Quick thinking

Weblogs (or blogs) are quite the Internet rage, but it's not easy to find good ones created for managers. **Freek Vermeulen's** blog (http://freekvermeulen.blogspot.com/) aims to attract readers to quick musings about business and strategy. Some edited highlights of his first postings follow, and we'll be eagerly awaiting his future thoughts.

Some time ago, I interviewed a guy called Farooq Chaudhry, a founder and producer of the Akram Khan Dance Company, which is a small but extremely innovative (and extremely successful) contemporary dance company. Farooq had several interesting things to say about creating an organization that excels in delivering continuing, successful innovation. One of them stuck to my mind: "In order to be truly innovative, you have to forget about your customer."

What? I don't know much about marketing (and would prefer to keep it that way), but don't these people always go on and on about "customer-focus", "client-driven innovation", "the customer always comes first", and so on? So I asked, "Farooq, do you perhaps mean that you should only have the customer in the back of your mind?"

"No, no, I mean, customers – just forget about them altogether".

Ok… what (on earth!) did Farooq Chaudhry mean? After all, this is one of the most innovative companies of its kind, since…well, like ever?

According to him, if you want to be truly innovative, you have to purposely not try to give the customer what he wants. Because, as he argued, if you set out to develop what you think the customer will like, you end up satisfying *existing* needs and tastes; you follow the customer rather than lead the customer. True innovation, according to him, is about changing the tastes of customers and giving them something that they have never seen or even imagined before.

Getting lucky – fortune favours the prepared firm

Once upon a time, there was a plumber, named Geoffrey Ward, who lived in London. One day a local government official told him he would have to vacate his workshop and office because it was located in an area reserved as a retail zone.

Geoffrey decided to place an old, slightly exotic-looking, artistically shaped radiator – which he had removed for a client because it was broken – in the window of his workshop, just to make it look like a shop. Yet, in the following days and weeks, people kept knocking on this door asking whether they could buy that funny-shaped radiator. Not for long, Geoffrey realized that he could have made quite a lot of money had he been able to sell such a "designer radiator" and decided to change professions.

This was how the company Bisque, who produce and distribute designer radiators, was founded.

Luck you say? Of course; but, as said before, many people don't take advantage of luck even when it is staring them into the face. Geoffrey did.

Andy Grove, former CEO of Intel, called it "strategic recognition capacity". He could have said "know it when you got lucky" (but I'm sure you agree that that wouldn't have sounded as fancy). Intel, which of course became one of the most successful companies ever by producing microprocessors, also got lucky. In the early 1980s, they were working on microprocessors when they did not have a clue what they would be able to use them for. They even made a list of potential applications – which had anything on it ranging from handheld calculators to lamp-posts. Yep, lamp-posts.

What was not on its list was: the computer. It was not until IBM kept persistently knocking on their door that they said "All right then, you can put our product in this thing you call a PC". Yet, was this all down to luck? Of course not, Andrew Grove and his partners recognized the opportunity when it came knocking on their door (in the shape of Big Blue's rather sizeable fist). But there's more to it.

"Fortune favours the prepared mind," Louis Pasteur famously said. He got lucky several times, making important yet serendipitous discoveries (such as a rabies vaccine). Yet, it was not mere →

→ chance that it was Pasteur who made these discoveries. First, he recognized opportunities that presented themselves to him; but second, he also had the skill, knowledge and ability to turn them into something useful. That required many years of careful practice and training.

Moreover, and importantly, he wasn't sitting in his kitchen waiting for lucky events to fall into his scientific lap. He was actively experimenting with lots of things. Most of them were bogus; others not. And that is what Intel did: running many experiments in the margin. Most of them failed and wasted money. But one sunny day, one of these experiments just might result into a thing called "microprocessors" and, believe me, you won't shed a tear about all the other ones that failed.

Management consultants – happy slapping

Is it just me or is it getting increasingly fashionable to dislike management consultants (but hire them anyway)? Now, I wouldn't say it is an entirely new fashion, but the loathing of the pinstriped mercenaries seems to be reaching new and unprecedented heights of late.

A short while ago, I was talking to three members in the top team of a British company who showed me the three main conclusions of their team's recent "strategy retreat"; and, believe it or not, one of the three was "no more consultants".

It is an unprotected profession and every idiot can call and list himself as a management consultant (and many do – I guess the remainder become professors). Yet, the reputable firms also seem to provoke a fair share of grunting, ground-spitting, and a wide array of hand gestures. Is it pure envy? Surely there must be some of that; being seen walking hand-in-hand with the CEO on way to an expensive restaurant for a PowerPoint presentation between the fifth and sixth course while overtly charging a couple thousand quid might do that to you.

Yet, there must be something more. Perhaps it is the fact the accountability of the consultant is knowingly nil; it is not that we withhold payment till the effects of the recommended strategy have become apparent in 10 years time (even if that were measurable).

Perhaps it is because everything they recommend has such a high value of *déjà vu.* Or perhaps it is because management consultants en masse recommended corporate diversification in the 1970s, a refocus on core activities in the 1990s, told "old economy" firms to keep their "new economy" activities as strictly separate entities during the dot-com bubble (but lately advise them to carefully integrate clicks and bricks), urged IT firms to get into consulting while currently stealthily de-merging them?

Surely you have both bad and good consultants. Just as you have bad and good clients. Consultants are undoubtedly more useful if you are genuinely open to hear what they have to say about your strategy. For example, ample academic research has suggested that bringing in an outsider's view can seriously improve the quality of decision-making (be it often at the price of slowing it down). Yet, hiring a consultant is, of course, no reason to stop thinking for yourself. As Richard Dawkins said, "It is good to be open-minded, but not so open that your brain falls out."

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"Today's fast-changing business environment"? – same as it ever was

Today's business environment is characterized by increasingly high levels of uncertainty and change. Ever read a business article that starts with a sentence like that? My guess is you have. It seems like every other management article I read starts with such a sentence. And it annoys me. Deeply.

In today's fast changing business world…
Many industries are increasingly characterized by rapid change…
High-velocity environments…
Increasing hypercompetition…

And so forth and so forth, bla bla, bla bla.

I know, it is slightly pathetic that something like this annoys me but it does. I guess it annoys me because people simply accept such statements as a given, as the truth.

But is the current business environment really so much more turbulent than 15 years ago when the world computerized, or when the Berlin Wall came down, or when electricity was invented? Somehow,

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I doubt it. But still, people always say that "the world of business is becoming increasingly volatile" (without showing me any evidence).

Fortunately, my fellow strategy professor Gerry McNamara, from Michigan State University, and two of his colleagues were equally annoyed. They analysed the financial performance of about 5,700 companies over a period of more than two decades, looking at measures such as performance stability, market stability, abnormal business returns, industry dynamism and munificence. And they found the following: nothing. Absolutely zilch.

Analysing 114,191 observations, starting from the late 1970s, they found that some industries may be turbulent, but no more turbulent than before. So, please stop telling me that "the world of business is increasingly changing fast". It is not. It is the same as it ever was.

Deal-eager executives – tribal instincts

Why is it that top managers often seem to become so gung-ho on acquisitions? Take Ahold's "fallen-from-grace" ex-CEO (now corporate convict) Cees van der Hoeven. Ahold actually started out with quite a careful approach to doing takeover deals; but, over the years, acquired itself completely out of control, like a Faliraki girl with a credit card in a Gucci store.

My guess is there are two causes of deal-eager executives. It is the type of person who becomes CEO and it is the type of person we make them. Let me discuss the first one with you.

An interesting line of research in social anthropology analysed what type of person is more likely to rise through the ranks to become the headman of a tribe. Often, this would be the most fierce, ambitious and aggressive warrior, who would be willing to take on all his opponents in the quest for leadership.

Yet, interestingly, although characteristics such as fierceness and ambition would be helpful in becoming tribe leader, these characteristics were not necessarily positive for the future of the settlement, since these type of leaders were prone to take the tribe to war. This would ultimately take its toll on the size, strength and survival chances of the tribe. Thus, the same characteristics that would make people more likely to become the head man, were likely to get the tribe in to trouble.

CEOs might not be all that different. Those people who are ambitious, risk-seeking and aggressive enough to be able to rise to the ultimate spot of CEO, just might be the same people who, once they're there, take their firm on a conquest.

Acquisitions offer the thrill of the chase. You select a target, mobilize resources and lead the attack. Sometimes there are others eyeing your prey, but skilful manoeuvring and a fierce battle will make you come out victorious again. And another victory means pictures in the newspapers, popping champagne, and a larger tribe to rule and command.

Most acquisitions fail – really

How about some hard stats on mergers and acquisitions (M&A)? You may have seen them before, but since I am sure you (still) don't believe them, here they are once more: 70–80 per cent of acquisitions fail, in terms of creating stock market value.

Three overview studies in the prestigious *Strategic Management Journal* showed that, on average, share prices of acquiring companies fall between 0.34 – 1 per cent in the 10 days following the announcement of an acquisition. And this is a result consistent over a period of 75 years of stock market data.

Another study, of 131 big deals (over $500 million), indicated that in 59 per cent of the cases, market-adjusted return went down on announcement. Hence, the stock market was positive about 41 per cent of the deals. Not an awful lot, but it could have been worse. Or could it…

After 12 months, 71 per cent of all those deals had negative consequences. That is, of the 41 per cent of cases in which market value went up on announcement because the stock market was optimistic about their potential to create value, only 55 per cent still had positive returns the year after. Thus, even the stock market initially had been way too optimistic. Even more deals ended up destroying value than they first had expected.

Yet, every time I show these statistics to a group of executives they frown and proclaim, "We know this, but it is not true for our company: we analysed all our deals and 2/3 of them were a success."

Yeah right.

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Thinking

→ But what really is the "analysis" that most of them performed? They have asked people in the relevant business units whether they thought the deal was a success. Now, if 1/3 of these people already overtly said no, I am pretty sure the acquisition was a disaster.

This leaves 2/3 of "non-disasters", which is not the same as a success. Perhaps another 1/3 did not cause major problems, as the integration went all right – but that does not mean that the (usually very expensive) deal actually created value beyond the premium that was paid. You might have been better off not having done the deal at all, despite having avoided a disaster.

So, believe me, 2/3 of acquisitions fail – yes, really.

Collective inertia – if you don't join them, you can beat them

Ever wondered why newspapers always had this ridiculously large, uncontrollable size? Perhaps when you were trying to read one in your garden on a sunny yet windy afternoon, forcing you to peel the pages of your face every annoying three seconds? Or, while reading one on the train and turning the page, smashing your elbow in a nodding neighbour's face? I did. Not smashing my elbow in anyone's face, but wondering why these pages had to be so bloody large. I simply assumed that it was much cheaper to print on large pages than small ones. Turns out I was wrong.

To my surprise, I found out that printing on large pages is actually more expensive than on smaller ones! Why did they do it then; are these *Times, Guardian* and *Daily Telegraph* people closet sadists, finding secret joy in giving us a daily struggle with inky pages?

Here's what happened: In 1712, British newspapers came to be taxed on the number of pages published. Editors then decided to print the news on enormous pages, and fewer of them, creating the broadsheet format. The original tax disappeared in 1855; but, despite being considerably more expensive, the format persisted.

As you may remember (if you're from London), a couple of years ago, after the free newspaper "Metro" entered the industry, the Independent was the first to abandon the broadsheet and "go tabloid". Their sales figures surged. Soon, *The Times* followed, and later also the *Guardian,* all to their benefit.

But why did it take so long – centuries? Had no one ever conceived the idea of printing newspapers on smaller (and cheaper) pages?

Sure, they had. Many times over the years someone would bring it up. But their associates would always dismiss the idea with comments like "no one is doing it" and, mostly, "the customer would not want it."

Yes we did.

I call this "collective inertia". Every existing player in the industry was afraid to break the mould and take the plunge. I have also learned, studying many firms in many different lines of business, that most industries have such a slightly strange, idiosyncratic convention that everybody adheres to but nobody really remembers why they're doing it that way.

But hardly anyone dares to challenge it. And that is where the business opportunity lies. If you're the first one to spot the silly convention (just to name a few candidates: buy-back guarantees in book publishing, detailing in the pharmaceutical industry, insane working hours in investment banking), and do it differently, it might just make you a heck of a lot of money.

And it would save many of us customers from a daily elbow in the face.

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It is ok to get lucky – even for a top manager

Let me tell you a story. A story of a company called Hornby. If you're British, you'll know them. You might even be feeling slightly nostalgic merely thinking about them. Hornby makes little model trains, and has been doing so for a very, very long time.

Ten years ago the company was nearly bankrupt. In an attempt to save costs, they decided to outsource production to China. However, much to their surprise, they discovered the Chinese not only produced much cheaper, they also delivered superb quality. Therefore, middle managers could not resist spending all the money that they were saving through the outsourcing on adding additional quality in their product designs and, most of all, a lot of extra detail: a working light on every table in the restaurant carriage, windscreen wipers on the locomotive, a bit of dirt (painted) on the bottom of the carriages. Their products became perfect scale models.

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Tunnel vision

Then, as much to their surprise as to their joy, they noticed sales increasing substantially. When it persisted, they started talking to their vendors to figure out what on earth was happening. They discovered that it was no longer fathers buying model trains for their children, but buying them for themselves (and in the process spending quite a bit more money on themselves than on their children). Inadvertently, Hornby had moved out of the toy market into the hobby market, producing for collectors rather than children.

Not long thereafter, Hornby was outperforming the FTSE dramatically, seeing its share price rise from 35 to 250 in just a few years. But what can we learn from a story like Hornby's? Isn't their smart change in strategy simply due to sheer, unintended luck? Well, partly, but that's perhaps the first lesson.

I find that many successful companies with great innovative strategies (for example, Southwest Airlines, Zara, CNN) experienced some significant element of serendipity at their inception. But we (and often, they) post-rationalize things as if it was all planned as such from the get-go.

But why? There is no shame in getting lucky. A great manager (such as Hornby's Frank Martin) does not necessarily come up with the strategy, but he is superb at recognizing the opportunity when it comes knocking on the company's door, while subsequently carefully adding all the other necessary strategic elements (such as marketing, investor relations and distribution) to take advantage of the opportunity. Just recognize the importance of luck rather than deny it – and make sure you gratefully take advantage of it. ■

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