

Chapter
2
Strategic Thinking
as a Mantra

“The future ain’t what it used to be.”

— YOGI BERRA

BEING AN OWNER OR CEO is the ultimate responsibility in a business, and there are a host of emotions that come along with it. I have had business owners share the sheer joy of achieving success, riches and independence, and have seen others simply break down, petrified that they will lose it all.

Great management teams have candid conversations based on the brutal, unbridled truth. As a result, they are able to be more nimble. They can move towards new products, markets, methodologies and systems because they are not afraid of upsetting the apple cart.

One of the most important lessons I have learned as a trusted advisor to senior executives is that they appreciate candor. As a strategy practitioner, that means challenging the underlying assumptions about the business. I cannot afford to be politically correct; that is someone else's job.

It is often lonely at the top. Most senior executives have very few people to talk to. They are often unwilling to have crucial conversations with Board members and employees are unwilling to have crucial conversations with them. So, they talk to people like me.

It takes a great deal of emotional intelligence and trust to engage in open debate. The best leaders are also willing to fail. Proctor and Gamble CEO A.G. Lafley said, "You learn more from failure...but the key is to fail early, fail cheaply, and don't make the same mistake twice."

The most dynamic CEOs surround themselves with direct reports and advisors who are willing to challenge their thinking and take risks. The old school executives who are caught up in ego are not long for a world where irrelevance is easy to come by. To compete in today's environment requires a mindset where no product, service, department, employee or methodology is off limits.

Companies must confront the change that confronts them. The question that every senior manager should ask is, "Will our business be relevant a year from now?" The great Peter Drucker once asked GE CEO Jack Welch, "If you weren't already in this business, would you enter it today?"

Many senior executives live in fear because they do not believe they are in control of forces that could dictate their success or failure. And in fact, often they are not. Others live in denial that their sheer will is enough for their company to prosper, regardless of outside forces that could have a material effect on their profitability.

Best-in-class companies are externally focused and they are thinking about the future all the time. Amazon is an example of a company adept at finding white spaces (competing against noncompetition) while also expanding the markets they already serve. Amazon has an extraordinary record of making long term wagers that have paid off.

Amazon's founder Jeff Bezos has woven strategic thinking into the fabric of the company. "We are willing to plant seeds and wait a long time for them to turn into trees. The important question to ask is, is it big enough to be meaningful to the company as a whole if we're very successful.³ It helps to base your strategy on things that won't change."

When asked by Harvard Business Review about Amazon's service model, Bezos said, "It's that our customers who are buyers are very convenience motivated. We make it really, really easy to buy things. You can see that if you look at a metric like our revenue per click or revenue per page turn. It's very high because we're efficient for people."⁴ Amazon uses operational measurements to track execution against its core business strategy, which has been derived from customer insights.

"Do we have the will and the vision to be in the business that is replacing us?"

To maintain focus on long term initiatives, senior Amazon executives attend a strategic off-site annually and dedicate four hours every Tuesday to monitoring progress versus long term initiatives. As a result, Amazon did not just innovate in creating the Web distribution for everything from books and CDs to appliances, the company has engaged in a continuous wave of innovation, slashing prices, expanding selection and making shopping online easier. Kindle is revolutionizing the book business; much in the way that iPod did the music industry.

Disruptive innovation is rare because we form opinions based on our own biases. We defend our biases ruthlessly from any contradictory view. In politics, our views have become so polarized that many liberals will not even consider conservative points of view, and vice versa.

Yet the greatest thinkers in history, such as Einstein, Newton and Galileo, spent most of their lives consumed with finding evidence that would disprove their own theories. This seems counter to our thinking because of what philosophers refer to as "confirmation bias" or our tendency to seek out information that validates our opinions versus those that provide a counterargument.⁵

It may not shock you that as a strategist, my favorite board game is chess. One of the attributes that separates great chess players from poor

players is that the master will consider bizarre combinations of moves which will include the sacrificing of pieces to achieve checkmate. The novice will summarily eliminate these combinations from consideration because they cannot project far enough ahead to see the strategic advantage gained by creating any short term disadvantage.

The first five or six moves of the game played by white (the player that moves first) are somewhat scripted (known as a gambit). The master knows every possible combination of moves that the opponent will make to counteract the gambit. In other words, the scenarios are clear to him, and he knows exactly how to play them to secure the ideal positioning. By the middle of the game, he uses his vision and creativity to expose his opponent's weaknesses.

Creativity in business is hampered by both hard and soft barriers to change. We are trained in business school to mitigate risks. Thus, businesses systematically create functional departments such as accounting, sales and operations and give them the authority to protect their territory as a defense mechanism.

So how is it that the most brilliant business minds of our time, such as the leadership at Bear Stearns and Goldman Sachs, were completely ill prepared for the liquidity crisis? The answer can be found in a metaphor provided by Nassim Nicholas Taleb in *The Black Swan*, his witty deluge into "The Impact of the Highly Improbable"⁶:

"Consider a turkey that is fed every day. Every single feeding will firm up the bird's belief that it is the general rule of life to be fed every day by friendly members of the human race, looking out for its best interests. On the afternoon of the Wednesday before Thanksgiving, something unexpected will happen to the turkey. It will incur a revision of belief."

As Taleb points out, our body produces Dopamine which is proven to regulate the chemistry of the brain in such a way as to create patterns in our thinking which minimize randomness. In other words, we are predisposed to think of things in terms of recurring events, and it is alien for us to think of things that do not fit into a logical pattern. This is why we panic during disasters, not only because of the fear of the unknown, but

because our mind cannot reconcile events we have not experienced before such as an earthquake or car accident.

The only plausible explanation for the liquidity crisis and the giant sucking sound that followed is that contrary viewpoints about the stability of our systems and our markets were not properly considered, and that oversight cost our economy trillions of dollars and millions of jobs.

Humans are wired to attach ourselves to patterns that we expect to continue and we avoid open, frank discussions about what will change. It is not that we are merely resistant to change; it is that considering information that does not fit a pattern requires more energy for us to process. It is actually more strenuous to our body chemistry to consider alternatives.

Being on the cusp of the baby boom generation, about the worst things my peers and I experienced growing up were early memories of the Martin Luther King's assassination, the Challenger accident and perhaps the Boston Celtics beating the Los Angeles Lakers in the 1984 championship series (for the record, the Lakers got them back in '85 and '87).

People of my generation grew up with a relative level of stability. We are not accustomed to much variability, a concept that was rocked on September 11, 2001. It was not only the loss of life and the realization that sects of people hated Americans to such a degree that shocked so many of us: it was that we felt that the safety of our borders was threatened, a notion completely incongruent with the pattern we have known since we were young.

Upon reflection, 9/11 taught us a painful yet meaningful life lesson: we often don't understand the gravity of a situation while we are watching it unfold. When my wife first called me at my office that September morning and told me a plane had hit the World Trade Center, my initial reaction was disbelief. I remember uttering the words, "You mean like a small plane; like a turboprop, right?"

The consequences of the liquidity crisis were eerily similar. Most of us did not understand the magnitude of the problem until it was too late. There are enormous business ramifications within the concept of variability. We

can be lulled to sleep by our access to capital, the stability of our markets and the satisfaction of our customers.

In the pages to follow we will present ideas on how to reduce variability and the business risk associated with it.



Chapter 2 Review

- ❖ Human beings are wired to seek out patterns. It is human nature to be myopic and have biases that cloud our vision. Great leaders surround themselves with people who challenge their thinking.
 - ❖ Few companies innovate because they are not capable of challenging their own assumptions. Seek out people who are willing to make counterintuitive bets.
 - ❖ Well run companies employ strategic thinking all the time and dedicate time to long-term planning and execution.
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Chapter

4

The Strategist's Ace in the Hole: Scenario Planning

“The reason why most people face the future with apprehension instead of anticipation is because they don’t have it well designed”

— JIM ROHN

In his book *Inevitable Surprises*, Peter Schwartz points out that the Hart-Rudman Commission scenario plan “anticipated terrorists would destroy the World Trade Center by crashing airliners into it.” These forces are what scenario planners call predetermined elements, forces that we can anticipate with certainty because we already see their early stages in the world today. They are also going to surprise us because, while the basic events are virtually predetermined, the timing, results and consequences are not.”

Scenario Planning is a methodology where possible scenarios and potential tipping points are schemed and prodded. Scenario Planning is usually

precluded by a STEEP Analysis. In conducting this exercise, a catalog of conceivable **S**ocial, **T**echnological, **E**conomic, **E**cological and **P**olitical trends are assembled. Then the participants rank the probability of each predication and create the most pessimistic, and optimistic set of scenarios. The greatest probability is that the reality will fall somewhere in-between.

One could wonder, will we ever return to normalcy, or is normalcy a concept from a past era? Has volatility become the norm?

The once predictable business cycle has become highly disrupted. In just one decade, the U.S. economy has been mired with Y2K, 9/11, the wars in Iraq and Afghanistan, the Asian Financial Crisis (and Bird Flu), Katrina, Tsunamis, Mad Cow, Enron and WorldCom (and the madness of the Sarbanes-Oxley Act that followed), the U.S liquidity crisis, and triple-digit fluctuations in energy and raw materials prices. Volatility has become the norm.

That is why scenarios must be considered, debriefed and planned. It is beyond comprehension that Countrywide, IndyMac and other subprime lenders did not have a contingency plan for the possibility of a collapse of the U.S. housing market (which finally happened in 2007–2008), that U.S. airlines did not prepare for volatile oil prices (beginning in 2007), or that U.S. automobile manufacturers were not prepared for a spike in demand of fuel efficient cars.

The master strategist does not presume to know the future. Yet time after time, those companies who have thought through future events are more prepared for the inevitable. Strategic thinking cannot be done in a vacuum. To promote a strategic viewpoint, organizational structures, capital structures, company culture, etc. must be built from the ground up to support the execution of strategy and potential market volatility. The quest to understand the possibilities uncovers important learning about vendors, competitors, customers and markets.

Companies often make failed assumptions about what the market will bear based on our bias and emotions. For years, computer manufacturers have been trying to pack more features and speed into laptop computers, while trying to price them in a range slightly higher than desktops. Those

assumptions were challenged in the One Laptop per Child initiative (the goal to develop the \$100 laptop for children of developing countries).

Asustek, a Taiwanese computer maker, developed a stripped down Internet ready version of an ultra light computer, using Linux and a tiny 7 inch screen.⁹ In relative terms, the computer was slow, and had few applications.

The product was the antithesis of everything perceived as a need in the marketplace, and thus marketers were shocked that the early adopters of the product were middle class consumers. And thus the “Netbook” was born. It turns out that there are a lot of people who only require a single icon on their computer; the one with their Internet browser. Instead of hardware innovation trickling down from high end to low, a new generation of computers were established on the low end and then sold upstream to consumers who were thought to want more features.

Emotions govern our thinking on many levels. The electronic age has brought new volatility to markets, and has created a fertile environment for both arbitrage by institutional types, and droves of individual investors moving in unison to support some conventional wisdom about energy prices, gold, or the stock price of Intel or Apple. It is as if our economy is a large rubber band susceptible to large swings based in part on consumer confidence. Our tendency to overreact to stimuli is a form of collective euphoria or despair.

Our thinking often crystallizes around “the economic cycle” which cannot be evaluated independently. The economy is merely a component of a spider web of stressors that can be deeply affected by social, economic, cultural, political and military events.

U.S. history is riddled with periods of growth and decline steered by the mood of the nation. After the panic and fear of the Great Depression, and World War II, the United States settled into a period of profound optimism and growth. They were happy days in America, as the Wonder Bread/Leave it to Beaver era reigned in conformity and stability.

With scant warning, the JFK assassination inflicted a deep wound, a precursor to two decades of volatility and violence, as our nation slid into a deep funk. It took twenty years for the pendulum to swing back again. On the heels of the U.S. hockey team Gold Medal in the 1980 Olympics, Ronald

Reagan proclaimed “it was morning in America” during his State of the Union in 1984 alluding to the nation’s restored optimism.¹⁰

The Dow Jones Industrial Average shot up by a factor of eight times from 1982 to 2000 only to lose half its value between 2000 and 2008 as the market crashed again.¹¹ A similar bubble occurred in oil futures, with oil reaching \$145 per barrel in July in 2008, only to fall within a year to trade in the \$50 range. Clearly, bubbles represent investors overreacting to markets and accepting a new perception of normalcy and a different tolerance for risk.

In *Animal Spirits*, George Akerlof, and Robert Shiller point out that the 2008–2009 recession mirrored the two that preceded it (1991 and 2001) both in terms of the converging factors that initiated them, and the emotional response that followed.

In both cases, scandals mired the financial markets adding to the severity of the contraction. In the early 90’s the S&L debacle followed deregulation. In the form of the Resolution Trust Corp., the U.S. government took on the burden of bad Savings and Loan debt. During the recession of 2001, Arthur Anderson folded after failing to provide oversight in its audit of the defunct Enron, creating the impetus for The Sarbanes-Oxley Act of 2002. In 2008, history repeated itself.

Alan Greenspan’s reference to “irrational exuberance” was code for saying, you’re all crazy to be paying these prices for real estate and stocks, and the market is going to spasm. Greenspan himself got caught up in the fervor, allowing the credit market to overextend itself based on the false premise that poor controls on derivatives were acceptable as long as the underlying assets (housing prices) continued to increase.

In poker, once a player has made several bets to a hand, he will often seek to protect his emotional and monetary investment by continuing to bet, even though the odds are no longer in his favor. This is a tendency known as being “pot committed.” Whether it be investing in chips, oil or a new product line, our emotions can get the best of us.

Decision making should always be based on current and future realities and not based on past investments. The strategist must consider a complex weave of mitigating factors (internal and external) from an objective (non-emotional) standpoint.



During my travels on the national speaking circuit, I have had the opportunity to pose questions to over 1000 senior executives about their fundamental business issues. My modus operandi includes asking them what their most pressing business problems are.

Typically the same issues come up over and over:

- Margins are eroding
- My customers expect the best quality, the lowest price, quick turnaround time and outstanding service
- I can't build infrastructure fast enough
- I can't hire and retain the best people
- It is hard to hold people accountable to specific outcomes
- There is a disconnect between the people who build the strategy and those responsible for executing it

Global hyper-competition has brought about massive cost cutting (off shoring and outsourcing) and an emphasis on efficiency (lean manufacturing, Six Sigma). Cheap communication has shrunk the globe. The business environment is very challenging and at an apex, where it will become more difficult to create differentiation and fend off commoditization.

The concept of singular “business cycle” is a fallacy, as businesses are working within four distinct cycles:

Business Cycle — The ebb and flow of various economic factors including the stock market.

Monetary Cycle — The manipulation of money supply, currency fluctuations (and the effect on imports/exports), and interest rates by central banks (generally in an effort to balance inflation and unemployment).

Industry Cycle — Dynamic changes in supply and demand within an industry, often driven by disruptive innovations and technologies that change the competitive landscape. External factors can drive substantial change such as the effect that Sarbanes Oxley had on finance and accounting (regulation is often cyclical). In technology, waves of innovation are typical, as the case of massive investments that take place around the release of a new Microsoft operating system, or a new generation of wireless technologies (the next big technology wave will be a combination of these two innovations as new cell phone operating systems allow enhanced functionality).

Company S Curve — The familiar phases of growth and stagnation for companies as they outgrow their infrastructure, processes and talent.

Here is an example of how a hypothetical company might develop visual depiction of the future (it would be bad form to print an actual client's Futures Map, even with their permission):

Assume we have done significant research on behalf of the fictional Z Vitamin Company. A STEEP Analysis yields us the following variables and trends to consider:

- The company believes it can grow quickly while targeting the Baby Boomers who prefer natural products to prescriptions drugs for treating ailments such as high cholesterol, aching joints and Arthritis.
- After three years of losses, the company lost its credit line. The company is not yet bankable in any material way and will need access to capital to grow. Short term cash flow must be optimized.
- The company needs to create a call center, but with a lack of funding to hire full time people and a costly facility, the company has opted in the short term to create a virtual call center (a growth area in call centers for companies such as Jet Blue).
- Consumer research reveals that more than a third of the company's clients will respond to marketing that demonstrates that the company uses recycled materials.
- The company will employ a two-pronged strategy to acquire customers: Z Vitamin will launch an aggressive campaign to position as subject matter experts in consumer magazines and on television; the company will hire a medical doctor as their spokesman.
- A recent search engine optimization project (SEO) yielded unexpected results. The company believes augmenting its Internet offering with the call center will generate significant consumer direct volume.
- The company will lean out its operations and outsource large shipments to a supplier who can offer drop shipments of a single item at low-cost. The company will still ship the more complex orders and custom formulations but will need to do so more efficiently with a shorter cycle time.

The process for conducting a STEEP Exercise is described in Chapter 10. After conducting a STEEP analysis and other research, Z Vitamin could develop a Futures Map.

A Futures Map is a powerful instrument for communicating strategic vision to visual thinkers (about half of the population). Within one document, the strategist can communicate the goals of the organization and roadmap for achieving competitive advantage.

Here is an oversimplified example:



To interpret unrelated combinations of events, economic and otherwise, marks the DNA of a visionary. In October 2007, DuPont CEO Chad Holliday was visiting a customer in Japan, who complained of poor conditions there, and the effect declining demand was having on his cash flow. Upon his return to the U.S.

Holliday heard that automakers, (who order paint from DuPont only 48 hours before applying it to new vehicles) were dramatically curbing production.¹²

The Action Plan

In the absence of clear directives, everything is a priority. Often, mid-managers and front line employees are unclear about the organization's top priorities.

Before leaving any meeting (strategic or otherwise), there should be complete agreement on who will do what and when. The best action plans are developed and organized by initiative. If sorted by action item, it is easy to lose sight of the overarching initiatives you are trying to achieve.

An action plan can typically have two or three tiers. You can organize by initiative and action, or by strategy, tactic and action.

	Strategy & Tactics	Champion	Due Date	Assisted By
	Lead our industry in customer loyalty			
2	Goal: Achieve 75% retention by 2010			
	<i>Tactic: Integrate CRM</i>			
2A	Hire CRM Consultant	Tom	5/1/2010	Jim
2B	Complete integration of SalesForce	Tom	12/1/2010	Jim
	<i>Tactic: Survey Clients on Satisfaction</i>			
2C	Establish survey process	Phil	2/1/2010	Carol
2D	Acquire survey tool	Karen	4/1/2010	John
2E	Complete test of 50 clients	Karen	6/1/2010	John

KPI's/Scorecards

The majority of key performance indicators should be specifically linked to the organization's strategic initiatives. KPI's (as well as things like departmental goals and the performance management system) are outputs of the strategy. They are the numbers that measure the company's ability to execute. Companies with strong business intelligence absorb less risk, as the path to profitability is clearer.

Organizations are often overly reliant on commonly accepted financial metrics (a form of collective myopia). What is the metric that most people use to measure their fitness and attractiveness? They use weight, which is a flawed measurement because muscle weighs more than fat. Body fat is a much more accurate depiction of fitness, but weight is much easier to