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Strategic flexibility: Organizational preparedness to reverse ineffective strategic decisions

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Executive Overview

In a highly uncertain and changing environment, managers need to have the strategic flexibility to respond to problems speedily. Strategic flexibility is the organization's capability to identify major changes in the external environment, quickly commit resources to new courses of action in response to those changes, and recognize and act promptly when it is time to halt or reverse existing resource commitments. This strategic flexibility requires managers to find the right balance between committing the resources necessary to carry out a decision and avoiding investment of good money in bad projects. This article seeks to help managers understand the importance of and difficulties in developing strategic flexibility. The challenge in doing this results from the substantial uncertainties inherent in making these strategic decisions as well as from psychological and organizational biases that affect the attention, assessments, and actions of decision-makers in ways that prevent them from recognizing problems and acting in a timely fashion. Being careful and rational is important but not sufficient if managers are to recognize when resource commitments should be halted or reversed and act quickly. We show that managers may become unconsciously trapped in a vicious cycle of insensitivity, self-serving interpretation, and inaction. We recommend six practical steps for avoiding such problems. We stress that managers and organizations should be prepared and proactive to overcome the biases, to avoid becoming trapped in the vicious cycle of rigidity, and to cope effectively with the uncertainties of a dynamic environment.

Recognizing problems and making changes to correct them often present substantial challenges. For example, after a firm finally recognizes a problem that has existed for about a year and initiates actions designed to correct it, another year is often required to accomplish the change. However, if it takes a firm two years to recognize a mistake, as long as four years may be necessary to resolve the problem.[1] This outcome is referred to as the "law of squares" (e.g., $1 \times 1 = 1$; $2 \times 2 = 4$). This "law" dictates that the longer problems go unrecognized or unresolved, the more damage that occurs to the firm and the more difficult it is to solve the problems. In a highly uncertain environment, firms need the capability to enact major strategic changes to resolve problems in a timely fashion. The importance of speed in recognizing and responding to problems has been dramatically accentuated by the dynamic competitive landscape in recent years. A former CEO of ABB once remarked that "The cost of delay is greater than the cost of an occasional mistake."[2] Similarly, Juergen Schrempp, CEO and chairman of DaimlerChrysler, stated in an interview with a *Wall Street Journal* reporter, "My principle always was. . .move as fast as you can and [if] you indeed make mistakes, you have to correct them. . . . It's much better to move fast, and make mistakes occasionally, than move too slowly."[3]

Although identifying and acting on problems have become increasingly important, commitment to initiatives is also necessary for organizations to

be successful. In many cases, new initiatives encounter various types of resistance and challenges in their implementation that must be overcome to be successful.[4] Without strong commitment and patience, their potential may never be realized. There are numerous examples of heroic leaders and innovators who achieved their final victories by maintaining a strong commitment to overcoming multiple obstacles. For example, it is well-known that Corning took more than ten years and $100 million—dealing with high market skepticism and middle-management resistance—to launch its optical fibers business.[5] Konosuke Matsushita, the founder of Matsushita, stated that the primary secret of success is to remain committed until success is achieved. A firm that frequently changes its strategy and course of action may vacillate, waste resources, and eventually fail.[6] Yet, being overly committed to an erroneous decision can also be disastrous.

Strategic flexibility can be defined as an organization's capability to identify major changes in the external environment (e.g., introduction of disruptive technologies), to quickly commit resources to new courses of action in response to change, and to recognize and act promptly when it is time to halt or reverse such resource commitments. Herein we focus on the ability to recognize problems and reverse resource commitments in a timely fashion when the initial action and resource commitments turn out to be unsuccessful (i.e., strategic mistakes). Strategic mistakes can result from an initial inaccurate evaluation of the environment and from maintenance of the status quo despite environmental changes.

However, distinguishing strategic mistakes from temporal setbacks is difficult. The decision-making process involved in maintaining strategic flexibility focuses on the use of three capabilities, each at a different stage: (1) the capability to pay attention to negative feedback (attention stage), (2) the capability to collect and assess negative data objectively (assessment stage), and (3) the capability to initiate and complete change in a timely fashion even in the face of uncertainty (action stage). Correctly balancing commitment and timely change should produce outcomes that maximize potential benefits and minimize losses.

At the same time, achieving the correct balance is undoubtedly challenging. Abandonment of an initiative too quickly because of initial problems may result in the loss of a large future potential benefit, while overly strong commitment to a money-losing project can only exacerbate problems. While once considered as an exceptional CEO, Percy Barnevik has been accused of mismanagement that produced ABB's performance problems. Juergen Schrempp has also received increasing criticism for the acquisition of Chrysler. Likewise, many Japanese firms, including Matsushita, that were once highly regarded for their long-term vision and strong commitment to a long-range strategy have been experiencing performance problems for over a decade. These examples reemphasize the fact that maintaining strategic flexibility is one of the most important yet most difficult tasks of managers and organizations in a dynamic environment.

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Our primary objectives in this work are (1) to help managers understand the importance and difficulty of developing strategic flexibility and (2) to provide practical recommendations to deal with this challenging task by focusing on structural issues (i.e., contingencies) that contribute to various biases and traps. Because these biases are frequently unconscious, and uncertainties are inherent in strategic decisions, we suggest that managers should proactively develop effective organizational structures and systems rather than struggling with the biases and uncertainties reactively. In the following sections, we first examine barriers that hinder strategic flexibility and then discuss prescriptions to help managers overcome the barriers and maintain strategic flexibility.

Barriers to Strategic Flexibility

As described, strategic flexibility requires use of three capabilities: maintaining attention, completing an assessment, and taking action. However, several barriers block the development and use of the organizational capabilities necessary for strategic flexibility. Next we examine the barriers along with the conditions under which an organization is more vulnerable to those barriers.

Barriers to Attention: Psychological and Organizational Insensitivity to Negative Feedback

Organizations need to be sensitive (maintain attention) to feedback from the market, particularly negative feedback. This sensitivity also requires organizations to respond to feedback in a timely

fashion. In a dynamic environment, even a seemingly good project may suddenly lose its potential value. Unfortunately, both research and anecdotal evidence suggest that managers often ignore early signs of strategic mistakes.[7]

Over time managers develop a particular mind-set along with a set of decision rules and heuristics based on their experiences.[8] As successful managers are promoted within an organization and successful initiatives are repeated, previous successful experiences control attention to and enactment of future issues and regulate responses to the enacted issues. The mind-set and rules are self-reinforcing such that successful experience often prevents managers from being sensitive to important new information. This situation nurtures managerial overconfidence and complacency. Moreover, successful experiences often attract media attention and praise, thus providing support for managerial hubris. As a result, overconfident managers assume that their decisions are unlikely to fail and unconsciously ignore negative signs regarding their decision outcomes.[9]

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Furthermore, the mind-set and decision rules of top management are often shared, routinized, and taken for granted within the organization. This process ensures that the same type of information will be collected using the same methods and that the information collected will be analyzed using taken-for-granted assumptions with routinized approaches. Ideas and actions that deviate from the current routines will not be considered legitimate. Such outcomes produce organizational inertia and make it less likely that an organization will consider (pay attention to) new information (e.g., negative feedback from the market). Instead, this type of information will be either ignored or assumed to be an exception and not analyzed further.

Naturally, managers and organizations are more likely to enact barriers to attentiveness when they have previously experienced success.[10] Successful experience contributes to the development of individual and organizational mind-sets that underestimate the negative feedback from the market and decision routines that repeat the same procedures, even if those procedures are no longer valid in the new environment. Additionally, long tenure among the top-management team is likely to rigidify its shared mind-set toward more narrow perspectives, resulting in a lower likelihood of incorporating new information.[11] Similarly, when organizations become older and larger, the shared perspectives and routines are likely to be more institutionalized and the interactions across the routines to become more complicated. In this type of organization, changing the attention patterns will be difficult, and therefore early signals of strategic mistakes are likely to be ignored.

This appears to be the case with Michael Eisner and Disney. After tremendous success in 1980s and 1990s, the Disney Company has performed below expectations for some time. The acquisition of Capital Cities ABC never produced the synergy foreseen at the time of the merger. Part of the reason for this outcome is the hubris exhibited by CEO Eisner. Accustomed to his old business model, he seemed incapable of recognizing the low probability of turning around the performance of ABC and other underperforming business units within the Disney Company without making major changes in the operations or how they were managed. In September 2004, Eisner agreed to retire in 2006 and may be pressured to step down earlier.

Motorola is another example of a firm haunted by its past success.[12] In late 1980s and early 1990s, Motorola was a market leader in the analog cell phone market. As stated by former CEO Robert Galvin, "We were the unbridled leader in analog devices around the world." Because Motorola was so successful and proud of its analog technology, it dramatically underestimated the effects of digital technology. Motorola responded to customer pleas for digital phones with contempt: "Remember the old phones in WWII—carried on backs. That is what our digital phone will look like. It can't be done." The hubris and biases of top management were exacerbated by Motorola's organizational structure. Past success had led Motorola to develop a decentralized structure, where new information developed by a division was not shared with others and previously successful division managers made critical decisions within silos. The established incentive system also promoted sales of analog cell phones and discouraged new investment to develop digital phones.

Barriers to Assessment: Self-Serving Interpretation of Negative Feedback

Even if managers remain vigilant and recognize a negative signal at an early stage, they do not necessarily initiate a response. First, managers are often reluctant to admit that they made a mistake.[13] To justify their decision and avoid admit-

ting a mistake, they may attribute the poor outcomes to external factors (e.g., the economy or other uncontrollable events like war in Iraq). Alternatively, they may reemphasize their commitment to make the initiative a success. Research has shown that people in situations that are likely to produce a loss are more willing to take risky actions to create positive returns. An early negative signal may be interpreted as the result of insufficient time or inadequate implementation actions, and thus even more resources may be invested. Therefore, when confronted with undesirable outcomes, managers who initially pursued an initiative vigorously may take a risk by making a further commitment to the project as opposed to taking the opportunity to abandon it.[14] These managers may continue to invest, hoping for a dramatic turnaround of the initiative. In so doing, they sequentially over-invest in the business and make it increasingly difficult to earn a positive return on the investment.

The organizational context and political processes often play important roles in decisions that involve reversing previous strategic decisions. Such decisions commonly produce a struggle for power in an organization. These potential power struggles and the potential career-limiting effects of strategic errors contribute to a manager's unwillingness to admit mistakes. When the supporters of the original decision have power, they prefer to retain the project and avoid admitting a mistake in order to maintain the power. Therefore, while poor performance may signal a need for change, organizational politics often prevent an organization from interpreting the signals correctly and/or in a timely fashion.

Several contingencies create strong barriers to objective assessments. First, when the size of the initiative is large, both the amount of commitment to the initiative and the size of damage when the initiative is deemed a mistake are likely to be large. The likelihood that the managers responsible for the project will be penalized or will have limits placed on their career opportunities is also significant. Accordingly, it is difficult for managers to analyze the information objectively and consider reversing an initiative in a timely fashion. Instead, managers may interpret the negative signal as a temporary setback or may underestimate the negative information in the hopes of salvaging their careers. In either case, they are likely to continue commitment to and investment in the money-losing initiative.

As Michael Eisner's record suggests, weak governance mechanisms allow managers to pursue their personal interests at the expense of an organization's interests.[15] A weak board may not be able to stop powerful managers from behaving politically or continuing the commitment to mistakes. It is also notable, however, that managers may consciously hide negative information even in cases of strong governance, because disclosing it could result in punishment by the board.[16] Finally, the organizational culture and institutional environment also influence the strength of the barriers. Leaders who overcome obstacles and eventually are successful in accomplishing their goals tend to be respected. In a culture where success is highly praised and mistakes are severely punished, managers avoid admitting mistakes.[17] Thus, we should not expect managers to give up on an initiative easily. Instead, many managers may believe (erroneously) that they can overcome the odds and succeed. These managers are unlikely to evaluate negative signals objectively regarding the strategic initiative.

In a culture where success is highly praised and mistakes are severely punished, managers avoid admitting mistakes.

A *Fortune* article entitled "CEOs in Denial" examined a number of former CEOs who were faced with problems, either denied them or attributed them to external environments, and led their firms to disastrous outcomes.[18] For example, Gary DiCamillo arrived at Polaroid in 1995 and predicted a turnaround in three years. After regularly blaming poor performance on external conditions such as Russia's economic problems and global turmoil, Polaroid filed for bankruptcy in 2001 and eventually stopped all business operations. Jill Barad, a former CEO of Mattel, unwaveringly maintained a positive assessment of her $3.5 billion acquisition of Learning Co. despite its poor performance and accounting problems. She later confessed that she did not fully grasp the problems in Learning Co. and resigned as CEO in 2000 after repeated recovery promises, none of which materialized. According to one analyst, "Because she was so results-oriented and never took no for an answer, she fostered a culture that made it nearly impossible to deliver bad news."[19]

Barriers to Action: Uncertainty and Resistance

Even if managers understand the psychological and organizational biases that produce barriers and attempt to be rational, the decision of whether

or not to maintain commitment to or change a poorly performing initiative is not solely a matter of economic calculation. This is mainly because of the uncertainty associated with the future of the project and its environment. Herein, uncertainty refers to a lack of information regarding potential outcomes.

To the extent that evaluation of a particular project involves assumptions about the environment and forecasts of the future, it is difficult to predict the outcome of any one project with confidence, especially a loss-generating project. The prospects of the project are often perceived as uncertain because predicting changes in the external environment, as well as their effects on the project, is difficult. While simple net-present-value calculations provide seemingly objective assessments, the results are dependent on assumptions such as the projected sales growth rate and discount rate, which are often derived from extrapolations based on historical data. In fact, many scholars question the argument that escalation arises solely from psychological biases and self-protecting behaviors. Instead, decisions regarding maintaining or withdrawing commitment are laden with uncertain consequences associated with either choice.[20]

Moreover, it may be difficult to identify the complex relationships leading to the poor outcomes. Poor results can come about because of the initial strategy, inadequate implementation, or mitigating environmental factors. Even if the current performance is poor, an initiative may still have potential. To the extent that the initial decisions involve future upside potential and actual causality is unclear, it is difficult to deny the potential for turnaround even if the probability is small.

Poor results can come about because of the initial strategy, inadequate implementation, or mitigating environmental factors.

Further, uncertainty often creates resistance. In general, people resist change because of familiarity with the current conditions and a fear of the unknown. People prefer the status quo because change disrupts the established routines and creates uncertainty, thereby involving risks. "Consequences of changing are usually less well known than the consequences of not changing."[21] Research shows that managers and organizations tend to maintain the status quo in the face of economic adversity.[22] When performance is weak, managers often become defensive and try to limit receipt of further information. As a result, exploration of other alternatives is constrained. People may ask, "Who moved my cheese?" and come back to the same cheese station every day. "I like it here. It's comfortable. It's what I know. Besides, it's dangerous out there."[23]

The uncertainty in the external environment is a major cause of managers' reluctance to reverse seemingly poor decisions. For example, rapid development of new technologies makes it difficult for managers to predict the consequences of such environmental changes. Thus, it is challenging to

Table 1
Barriers to Strategic Flexibility

Component of Strategic Flexibility	Barriers	Conditions That Increase the Risks of the Problems
Attention	▪ Complacent mind-set/decision rules (including hubris) ▪ Organizational inertia ○ Institutionalizing initial decisions by rules and routines ○ Ignoring ideas and actions that deviate from the routines	▪ Past success experience ▪ Long tenure of top management ▪ High age and size of organization
Assessment	▪ Self-justification ▪ Framing effects (managers tend to take risks in the face of losses) ▪ Organizational politics	▪ Large-size projects (that result in large commitment and loss) ▪ Weak governance ▪ Organizational and social culture that is harsh on mistakes
Action	▪ Perceived uncertainty regarding the prospects of the project ▪ Resistance to change	▪ High environmental uncertainty ▪ Financial resource availability

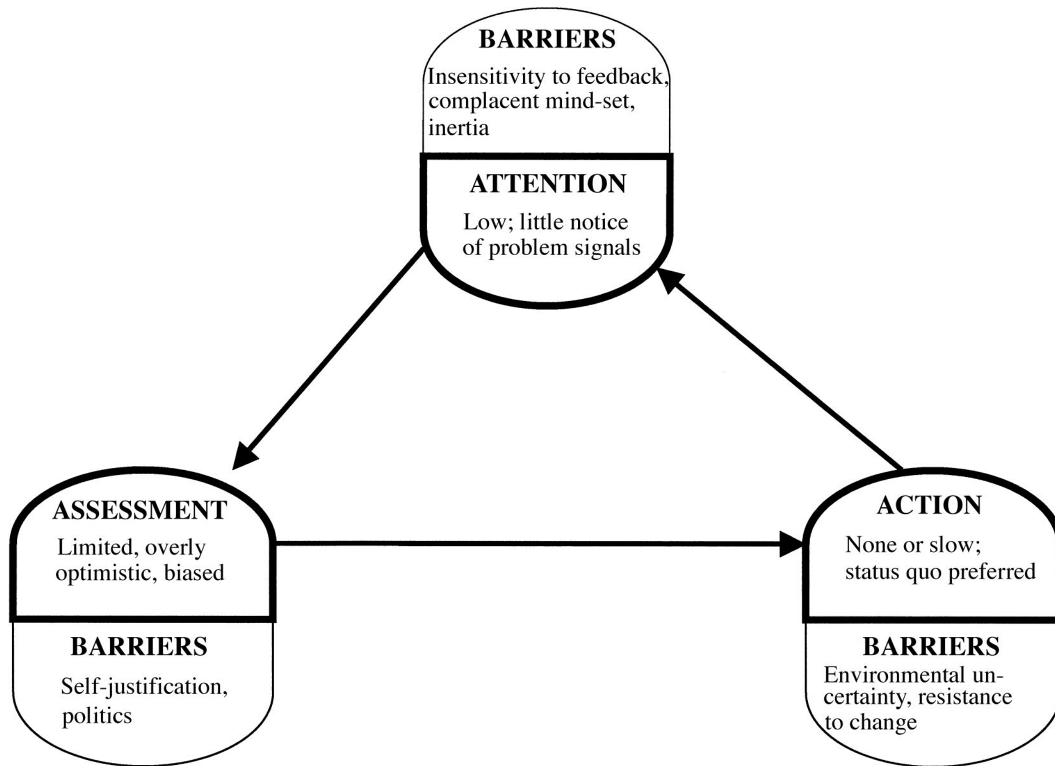


FIGURE 1
Vicious Cycle of Strategic Rigidity

determine the appropriate type and timing of changes needed to initiate a response. Availability of financial resources also influences the timing of action.[24] When an organization has abundant resources, it may be able to take more risk and wait for uncertainties to be resolved. Alternatively, resource-rich organizations often have multiple alternatives, allowing them to abandon the focal initiative without material harm. In other words, wealthy organizations enjoy the flexibility to commit to a particular initiative or to make changes by reverting to one or more other feasible options.[25] Alternatively, a resource-poor organization is limited in terms of the alternative actions it can take in response to the negative outcomes of an initiative. This type of organization may either abandon a potentially valuable initiative at an early stage to minimize losses or commit to a loss-generating project because it does not have other feasible options.

Managers often prefer the status quo as the easiest path until the outcomes become extremely bad.

Table 1 summarizes the barriers that hinder strategic flexibility based on the perspectives of attention, assessment, and action. These barriers, however, rarely have independent effects on strategic flexibility. Rather, the barriers often interact with each other and create a vicious cycle that makes it exceedingly difficult for managers and organizations to maintain strategic flexibility, as shown in Figure 1.[26] As explained, overconfidence, a complacent mind-set, and organizational inertia often hinder managers' attention to early signals of mistakes. With these attention barriers in place, only limited negative information may recognized, making it easier for managers to bias assessments of that information. Coupling the limited negative information with the assessment biases, negative outcomes are particularly likely to be interpreted optimistically, and therefore problems are unlikely to be carefully examined. Further, the extent to which the assessment of outcomes is positively biased can heighten organizational resistance to changing the initiative. Also, if blame is deflected by citing external forces, the assessment of outcomes may increase or introduce uncertainty. In this case, uncertainty can limit motivation to change, and resistance is likely to be strong. Because change involves risks, it is difficult, even for excellent managers, to initiate a new action. Instead, managers often prefer the status quo as the

easiest path until the outcomes become extremely bad.

When no action is taken, the existing mind-set and current routines are further reinforced. Uncertainty and resistance may also lead even effective managers to unconsciously place a lower priority on resolving problems with major changes. Some have referred to this inaction as "the ostrich effect" because ostriches stick their heads in the sand assuming that those who pose a threat cannot see them. In this case, uncertainty is seemingly "controlled" by ignoring it.[27] When these conditions occur, any negative information may be overlooked. This cycle gradually becomes institutionalized as suggested in Figure 1.

Even in legitimate decision-making processes, the cycle shown in Figure 1 can occur. An example of this complex situation existed in AOL Time Warner. The merger of the Internet portal AOL with the media company Time Warner has been highly unsuccessful. The lack of success is partly because of the excessive premium that was paid for the merger, partly because of the crash of inflated Internet company valuations, and partly because assumed synergies between the two companies failed to materialize. However, because of the hubris developed from past successes, AOL Time Warner continued to deny its problems and stressed the upbeat performance forecast. In spite of its insistence on an optimistic future, the company's market capitalization decreased by $223 billion in the first two years following the merger. The merged company was initially dominated by the former AOL managers (based on the past success of AOL), and they were unwilling to admit problems and to make needed changes in the struggling company. In 2004 the new CEO, Richard Parsons, considered spinning off AOL as an independent business. Although this seems to be an appropriate action, delays in such a decision continue, which suggests that the complacent mind-set still prevails. Thus, even with the change in CEO, there is reluctance to admit an error, fully assess the situation, and take the necessary action to stem the weak performance.[28] AOL Time Warner (now called Time Warner) seems to have been trapped in the vicious cycle.

The arguments presented above suggest that barriers interact and are self-reinforcing, thereby severely limiting strategic flexibility. It is thus important for an organization to avoid being trapped in the vicious cycle. We discuss various actions for this purpose in the following sections. We begin with a discussion of our research results that highlight actions and characteristics of the situation serving as catalysts for change.

Triggers for and Barriers to Change: Research Results

In the previous section, we explained the barriers at each stage of organizational strategic flexibility. Because cognitive biases and organizational inertia can disrupt top managers' attention to the focal decision, they may not recognize potential problems in a timely fashion. Even if they do, admitting a mistake may be difficult, so they choose instead to continue investing in the losing project. Finally, uncertainty still remains even without the attention and escalation problems, because changing or withdrawing a particular initiative may result in the loss of future value.

Because cognitive biases and organizational inertia can disrupt top managers' attention to the focal decision, they may not recognize potential problems in a timely fashion.

Because most organizations face these challenges, particularly in a dynamic environment, the results of our research provide important insights. Our arguments in this article are based on two separate but related studies. The first exploratory study examined 18 cases to identify how and when changes were made in a previous strategic decision based on interviews with 17 managers in 11 organizations.[29] The second study, drawing on the findings from the first study, examined the barriers to change and the situational characteristics that triggered change, using a sample of acquisitions that were later divested.[30]

A key finding from the first study is that change in an initial decision is often triggered by "unrelated" events within an organization. Although poor outcomes may be a necessary condition for initiating a change, it is rarely a sufficient condition alone. Many firms that we studied needed more than a year (sometimes several years) to initiate a change after the poor outcomes were initially reported. Even highly intelligent managers struggle with the decision of whether to commit further or withdraw the investment after acknowledging poor outcomes. In this context, an organization often needs external events to overcome the vicious cycle as described in Figure 1 and to stimulate and increase momentum for change. To illustrate, two example cases are briefly described be-

low. The first case exemplifies lack of attention and assessment, and the second one is an example of delayed action due to uncertainty.

One manager in a firm we studied described how his organization remained committed to its initial marketing strategy in Europe for more than five years, despite its poor outcomes during this time. Top management attributed the poor performance to the immaturity of the market. The firm had achieved success in the US with a similar marketing strategy, so the executives were comfortable with it. As a result, they did not adequately attend to the business environment and competitive practices in Europe. When a new manager was appointed, he reviewed the entire European market to understand it and the firm's current position in the market. He then provided a summary presentation at a meeting of other top managers. While the information in his presentation had been reported piece by piece previously, his presentation became a "wake-up call." Only then did the top managers pay attention to the information and its implications for the firm's marketing practices. The firm changed its marketing strategy in Europe.

In another firm studied, top management changed its organizational structure after three consecutive years of losses. For top managers, it was difficult to assess whether the poor outcomes arose from fundamental problems in the organizational structure or something transitory, and thus they were hesitant to initiate a change. A failure of a strategic project, however, produced the momentum to examine every major problem within the organization, deny any "wishful" assumptions, and initiate necessary changes. According to a director, "Why did it take three years? Yes, we should have done it earlier, but it was hard to evaluate the decision in a short period."

Top managers often ponder what should be done when an acquired business produces unexpectedly poor results. Should they remain committed to the acquired business or sell it?

To extend our understanding from the first study, we also examined the effects of barriers and trigger events on strategic flexibility in the context of mergers and acquisitions, an increasingly important strategy used globally. In contrast to the popularity of acquisitions, the results of an acquisition strategy are often not positive. For example, *Business Week* reported that of the largest M&A deals in 1998-2000, 61 per cent destroyed shareholder wealth and only 17 per cent created positive returns.[31] Thus, top managers often ponder what should be done when an acquired business produces unexpectedly poor results. Should they remain committed to the acquired business or sell it?

Triggers that counter barriers include factors such as a large decline in acquired unit performance, arrival of a new CEO from outside of the firm, or arrival of a new outside director. These triggers serve as a catalyst to accelerate the divestiture of a poorly performing acquired unit.[32] Our research showed that divestiture of such a unit is over 100 times more likely when a new outside CEO is hired compared to when the current CEO remains in the position. A large decline in the performance of the formerly acquired unit increases the pressure on managers to take action.

Although less influential than a new external CEO, a new outside board member also increases the pressure for action. Our research showed that divestiture is two times more likely when an organization has a new outside board member. Such a member is more likely to break the chains of inertia and redirect the attention patterns of top management. A new board member can also infuse the other directors with a fresh perspective by bringing a different experience base to the firm.

Recommendations for Maintaining Strategic Flexibility

Because managers are subject to various psychological and organizational biases when evaluating previous strategic decisions, especially when the outcomes of those decisions are undesirable, it is difficult to maintain strategic flexibility. The uncertainty exacerbates the challenges in making decisions about whether to continue commitment to previous strategic decisions or to change them. Yet, there are steps that organizations can implement to reduce these problems and avoid the vicious cycle described earlier.

Extending our research on 18 cases where changes in decisions were needed and on 140 acquisitions, we propose the following six principles to build organizational preparedness that allow managers and organizations to effectively maintain attention to negative signs, evaluate and analyze outcomes objectively, and initiate actions that reverse, where necessary, previous strategic decisions. The key is being proactive and focusing on structural issues (i.e., contingencies) that contribute to the various biases and barriers. These

actions need to be taken before managers become victims of the vicious cycle shown in Figure 1. Once in this cycle, exiting from it is difficult because the biases are subconscious, and managers often become unknowingly trapped.

1. Measure and Monitor Decision Outcomes.

If managers are unaware of the specific outcomes of a decision, it is unlikely that they will attend to it or that they will change the decision. Therefore, managers must ensure that decision outcomes are measured and monitored. While this recommendation seems obvious, the reality may not be so. When managers have experienced previous successes, they can become overconfident. Praise from others and routinized "success patterns" contribute to managers' beliefs that their decisions are unlikely to fail. As a result, they make decisions and then move on to the next initiative without considering the outcomes of the earlier decisions. For example, a manager in a company that grew through several M&As was asked if all of the acquisitions had been successful. She stopped and pondered: "Well, the interesting thing is, I don't know. . . . I don't know if the president would know how the acquired firms are performing. Because what generally happens is that those businesses are integrated with other businesses in the regions." Thus, in this case, no one was clearly measuring the performance of the businesses acquired, and therefore the managers were neither attentive to the outcomes nor able to assess them.

Managers must ensure that decision outcomes are measured and monitored. While this recommendation seems obvious, the reality may not be so.

Managers have many competing demands for their attention every day; if managers have been successful, they may regard decisions as end points even though in reality, decisions need to be implemented and adjusted or terminated. Therefore, our recommendation to measure the outcomes of decisions is an important first step in maintaining attention to critical strategic issues. As Jack Welch states, "What you measure is what you get."[33]

2. Stimulate Decision-Making Processes by Incorporating a Devil's Advocate Approach.

As discussed in the previous sections, managers embedded in organizational contexts are subject to various biases and inertia. The problem is not so much the existence of the biases as the fact that these managers are *unaware* of them.

Ignoring mistakes is common when alternative viewpoints are not considered. Incorporating and evaluating new ideas often help firms to adjust their initial decisions flexibly. Team-based decision-making enhances the opportunity to incorporate different perspectives into decisions. Team-based decision-making processes also create means for a check-and-balance to the CEO's opinions. However, using a team to make decisions is not always effective. For example, teams are subject to groupthink whereby team members focus on a single perspective and reinforce each other even though that perspective is inaccurate. Accordingly, team decision-making processes need to be carefully designed to avoid this problem and to achieve maximum effectiveness. One useful team-based design is the devil's advocacy approach because it can forestall a biased diagnosis of the original strategic decision and thus help to avoid groupthink.[34]

The value of a team-based approach can be best derived from the diversity of the members' perspectives and experiences.[35] This diversity is formally emphasized when a member of the top management team is designated as a devil's advocate. The role of the devil's advocate is to question the assumptions and alternatives presented. In this way, alternative solutions are analyzed more completely and from many different vantage points. Such an approach can be particularly effective when managers are complacent, a decision-making team is relatively homogenous or even rigid in its approach to decision-making, or organizational inertia is high.

However, the CEO must be prepared to receive challenges to his or her position in this process. The CEO should build a nurturing organizational culture that encourages open communications. Disclosing and sharing bad information is important to develop the necessary momentum to overcome problems.[36] Without such an approach, managers may unknowingly enter the detrimental cycle described earlier, which is difficult to break. GM provides a classic example. The culture of GM under Roger Smith was once described as follows: "If you raised a problem, you got labeled as 'negative,' not a team player. If you wanted to rise in the company, you kept your mouth shut and said 'yes' to everything."[37]

3. Create Dynamic Mechanisms to Gain New Ideas and Perspectives from Outside of the Firm, Before Problems Appear.

Conventional wisdom suggests "Don't fix something if it is not broken." However, such an approach is highly risky. As explained previously, poor results may be interpreted as temporary, either intentionally or unintentionally, with no actions taken. When managers finally recognize or admit that the outcomes are "really" bad and that something *is* broken, it may be late and very costly to create a turnaround or to make needed changes (refer to the law of squares).

When managers finally recognize or admit that the outcomes are "really" bad and that something* is *broken, it may be late and very costly to create a turnaround or to make needed changes.

Following a careful process is important but unlikely to be sufficient to avoid being trapped in the potentially debilitating cycle. Instead, it is important to be proactive; don't wait for something to break. For example, establishing an organizational system that regularly receives new ideas and infuses new perspectives from outside the firm can provide a "wake-up call" to managers. These outside ideas help managers avoid being trapped by path dependence.[38] By exposing themselves to external ideas, managers can evaluate the firm's past strategic actions, its current strategy, and the outcomes achieved through the lens of external standards. This approach is similar to informal benchmarking. Exposure to external ideas provides perspectives that are unbiased by internal political processes or by involvement in the initial strategic decision. Thus, an external perspective helps managers to be more sensitive to negative feedback by questioning assumptions regarding previous successful experiences. Managers can then change the group dynamics within the top management team and stimulate the development of new routines.

An external perspective also helps an organization to make a more realistic and effective assessment of the negative information by nurturing a culture of learning from mistakes and creating a new dynamic that "refreshes" the relationship between top management and the board of directors. Based on our research results, we suggest several ways that firms can inject new ideas and external perspectives into the decision-making processes.

a. Limit the Tenure of Top Executives

In support of past and continuing research,[39] our study found that appointing a new CEO from outside of the firm dramatically increases the probability of divesting an acquired business that is performing poorly. A new outside CEO brings perspectives developed from different experiences and different settings that may redirect an organization's strategic intent, policies, and assumptions. Arrival of a new outside CEO provides an opportunity for an organization to revisit obsolete assumptions and correct mistakes in past strategic decisions.

We recognize that hiring a new CEO from outside the firm is not feasible in all succession events and, indeed, such an action could have negative effects on the motivation of internal managers. However, turnover in the top-management team, especially when a team approach is used to make strategic decisions, can be healthy. Furthermore, limiting the tenure of top managers provides the opportunity to infuse the firm with new leadership and new perspectives, thereby reducing path dependence in the thinking and learning process of the firm. Such changes may well enrich the capacity of the team to learn and to develop new strategic approaches. Often, CEOs are replaced only when the performance of the firm deteriorates, in which case it takes more time to recover (refer to the law of squares). However, precedent exists for building in regular turnover in the top management team. Both Toyota and Honda change their CEOs every four to five years, regardless of their performance. In contrast, Michael Eisner has been Disney's CEO since 1984.

Although there are companies that have infrequent top-management changes and maintain high performance (e.g., GE), those companies are becoming more rare (e.g., see Coca-Cola). Given the importance of maintaining strategic flexibility, companies should seriously consider and evaluate the pros and cons of limiting the tenure of top executives. This point is also applicable to the following two recommendations.

b. Routinely Appoint New Outside Directors

Interestingly, our research showed that appointment of new outside directors also increases the probability of divesting an acquired business that is performing poorly. The rationale here is similar to that for new CEOs but with an additional twist. New outside directors also bring different experiences and potentially fresh perspectives to the

firm. To learn about the firm, these new directors are likely to pay special attention to important strategic issues, some of which may have been taken for granted by incumbent directors. They also may change the power balance between the CEO and the board. Thus, while a change in the top-management team, especially in the CEO position, brings new leadership, a new director can potentially infuse new perspectives into the governance process. As a result, the director's new ideas have the potential to unlock the cognitive inertia in the firm that reinforces past actions and serves as a barrier to changing previous strategic decisions. New outside directors also add a new dynamic in the relationship between top management and the board of directors with the potential to prevent directors from becoming entrenched and ineffective.

Our research showed that appointment of new outside directors also increases the probability of divesting an acquired business that is performing poorly.

Although excessive turnover of directors can be dysfunctional because of the need for continuity (e.g., for organizational memory) and the time required for new directors to learn about the industry and the firm, these concerns must be balanced with the importance of injecting new perspectives.[40]

c. *Rotate Managers in Key Positions Routinely*

Accumulation of experience and expertise along with maintaining an organizational memory are important for an organization. However, creating a closed circle in a management team can also produce an inertial mindset (as shown in the case of Motorola). Regular rotation of managers in key positions ensures that fresh perspectives will be considered in each area important to the company over time. Also, new managers are more likely to evaluate previous strategic actions taken in the area because their performance will be appraised based on the unit's outcomes, some of which will be due to prior decisions made by their predecessors. Further, when lower-level managers observe their superiors asking questions, they may become more open to share their ideas, ask additional questions, and possibly even communicate mistakes.

The merits of proactively providing a stimulus for attention to and assessment of problems requiring change are important advantages of managerial rotation, particularly to those organizations with complacency, rigidity, and/or inertia. Japanese companies such as Toyota and Honda take advantage of rotation to provide broader views of the organization to managers and prevent them from being entrenched in excessively narrow and rigid functional perspectives. Jack Welch's experience is also consistent with this idea. When he offered critical comments to managers of the problematic nuclear business in 1981, they argued, "Jack, you really don't understand the business." Based on his objective assessment of the situation, he commented. "That was probably true, but I had the benefit of a pair of fresh eyes. I hadn't invested my life in this business. I loved their passion, even though I felt it was misdirected."[41]

There are also some risks and disadvantages in a regular rotation of managers. A major risk is that new managers may change effective strategic activities in order to put their own "stamp" on the job, when no change is warranted. Also, while regular rotation is desirable, adequate time in a position is necessary to evaluate and create new directions, as well as to implement and nurture them. Thus, balancing the advantages and disadvantages of rotation is critical to the program's success.

d. *Exploit Alliances with Other Firms as a Way to Incorporate New Ideas*

Alliances with other firms through joint ventures or long-term contracts have become highly popular strategic moves. In fact, they are probably the most common global strategic action taken by large and small, established and new firms.[42] Strategic alliances provide a valuable source of new ideas. While firms can gain from the complementary resources provided by partners, perhaps a longer-term advantage is learning new capabilities and technologies.[43] Strategic alliances provide a useful source of new perspectives as well.[44] Experience in managing the integration of two or more different corporate cultures and mind-sets should help to promote the creation and communication of new ideas inside the firm. The experience may also provide an opportunity for managers to recognize that their own internal standards or perspectives, which they thought were absolute, may not be adequate for gaining and/or sustaining a competitive advantage. In other words, alliances can provide a means of benchmarking the standards used within a firm.

While alliances are often developed for strategic purposes, their potential value extends beyond these initial purposes. In particular, exposing

managers to new cultures and ideas is an opportunity that should be exploited when available. These ideas provide a source of and a catalyst for developing a culture of learning and needed changes.[45]

4. Recognize the Limitations of Static Governance Systems.

Strong corporate governance should ensure that executives examine appropriate alternatives and opportunities when they exist. One element of a governance system touted for many years is a majority of outside directors. However, research has produced mixed results regarding the effects of board composition or leadership structure on firm performance.[46] And, as we have learned from recent major scandals such as Enron, unethical top executives may be able to work around the governance system unless careful safeguards are in place.

Unethical top executives may be able to work around the governance system unless careful safeguards are in place.

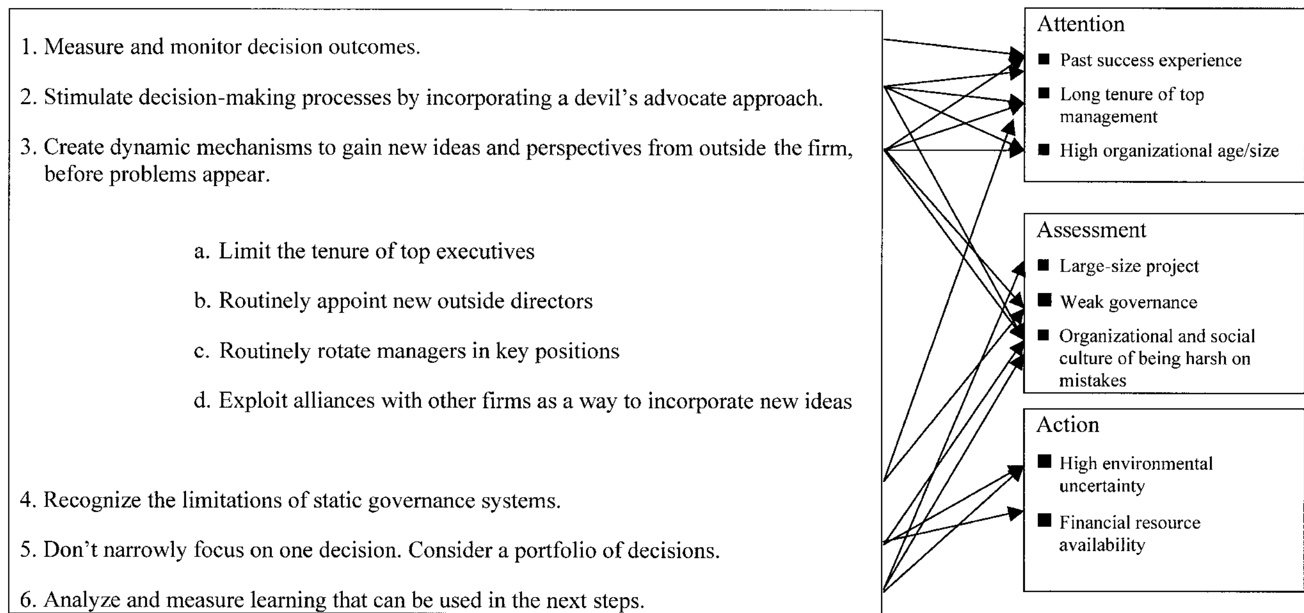
Recent proposals for a lead director and assurances of an independent audit committee on the board are correct steps. The separation between the CEO and board chair positions is also important. However, we recommend further actions to infuse additional dynamics into the board decision processes as well. First, as stated above, routinely appointing new outside directors can be beneficial. While static conditions in the board composition may be useful for monitoring and forestalling opportunistic behaviors of managers, long tenure can also result in a homogenization of perspectives, cognitive inertia, and entrenchment of the board. In fact, our research implies that relatively static monitoring by outside directors and investors has less influence on decisions to divest poorly performing units than do the arrivals of new key leaders and board members (i.e., CEO, outside director). Supporting this argument, finance researchers found that "appointment of an outside director is accompanied by significant positive returns, even on boards which are numerically dominated by outsiders before the appointment."[47]

Second, we recommend that processes be established to ensure that a devil's advocacy approach be used in board decision processes similar to the processes used by the top-management team to make strategic decisions. As a result, there should be some processes to ensure regular turnover on the board and, importantly, actions should then be taken to ensure that new members infuse the board with new ideas and different perspectives. Thus, incorporating a more dynamic view of board membership and processes can improve governance effectiveness and rejuvenate the assertiveness of boards of directors.

5. Do Not Narrowly Focus on One Decision. Consider Decision Portfolios.

If an organization has only one project and is dedicated to the project, it may be natural to continue commitment to the project despite warning signs of negative outcomes. In reality, most organizations have various functions and projects. Resources must be allocated across such functions as research and development, operations, and marketing, and multiple projects may be simultaneously active in each function. If the top managers ignore the existence of multiple projects within an organization and focus only on a particular project, they may not only risk escalating commitment to a losing project but risk underfunding more promising projects. Alternatively, if top managers consider projects as a portfolio of options, it is easier to compare multiple projects and prioritize them, while independently assessing a single project's potential and risks under uncertainty is much more difficult.[48] Even if a focal project seems to have potential, a decision to allocate resources to a more promising project will be easier using a portfolio approach. Meanwhile, if the focal project is truly more promising than other projects, managers can decide to maintain commitment and consider the next steps.[49]

While using a broader view may be difficult for middle managers because they are often dedicated to one project, top management should maintain a portfolio view of multiple decisions to effectively assess decision outcomes and allocate resources accordingly.[50] Although it is difficult for small or less-resourceful organizations to have multiple alternatives, using small trials as an experiment will allow those organizations to enjoy the similar benefits of having multiple alternatives.[51] Comparing multiple alternatives can also produce new ideas by, for example, integrating those alternatives. Thus, examining multiple alternatives can contribute to nurturing an organizational culture that encourages learning and knowledge sharing.



* Specific causal connections discussed in the text are shown with arrows. Other connections are possible.

FIGURE 2
Creating the Capability to Maintain Strategic Flexibility*

6. Analyze and Measure Learning That Can Be Used in the Next Step.

A real-options approach also suggests that a decision can be positioned to provide a base for the next step.[52] Because organizations are ongoing, one decision rarely determines their long-term success, especially under conditions of uncertainty. Instead of gambling on one or a few decisions in the short run, it is important to learn from decision outcomes and use the learning for subsequent strategic decisions or in the next steps of the focal initiative. Our research also suggests that past experience helps an organization to understand and initiate strategic changes such as divestitures.

As discussed, it is difficult to clearly predict future potential and risks and make major decisions under conditions of uncertainty. However, assessing the return on investment by incorporating the investment's learning and value can provide managers with a new perspective to help making difficult decisions. For example, when managers are faced with the unsatisfactory performance of an acquisition, considering the benefits of learning from the experience will help in making the difficult decision. If the organization has learned well from poor acquisition experience (i.e., they know the reason for the failure), this knowledge can be utilized in future acquisitions and the business can be sold. Alternatively, when managers think that poor performance results from ineffective integration but that they need more experience with integration to better understand what went wrong or how to improve the integration, they may delay making major changes (such as divesting the business) until adequate learning is obtained. Although measuring the knowledge learned is difficult, the organizational process of building knowledge has become critical to gaining and sustaining competitive advantages.[53] In fact, various strategic initiatives such as alliances and new business development include learning as one of the key objectives.[54] Moreover, vigorously analyzing learning can facilitate the development of an organizational culture that encourages sharing information and ideas including past strategic errors.[55]

Although measuring the knowledge learned is difficult, the organizational process of building knowledge has become critical to gaining and sustaining competitive advantages.

While Cisco Systems has experienced some problems over time, a substantial amount of its growth has come through acquisitions, and a reasonable amount of its success is due to the capabilities and learning it captured in these acquisi-

tions. Cisco Systems uses an elaborate process to integrate the acquired firm quickly into its operations. Furthermore, Cisco Systems takes great pains to avoid the departure of key personnel from the acquired firm because of the knowledge it could lose if they leave.[56] Often, however, learning is not easy to achieve. The Interpublic Group (IPG) made over 300 acquisitions in the span of five years (1997–2002). The expected synergies did not materialize from the acquisitions, and the firm now has substantial debt. The performance of the firm is suffering. In this case, the firm was so focused on making acquisitions that it failed to evaluate their performance and learn from them.[57] So, IPG failed to use our first and sixth recommendations.

Can a large, difficult-to-reverse investment such as a major acquisition be justified by the potential learning from it? The answer is probably "no." From the perspective of strategic flexibility, large and difficult-to-reverse investments are particularly risky. For example, such investment decisions are often affected by hubris, organizational politics, and significant uncertainty. This type of investment can be justified only when an organization has accumulated enough knowledge from its past experiences. Although a large acquisition is often characterized as a "once-in-a-lifetime opportunity," its potential is unlikely to be realized unless an organization is fully prepared. In this sense, managerial styles/approaches and an organizational culture that encourage learning from the initiatives are important not only for managing a focal investment but also for managing a portfolio of strategic decisions over time.

Can a large, difficult-to-reverse investment such as a major acquisition be justified by the potential learning from it? The answer is probably "no."

The key linkages of our recommendations to the contingencies in the three processes of attention, assessment, and action are depicted in Figure 2.

The Managerial Dilemma: Final Thoughts

We examined the managerial dilemma of balancing the need for change to minimize loss with the need for commitment to ensure that a strategic action is given adequate opportunity to be successful. It should be noted that the lack of change by top executives is not always because of opportunistic reasons. Steve Usselman, a professor at the Georgia Institute of Technology, argues that many executives suffer from a common malady: "habits of the mind." He suggests that it is often difficult for top management to develop a vision for the firm that departs from its current trajectory.[58] His observations match well with the arguments presented herein. Psychological and organizational biases often affect managerial attention, assessments, and actions in ways that prevent managers from recognizing and acting on a failing course of initiative in a timely fashion. Moreover, inherent uncertainty regarding the future potential of strategic initiatives often makes even effective managers hesitant to initiate a change quickly. This uncertainty suggests that it is difficult to make effective strategic decisions even when managers use an appropriate process to do so. Our recommendations should help to avoid or to heal the executive malady "habits of the mind" and help to reduce some of the uncertainty inherent in strategic decisions.

Given that new ideas are often a result of a recombination of well-known elements, this article provides new and practical implications to researchers and managers. These include:

(1) We provide a comprehensive set of challenges that managers encounter in maintaining strategic flexibility from the perspective of attention, assessment, and action. While research often focuses on the irrationality of decision-making, including psychological biases (e.g., escalation of commitment) and inertia, we go beyond the conventional boundaries, focusing additional attention on future uncertainty in reversing a strategic decision.[59]

(2) We explain that managers may be unconsciously trapped by various barriers to strategic flexibility at multiple stages. Corresponding to barriers in each stage, specific contingencies are presented for which managers need to be prepared.

(3) We present six recommendations as summarized in Figure 2. However the difficulty of maintaining strategic flexibility must be acknowledged; there is no panacea. Accordingly, rather than discussing "easy-to-state but difficult-to-accomplish" solutions, we explain the importance of being proactive and the risk of taking for granted the outcomes of prior decisions, offering specific actions that managers can take. We emphasize the importance of attacking structural issues that contribute to problems, rather than reacting to each problem on a case-by-case basis. The recommended actions can serve as a "wake-up call" for many managers by helping them to revisit their taken-for-granted assumptions, examine their current organizational structures and processes, and increase their preparedness to make effective decisions.

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