in looking for role models. They look past their market, the next five years, and the status quo in preparing their organizations to compete. They imagine bogeymen around every corner. Resilient organizations are the first to recognize a burning platform; in fact, they often light the match. They see the handwriting on the wall and anticipate and adapt their organizations to change, always with a focused and productive sense of urgency. They break the mold, so they can be the first to cast the next one.

2. Build a culture of commitment and accountability.

All organizations make commitments. It's how they define these commitments, translate them into decision rights, and measure performance against them that distinguishes resilient organizations. Commitments and the decision rights that result are not soft or subject to interpretation; they are etched in stone and obvious to all, particularly to the individuals held accountable. In fact, a resilient organization's commitments are hard currency backed by the "gold standard" of full and clear accountability.

Just as people accept paper money in a gold-backed monetary system, the market invests on the mere promises of a resilient company, because they know that promises made by this firm are as good as results. They are backed by appropriate and unambiguous decision rights that are transparent, both internally and externally. There's nothing to hide and nowhere to hide it. Therefore, shifting blame is a futile exercise. Welcome to a true meritocracy; this is an organization that extracts the best from its people because it expects and rewards no less.

Nissan Motor Co. Ltd. distributes a "Values Reference Manual" to all new managers in which 32 key words are explicitly defined. Commitment is defined as "taking responsibility for accomplishing the objective. The objective to be accomplished is expressed by numerical values, and pledged. Once individuals have committed, they must achieve the objective except under extraordinary circumstances. When they do not accomplish the objective, individuals must be prepared to accept the consequences." In October of 1999, then-COO (now President and CEO) Carlos Ghosn defined "consequences" in vivid terms when he put his own job on the line if the company failed to accomplish the three objectives of Nissan's Revival Plan within three years.

"I said that if any one of the three main commitments—any one of them—was missed, I would resign and, with me, all the members of the executive committee," recalls Ghosn. "And this helped a lot in communicating the sense and meaning of 'commitment' within the organization."

3. Move the goalposts—every three years.

Most resilient companies, like Nissan, are known for their rolling and continuous transformations. To motivate employees and move the organization forward, management moves out the goalposts, typically every few years…whether or not they feel the hot breath of competition on their necks. These transformation agendas are grounded in the foundational values and principles of the organization and have clearly defined end states; everyone understands the destination and the guideposts they must pass along the way. But the route is not mapped. Each unit, team, and individual must define the journey and chart a course.

The organizational building blocks are designed and aligned to facilitate their progress, so everyone has the right information, incentives, and authority to be effective. The objectives to be achieved are ambitious; they are designed to stretch the organization and the people who populate it, but not until they break. Senior management needs to exercise its best judgment and intuition in setting goals that are challenging but manageable.

4. Show the courage of your convictions.

Resilient companies do not follow fashion. They do not succumb to the latest business fads, nor do they court the fancy of Wall Street. By the same token, resilient companies do not accept the status quo as an article of faith simply because "that's the way it's always been done." They chart a strategic course based on their best instincts and information, and they stay the course as long as their own market intelligence validates it. The same holds true for organizational changes. They shake up things as necessary—that's part of being resilient—but they don't change for change's sake or to curry favor with the board, analysts, or shareholders. Resilient organizations have faith in their people and their capacity to make effective decisions and execute them even as strategic objectives change. Therefore, they are more sure-footed in pursuing these objectives—and in dealing with temporary setbacks.

Resilient organizations have faith in their people and in their capacity to make effective decisions.

They don't collect "Flavor of the Month" organization improvements that others are implementing and try to "shoehorn" them into their model, but they also don't look the other way when the need for improvement is apparent. They have a solid foundation built around core values that not only guide decision making but also inspire and motivate employees at all levels.

UNDERSTANDING RESILIENCY

In *Results: Keep What's Good, Fix What's Wrong, and Unlock Great Performance*, Gary L. Neilson and Bruce A. Pasternack present their definition of resiliency:

> *Flexible enough to adapt quickly to external market shifts, the Resilient organization remains steadfastly focused on and aligned behind a coherent business strategy. This forward-looking and self-correcting type of organization anticipates changes routinely and addresses them proactively. When it does hit a bump in the road—as all companies do—the Resilient organization distinguishes itself in its response, which is immediate, thorough, and constructive.*

5. Bounce back from adversity.

Even the most resilient organizations encounter setbacks. Healthy DNA does not protect a system from all external risk factors; it does, however, facilitate a quick internal reaction. When resilient organizations suffer a discontinuity in their marketplace—be it technological innovation, economic downturn, or competitive challenge—they detect it early and mobilize a response quickly. They don't waste time and resources assigning blame and applying makeup. They confront the enemy head on. They cauterize wounds and defend core market positions. More important, they seize offensive opportunities to pursue growth aggressively. Resilience is defined as "the ability to recover strength, spirits, etc., quickly." These organizations live up to that name.

6. Think horizontal.

When you think of most organizations, you think of a hierarchy, a structure that operates from top to bottom. In business, we are conditioned to think in vertical terms. The chain of command runs up and down; you are generally promoted up a level. Resilient organizations, however, manage to introduce a second dimension to their world view. They capture full value by flattening their organizations and working across vertical boundaries, breaking down silos, transferring best practices, collaborating cross-functionally, and promoting laterally. They think horizontal—and reap the benefits of a more coordinated, efficient, and broadly competent organization.

The flow of information up and down and across organizational boundaries is critical to maintaining a resilient organization. If someone in another business unit or function can serve a customer better with information you have, you give it to her. You do so because you recognize that a greater good is served and because you are motivated through shared objectives, common metrics, or outright bonuses for working collaboratively. Silo walls and NIH ("not invented here") thinking fade into oblivion in the resilient organization. Instead, it's "How do we get ahead… so I get ahead?"

7. Self-correct.

Resilient organizations have developed and institutionalized internal mechanisms for finding and correcting problems before they reach task-force or profit-warning proportions. Information is timely, robust, and accessible to those who need it, and systems and processes have feedback loops that are automatic; they don't have to be triggered from the outside. In short, resilient companies are self-correcting organisms that learn as they grow. As the DNA building blocks are refined over time, the overall organization becomes more intelligent and agile. It moves up step by step until it reaches a whole new level of performance. The organizational characteristic we're describing here is more than an early-warning light; it's a self-generating remedial system that fixes problems before they even reach the radar screen.

Delivering a negative review is difficult, but the alternative is an organization overrun by mediocrity.

8. Listen to the complainers.

Resilient organizations do not ignore squeaky wheels; they listen and learn. Complaints are, by their very nature, unpleasant. No one likes to hear what he is doing wrong, but resilient companies understand that complaints are also opportunities...invitations to improve what isn't working smoothly. Therefore, resilient companies institutionalize mechanisms for surfacing and addressing dissatisfaction not only among customers but also among employees.

These are the individuals "at the coal face" who really understand how the business operates…or doesn't. To enhance performance, you must find ways to solicit their input—town hall meetings, ethics hot lines, interviews with customers and customers' customers. Employees, in particular, need to feel free to air substantive grievances without fear of retribution. All of this is so much posturing, however, if the organization does not do anything to acknowledge and address the behavior being questioned. Resilient organizations act on complaints and end up making positive changes to the organization that accrue to the benefit of everyone, not just the original complainer.

9. Put your motivators where your mouth is.

The resilient organization does not pay you for one behavior and promote you for another. All oars—both financial (e.g., raises, bonuses, benefits) and nonfinancial (e.g., promotions, transfers, exposure)—pull in the same direction. It's not "Yes, I know we should do the right thing for the company, but that's not the signal I'm getting from my boss." Another trademark of the resilient organization is a performance-appraisal system that clearly differentiates between above-average and subpar performers.

Delivering a negative review is a difficult, often uncomfortable experience, but the alternative is an organization overrun by mediocrity—not just because poor performers stay and fail to improve but also because strong performers witness this lack of consequence and become disillusioned. A resilient organization avoids this dilemma by being straight with employees and by linking motivators to what matters.

10. Refuse to rest on your laurels.

Resilient organizations are not complacent; in fact, they take the view that a little paranoia is good for you. Despite irrefutable success, resilient companies never gloat or take satisfaction in their victories. They reward their people for a job well done and then move the finish line. To maintain their market leadership, they need to spend more time fine-tuning their organization and less time publicizing their successes. In fact, quite a few resilient companies have an active aversion to media exposure, however fawning. It demotivates employees and takes the organization's focus off the ball. What matters is what's measured: results. ◆

Gary L. Neilson is a senior vice president at Booz Allen Hamilton in Chicago. Bruce A. Pasternack was a senior vice president for almost 30 years at Booz Allen Hamilton and was a founding partner of its organization and strategic leadership practice. They can be reached at MUOpinion@hbsp.harvard.edu.

Harvard Business Review

Briefings

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>>> Delusions of Success: How Optimism Undermines Executives' Decisions

by Dan Lovallo and Daniel Kahneman
Harvard Business Review, *July 2003*
HBR OnPoint Reprint # 4279

The Idea in Brief

Three-quarters of business initiatives flounder—new manufacturing plants close prematurely, mergers and acquisitions don't pay off, start-ups fail to gain market share. Why? **Delusional optimism:** we overemphasize projects' potential benefits and underestimate likely costs, spinning success scenarios while ignoring the possibility of mistakes.

The culprits? Cognitive biases and organizational pressures to accentuate the positive. We can't eradicate either, but we **can** take a more objective view of an initiative's likely outcome. How? **Reference forecasting:** comparing a project's potential outcomes with those of similar, past projects—to produce more accurate predictions.

The Idea in Practice

ROSE-COLORED GLASSES

We're subject to numerous **cognitive biases**:

Anchoring.

Competing for limited funding, we create project proposals accentuating the positive. These initial forecasts skew subsequent analyses of market and financial information toward overoptimism: we don't adjust our original estimates enough to account for inevitable problems.

Competitor neglect.

We ignore competitors' capabilities and plans. Rushing to secure a new market, for example, we forget that rivals will follow suit. As competitors ramp up production and marketing, supply outstrips demand—rendering the market unprofitable.

Exaggerating our abilities and control.

We take credit for positive outcomes while attributing negative outcomes to external factors, and deny the role of chance in our plans' outcomes. Result? We assume we can avoid or overcome all project problems.

We also fall victim to **organizational pressures**:

- We approve proposals with the highest probability of failure.
- Since only the most promising proposals attract investment dollars, we make overoptimistic forecasts. Highly overoptimistic proposals are approved. We reward optimism and interpret pessimism as disloyalty.

Reinforcing one another's unrealistic views of the future, we undermine our company's critical thinking.

THE OUTSIDE VIEW

How to counteract cognitive biases and organizational pressures? Awareness and a more objective forecasting method—especially with never-before-attempted initiatives. These steps can give us an "outside view" to augment our intuitive "inside view":

Select a set of past projects to serve as your reference class.

A studio executive forecasting sales of a new film selects recent films in the same genre, featuring similar actors and comparable budgets.

Assess the distribution of outcomes.

Identify the average and extremes in the reference-class projects' outcomes. The studio executive's reference-class movies sold $40 million in tickets on average. But 10% sold less than $2 million and 5% sold more than $120 million.

Predict your project's position in the distribution.

Intuitively estimate where your project would fall along the reference class's distribution. The studio executive predicted $95 million as his new film's sales.

Assess your prediction's reliability.

Now counteract your biased prediction. Based on how well your past predictions matched actual outcomes, estimate the correlation between your **intuitive** prediction and the **actual** outcome. Express your estimate as a coefficient between 0 and 1 (0 = no correlation; 1 = complete correlation). The studio executive expressed his correlation coefficient as 0.6.

Correct your intuitive estimate.

Adjust your intuitive prediction based on your predictability analysis. The studio executive's corrected estimate was $62 million: $95M + [0.6 ($40M–$95M)]. ◆

The Quest for Resilience

by Gary Hamel and Liisa Välikangas
Harvard Business Review, *September 2003*
HBR OnPoint Reprint # 4910

The Idea in Brief

Corporate success has never been so fragile. Technology breakthroughs, regulatory upheavals, geopolitical shocks—these are just a few of the forces undermining today's business models. With the world growing increasingly turbulent, perennially successful companies are failing. Corporate earnings are whipsawing. Performance slumps are proliferating.

Firms can no longer count on the flywheel of momentum and incumbency to sustain performance. Instead, they need **strategic resilience**: the ability to dynamically reinvent business models and strategies as circumstances change, to continuously anticipate and adjust to changes that threaten their core earning power—and to change **before** the need becomes desperately obvious.

The quest for resilience starts with these bold aspirations: a strategy that's forever morphing in response to emerging opportunities and trends; an organization that's constantly remaking its future rather than defending its past; a company where revolutionary change comes in lightning-quick, evolutionary steps—with no calamitous surprises, indiscriminate layoffs, or colossal write-offs.

Fantastical, you say? Not if your company addresses four major challenges.

The Idea in Practice

Any organization striving for strategic resilience must master four challenges:

CONQUER DENIAL

Though warning signs of dramatically changing circumstances abound, many of us refuse to acknowledge them because the implications are unpalatable. To boost your corporate resilience, replace "That can't be true" with "We must face the world as it is." Become deeply conscious of what's changing—and perpetually consider how those changes might affect your firm's current success. Here's how:

- Witness change closeup—and often. Visit cutting-edge labs, talk with fervent activists—and anyone under 18. Ask, "What are the potential consequences of the changes I'm seeing?"
- Find out who in your organization is plugged into the future and understands its implications for your business model. Ensure that they have access to you. Go out to dinner with your most freethinking employees. Talk with potential customers who aren't buying from you. Review proposals that **don't** make it to the top.
- Acknowledge that your company's strategy will inevitably get replicated by rivals, supplanted by better strategies, exhausted as markets become saturated, or eviscerated when power shifts to new players.

VALUE VARIETY

Variety is insurance against the unexpected. Instead of making a single billion-dollar bet, launch a swarm of $10,000–$20,000 bets—smaller, lower-risk experiments. Thousands of ideas will produce dozens of promising ones that may yield a few huge successes. Test promising ideas through prototypes, computer simulations, and customer interviews. Most experiments will fail. But it's your experiment **portfolio's** performance that matters.

Example:

When domestic-appliance maker Whirlpool invited 10,000 of its 65,000 employees to brainstorm product breakthroughs, they generated 7,000+ ideas that spawned 300 small-scale experiments.

Results? A stream of new products—from Gladiator Garage Works (modular storage units) to the Gator Pak (an all-in-one food and entertainment center for tailgate parties).

LIBERATE RESOURCES

To avoid overfunding moribund strategies, get cash to people who can bring new ideas to fruition. Create an investment market inside your firm by giving everyone who controls a budget the ability to provide seed funding for ideas aimed at transforming the core business. "Investors" could form syndicates to take on bigger risks or diversify their "portfolios."

EMBRACE PARADOX

Dedicate as much energy to systematic exploration of new strategic options as you do to the relentless pursuit of efficiency. Reward people for strategic variety, wide-scale experimentation, and rapid resource deployment.

Your reward? An organization that responds to change continuously—without destructive turmoil. ◆

Debriefing Robert Mittelstaedt

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Will Your Next Mistake Be Fatal?

by Lauren Keller Johnson

What's not to like about success? If you're not careful, there's plenty, says Robert E. Mittelstaedt Jr., author of *Will Your Next Mistake Be Fatal? Avoiding the Chain of Mistakes That Can Destroy Your Organization* (Wharton School Publishing, 2004). In many organizations, success breeds dangerous attitudes—myopia, hubris, egocentricity—that may ultimately cause executives to ignore signs of trouble because they can't imagine a reason to expect it.

And when such attitudes go unchecked, they can give rise to patterns of repeated mistakes, in which decision making is not sufficiently rigorous and the prospect of failure never seriously considered. In the worst-case scenario, this can lead to the ruin of once-high-performing companies (see the sidebar "Where Strategic Hubris Can Take You").

Yet many very successful companies manage to avoid mortal errors. Such firms still make big mistakes—but they commit fewer of them, discover them earlier, and fix them more skillfully and aggressively than less savvy firms.

How to ensure that your company falls into this camp? Start by understanding the attitudes that spawn a culture of mistakes (see the sidebar "A Bad Attitude") and then embed five principles in your organization's culture and management systems.

1. Create systems to detect patterns of mistakes early

Detecting mistakes promptly is easier said than done, Mittelstaedt concedes. Yet several techniques can help. He recommends training a wide range of people in your organization to follow well-established operating procedures—especially in functions related to product or service quality and customer service—and to watch for anything that deviates from the norm. "If you see something you haven't seen before—a rise in product defects, a sudden jump in order-delivery errors—trust the data. Be vigilant in finding out what's going on," he advises. And empower people to address anomalies immediately. For example, retailer Nordstrom puts heavy emphasis on making customers happy. Its salespeople are free to take whatever action they think is required to correct a mistake that risks angering a customer.

In addition, analyze decisions retrospectively. Ask, "Why did this decision fail/succeed? What have we learned?" In analyzing your successes, "strip out any factors you didn't control," Mittelstaedt says. "When external forces are going your way, you tend to think you did something to cause your success. But, in truth, you were just in the right place at the right time. When you remove factors outside your control, you get a clearer sense of why you really succeeded."

2. Seek others' expertise

It's vital for leaders to use advisers and consultants, says Mittelstaedt. Executives need outsiders' ideas as well as someone to help them rise above the organizational politics that can muddy their thinking. Seeking advice from experts inside and outside the company can serve as a reality check against attitudes that could blind a leader to ominous signs of trouble in his organization.

For example, if your unit starts experiencing difficulty with collections, don't assume that the problem is just temporary or minor. Ask your internal IT experts to investigate your accounts-receivable system for glitches that may have caused the problem. If your IT people are already overworked, hire an outside consultant who can investigate the problem.

3. Imagine the unthinkable

Whenever you're launching a major initiative—getting a new product to market, opening operations in a new region—use worst-case scenario

A BAD ATTITUDE

A nasty concoction of human tendencies gives rise to the executive shortsightedness, overweening pride, and arrogance that can doom companies. For one thing, says Robert Mittelstaedt, author of *Will Your Next Mistake Be Fatal?*, "If you're successful, you believe that you know what you're doing and that you can and should keep operating in the same way as before." In addition, "most of us feel compelled to rationalize away bad decisions. It's a self-protection mechanism, saying 'It wasn't me!'" Finally, a desire to bury failures often prevails. "Most physical disasters get investigated," Mittelstaedt says. "But in business, people don't look into disasters as much as they should."

WHERE STRATEGIC HUBRIS CAN TAKE YOU

Overconfidence in your market position can be a dangerous thing. Consider telecommunications giant AT&T. "The company did everything right in a regulated environment," says Mittelstaedt. After deregulation, AT&T's leaders thought the company was so powerful that "nothing could dislodge us."

Owing to this attitude, executives never asked crucial questions, such as "What if the long-distance market becomes more competitive?" "What if new technologies come along that completely change the market?" Rather than using scenario planning to envision multiple possible futures and prepare contingency plans for protecting its core long-distance business, AT&T's leaders bickered over whether to acquire NCR Corp. (Dayton, Ohio), a move that had nothing to do with strengthening the company's competitive position in its core market. In the end, the once-dominant long-distance business sold itself to one of the former "Baby Bells" it used to own.

analysis to envision how problems might play out to their most disturbing end. List all key success factors, including those beyond your control. For example, will a positive outcome of your initiative hinge on sufficient capital? Or on market acceptance of your product by a specific date?

Then describe what could happen if certain success factors don't work out: Will you lose a specific amount of money annually? Will you be forced to scramble for resources? Come up with a range of potential scenarios and then make contingency plans for each. Be sure to define the data points (such as a drop in sales or loss of a key customer) that will alert you to the possibility that something has taken a wrong turn.

4. Protect customers at all costs

"Too many companies lose track of their customers," Mittelstaedt says. That's dangerous in a world where competition has reached brutal extremes. "Customers today get really mad when they feel they've been badly served. And they can do a lot of damage." Indeed, research says that customers who aren't happy with the way a problem is handled tell two-and-a-half times as many people as customers who are satisfied, according to Marc Grainer, chairman of Customer Care Measurement & Consulting, in Alexandria, Va.

Thus, with every decision you consider, it's vital to envision the impact of mistakes on customers. Think through the various ways a customer might perceive a particular type of mistake and then identify the implications of those perceptions.

The Coca-Cola Company failed to do this when it conducted market research for New Coke. "They had a real disconnect with their current customers," Mittelstaedt says. "During the tests, they asked potential new customers if they liked New Coke versus Pepsi. They didn't ask, 'Do you like New Coke versus old Coke?' They focused on the wrong thing, and the product failed."

5. Make data analysis a habit

"Executives at sophisticated companies don't go into data denial when they see an anomaly," says Mittelstaedt. They don't blame supply problems on an unexpected weather problem, for instance. "Instead, they dig deeply into the data to determine what's really going on with customers. And they don't make light of what may strike others as a minor blip."

For example, suppose your company has recently lost a few customers. "Unhappy customers don't take time to complain; they just defect," says Mittelstaedt. "And the few who do take time to squawk call frontline employees, not the senior management team. If you're in a senior managerial role, that means you need to multiply every lost customer you do hear about by 10 more that you haven't heard about." In this case, Mittelstaedt recommends asking questions about every lost customer, even if others view your behavior as overreacting. Your goal? To find out what caused the defection—and to address it promptly.

By taking this approach, you model analytical skills and behavior that can inspire the same in others. "You need everyone to make a habit of thinking analytically," says Mittelstaedt. "And that doesn't necessarily mean thinking quantitatively. It's all about wondering why things are happening the way they are."

Moreover, data analysis should be a way of life, not a one-time action intended to address a particular problem. In firms demonstrating this kind of commitment, leaders tolerate being questioned and challenged. With strong data at their disposal, "people feel they can safely point out that the emperor has no clothes," says Mittelstaedt. "They focus on data, not opinions or politics. And they're constantly trying to get at the root of anomalies."

By taking this kind of approach, you create a culture of continual learning—one in which you and other executives don't wait for a crisis to analyze the data. Rather, you conduct regular reviews of what led to failures and successes. And you weave analytical thinking into all your company's operations. ◆

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Executive Toolkit

by Loren Gary

Who Will Advance Your Cause?

Who is going to help you get the results you are aiming for? It's a key question for every manager. To answer it, you need to be able to separate out those who share your priorities from those who don't. But few of us use all the tools at our disposal to do so.

Determining who is most likely to help advance your cause, says Eileen Shapiro, coauthor with Harvard Business School professor Howard Stevenson of *Make Your Own Luck: 12 Practical Steps to Taking Smarter Risks in Business* (Portfolio, 2005), requires you to call on your ability to think empathetically—to envision how others view the world.

Without empathy, you can't judge whom you may be able to count on for support or how to encourage it.

"Once you understand how the other person sees the world," says Shapiro, a former McKinsey consultant and cofounder of the Cambridge, Mass.–based consultancy The Hillside Group, "you can focus on creating a large enough area of shared interest to get him to invest some of his time and resources toward your goals."

The place to start is using your powers of empathy to classify people into three categories.

Core Allies are those with whom "you have important and enduring overlaps." You can trust these people "over a broad range of issues because you feel fairly comfortable predicting that their future actions will support your mutual goals."

The **Possibles** comprise "those with whom you can build temporary or situational overlaps that will be mutually beneficial." The Possibles are far more numerous than Core Allies. You don't collaborate with them on a long-term and trusted basis "as much as you work alongside them, operating in parallel on particular projects or in particular situations."

The **Null Setters** are "those with whom you have few motivations in common and who may even stand in opposition to your goals." Trying to predict what Null Setters might do in future circumstances, "you find yourself either at a loss" or worse, pretty sure that they will "try to harm you in some way."

As you think about who fits into which category, look not only inside your firm but also at the external players—people and organizations—that can play significant roles in the outcome of your goals. These external players can include regulators, customers, or even competitors.

And then beware these pitfalls.

Neglecting your Core Allies

Even though you share fundamental values and interests with your Core Allies, you still need to nurture the bonds that unite you. "Because the Possibles outnumber your Core Allies by 10 or even 100 to 1, you have to spend more time, in absolute terms, with Possibles than with Core Allies," says Shapiro. "But you should never take your Core Allies for granted. Time invested here almost always pays off."

The flip side is true, too. If you rely too much on your inner circle of Core Allies, you can alienate a lot of valuable Possibles. "'Big tents' are true in business as well as politics," Shapiro says, "so you need to find ways to maintain your Core Allies and include more of the Possibles."

Misreading the Possibles

It's easy to misread the Possibles. If you think that your bosses, protégés, joint-venture partners, and investors are your Core Allies, you're likely to be wrong. Usually most or even all these people are Possibles; their support depends on the situation. Change the situation, and you change their levels of support.

By the same token, competing firms, employee groups, and regulators often also fall into the Possibles category—when their interests and yours can and/or do overlap. Then the key is creating and maintaining a large enough shared agenda that the other parties are willing to work with you for your mutual benefit.

Overinvesting in Null Setters

Finally, remember that some people hold very different goals than you do and are therefore Null Setters. Trying to convert these people is usually a poor investment of time and money.

Instead, concentrate your resources on the people with whom you have the most significant shared goals—your Core Allies and the Possibles. That's where the power of empathy comes in—envisioning how others see the world so you can assess and build areas of shared purpose. ◆

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