STRATEGIC TRANSFORMATION

CHANGING WHILE WINNING

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PART I

What's the Problem?

Chapter 1

The Challenge of Change

Every decade has at least one: IBM in the 1980s, General Motors and Marks & Spencer in the 1990s, Dell, Nissan, Sony, BP, Toyota, and Nokia in the new millennium. The pattern is so familiar that it has come to seem inevitable. A company that is admired and respected as a paragon of its industry falters and runs into financial crisis. Hero becomes zero. Shareholders rebel, managers are sacked, and ultimately major change ensues. What is going on here? Why don't organizations see what's coming, or if they do, why don't they react until the 11th hour? Why does it take a crisis to induce change?

Success is a paradox. Naturally, success is ardently desired and pursued, then feted and envied when achieved. But along with the applause come invisible dangers. Not surprisingly, successful businesses, usually to the approval of shareholders, seek to build on their success; the impulse is to go on doing what they are good at, only more so. But over time their very success seems to blind them to the changing reality of their business environment. Imperceptibly, their picture of what is happening diverges from real events. They "drift;" indeed, in this book, borrowing from other studies, we refer to the phenomenon as "strategic drift." Performance declines, sometimes gently, sometimes less so, until the inevitable eventually has to be faced and radical change takes place.

This is of course a hugely inefficient and wasteful pattern of change. For customers, managers, suppliers, and workers alike, the damage is immense. Jobs, shareholder value, the supply chain, and the economy as a whole all suffer. Sometimes the business itself disappears, either being swallowed up by another or going out of business altogether. Gary Hamel calls this a third-world dictatorship model of change and adds: "A turnaround is a transformation tragically delayed – an expensive substitute for well-timed adaptation." If the pattern is indeed inescapable, it is also highly regrettable. So, is it inevitable? Some argue it is, that it is the natural evolution of businesses. Or is it avoidable? Can businesses both build on their success and also transform the basis of their success? Before going any further, we need to dig a little deeper into these issues.

THE PROBLEM OF STRATEGIC DRIFT

Why is our research important? We believe that it raises major questions about the received wisdom that managers use to guide responses to one of their most significant challenges: managing strategic change.

Not surprisingly, most company strategies are based on what has been done in the past – especially if it was successful – and change only gradually. For example, for decades until the early 1990s, Sainsbury's formula of selling superior-quality food at reasonable prices made it consistently one of the top-ranking retailers in the world. Under the patriarchal guidance of a succession of Sainsbury family chief executives, it steadily extended its product lines, enlarged its stores, and widened its geographical coverage, without ever deviating from its tried-and-tested methods – refusing to branch out into clothes or other non-food items, for example. Most successful businesses resemble Sainsbury's. They go through long periods of relative *continuity* during which established strategy changes, but only *incrementally*, building on what has been successful in the past.

Without necessarily being conscious of it, firms develop a "dominant logic," a way of doing business, unique to each, around which all the different aspects of the business tend to cohere. It is "a way of doing things around here" that is at the same time a major asset and a major potential liability. The benefit is that those who work in it, or indeed deal with the organization, know where it is coming from and how it operates. The approach may have been the foundation of success in the past. The disbenefit is that it can be so dominant that it not only crowds out any other way of doing things, but also denies or smoothes out contrary evidence, with the result that the dominant logic remains unchallenged. What was previously a source of strength becomes the opposite – the invisible bars of a prison from which it is very hard to escape.

There are good reasons why this should be so. It does not make sense for strategy to change faster than the markets in which a company operates. Why should managers change a winning formula, especially if it is built on capabilities that have yielded advantage or innovation in the past? Clever managers may have learned how to spin variations around their successful formula, in effect experimenting without moving too far from their comfort zone or capability base. So they will argue with some justification that their organization is in fact changing.

The tendency, then, is for strategies to develop incrementally on the basis of the dominant logic of businesses, but to fail to keep pace with a changing environment, a tendency that has been described as "strategic drift."[1] Problems do not arise because organizations fail to change *at all*, but because the rate or nature of change of strategy lags behind the rate of change in their environment. Thus, while Sainsbury's continued on its well-trodden way, rival Tesco, starting from a much less successful base, was developing much larger stores with a wider range of goods, including non-food. It was also modifying its distribution logistics and supply chain. There was no single point in time when Tesco "changed." The modifications took place over many years – and Sainsbury's managers were well aware of them.

So changes in the market do not need to be dramatic or invisible for drift to occur. The problem was that, as with many organizations, Sainsbury's strategy failed to address the changes. Why not? There are several contributory reasons.

A common management mantra is that managers should "stick to the knitting," that is, focus on their core competences and stick to doing what they know best. It sounds plausible (remember that "sticking to the knitting" was one of the attributes of Peters' and Waterman's excellent companies in *In Search of Excellence*). The snag is that sticking to the knitting can easily develop into corporate sclerosis or what Dorothy Leonard Barton[2] calls "core rigidities." If managers do only what they know best, there comes a time when core competences become so taken for granted, so ingrained, that they are impossible to shift even when they become redundant.

As an example, consider how Sainsbury's decades of postwar success came to be identified with CEO John (now Lord) Sainsbury, whose empathy with customer needs and intuitive understanding of the details of retailing were legendary. Not only were these skills tacit, but managers, staff, and even retail analysts took for granted that they would be enough to sustain the fortunes of the business into the future. Imperceptibly, taken-for-granted ways of seeing and doing things take root in an organization's culture. Core assumptions, organizational routines and structures, even the stories people tell each other, all cohere to reinforce "the way we do things around here." So the Sainsbury way was not just a matter of the formalized buying and distribution systems, or even the undoubted centralized power wielded by John Sainsbury. It was also enacted in his legendary retail "feel," his attention to detail, his ritualized store visits, the stories staff told about them, and the expectations that they read into them.

In these ways, an organization's historical legacy comes to weigh heavily on the present. This is encapsulated in the idea of *path dependency*, where formative early events and decisions establish "policy paths" that effectively condition the future,[3] sometimes trumping apparently superior present alternatives. Cadbury was profoundly influenced by its Quaker origins. The founding ethos of Sainsbury's to provide value for money and good quality endures to this day. Early decisions about how the Dutch and the British would work together in Unilever, not least in the top executive team, indelibly marked the company's character over decades. Not surprisingly, whether consciously or not, firms develop strategy – which markets and segments to enter, how to build their infrastructure, where to diversify – around path-dependent capabilities that gradually become second nature. Strategies themselves become so deeply grooved that there seems no more possibility of an alternative than there is for a needle on a gramophone track. Thus, in sum, do businesses, not least successful ones, come to be captured by, and victims of, their own dominant logic[4] – a tendency graphically described by Danny Miller as the Icarus Paradox?[5]

The way in which individual managers perceive the world can also contribute to an imperceptible drift of strategy away from reality. We are all "boundedly rational" – that is, we can only operate within the limits of our knowledge and experience. More formally, we make sense of the world by applying that knowledge and experience in the shape of mental models, beliefs about the way the world works that function as a kind of pattern recognition system allowing us to relate present problems to past events and interpret one in the light of the other. This has major advantages – indeed, we couldn't function without such models. But there are downsides too. By definition, models are simplifications of reality, rules of thumb that enable us to use partial knowledge to interpret complex situations. The danger of "selective attention," as it is called,[6] is that managers use the wrong simplification, or alternatively that they apply the same one to every situation (to a man with a hammer every problem is a nail …), in effect editing out information that does not fit the model. Unfortunately, this sometimes leads to severe errors as managers fail to pick up crucial indicators because they are scanning the environment for known issues rather than unknown ones.[7] All this will lead to a bias toward continued incremental strategic change.

To continue the Sainsbury story, as Tesco prospered, Sainsbury managers clung to the conviction of their own superiority on the grounds that they were doing better in terms of sales per retail square foot – their traditional yardstick of success. Tesco was by then changing the nature of the game by building much bigger stores. But Sainsbury's chosen measure gave it no cause to alter its tried-and-tested strategy, or the unshakeable conviction that it was in little danger from what it saw as a downmarket rival offering inferior products.

Office politics and power games can also play a part in entrenching individual positions and fostering compromise around existing strategy. Together, these are powerful forces. Just how powerful is shown by well-documented cases in which managers have been aware of market shifts, well positioned to take advantage of them, even intellectually conscious of the need to alter strategic direction, but still unable to do so. Take, for example, the story of Motorola.[8] Motorola's success was built on innovation bubbling up from a wellspring of technological expertise. In the mid-1980s it was the world leader in analogue cell phones, a logical progression from the military walkie-talkie systems it had developed after the war. By 1994 it had a whopping 60 percent share of the US cell phone market. However, that decade saw the arrival of mobile digital technology, which offered clear advantages over analogue including better reception and security, clearly setting the scene for the development of a mass market. Sure enough, consumer demand for digital phones exploded; Motorola, claimed CEO Robert Galvin, "was at the forefront of the development of digital technology." Yet it chose to stick with analogue for years, lucratively licensing its digital technology to Nokia and Ericsson instead. Incredibly, even when increasing royalties were telling it in the most direct fashion that digital was taking off, and wireless carriers were pleading with it to develop digital devices, Motorola launched and aggressively promoted a new analogue phone. From a once-dominant position, by 2008 the company's share of the global handset market had sunk to 23 percent, and it continued to shrink.

To make matters worse, the significance of shifts in the marketplace may be easier to spot *in hindsight* than at the time. Managers will understandably hesitate to alter a winning strategy on account of what seem initially like blips or fads, or a temporary downturn. Then, by becoming more efficient, cutting costs, or making acquisitions, the company may ironically for a time hide the reality of strategic drift from itself, as well as from investors and observers. At Sainsbury's, shareholder returns continued to grow year on year well into the 1990s. Only subsequently did it become apparent that growth was latterly in effect an overdraft drawn against the future, only achieved at the expense of reinvestment in the business infrastructure.

MANAGING CHANGE

Airport bookshops are full of tomes that assume that strategic change is rare and radical, interspersed between long periods of inactivity. In these accounts, change management is all about overcoming core rigidities and crafting quite new ways of seeing business realities, often in the face of actual or impending financial crisis. Such narratives almost always privilege stories of heroic change leaders who step in to rescue the business and single-handedly reshape it for a new era of prosperity. All too rarely do they focus on what might be called the real challenge of managing strategic change, which is to ensure that transformation occurs while the business is still ahead.

Whether in academia or the business press, a kind of fatalism rules. Firms are born, and some will prosper; those that prosper will eventually be subsumed into their own overdominant logic and succumb to drift; shock treatment will bring some round, but others will fail and go under, eventually spawning new businesses, and so the cycle goes on. But is this cycle really inevitable? Can there be major strategic change without financial crisis? Are there examples of firms that have remained successful by continuously transforming themselves at the same time? If so, what is different about them, and how have they done it? Could their lessons help companies to avoid the perils of strategic drift and the value-destruction of lurching, crisis-induced change? The stakes are high. This book sets out to provide some answers.

MANAGEMENT CONSEQUENCES AND IMPLICATIONS: RECEIVED WISDOM AND SOME QUALIFICATIONS

If left to themselves, the tendency for companies to drift away from strategic "true north" is unavoidable, and managers should presumably be taking action to counteract it. However, some of the assumptions they use to guide them in this search may be questionable – and the questioning in turn points to some of the findings and arguments we develop in subsequent chapters of the book. To put those findings in context, we need to understand the main lines of conventional thought, which we outline below.

Managing strategy is about the future … or is it?

Fundamental to the concept of strategy is that it looks toward the *future*. Popular management writers Robert Heller and Edward de Bono head their web page with the strap line: "Forget the past and aim your future strategy toward a clear end result." A common critique of managers is that they are hidebound by a past that prevents them from exploiting opportunities that may arise in the future. Consider the two main tools used by managers in thinking about strategy.[9] By far the most common is SWOT – assessing a company's strengths, weaknesses, opportunities, and threats. In so far as the past plays a role here, it is in the identification of, perhaps, strengths but certainly weaknesses. It is the future where the opportunities and maybe the threats come from. The second most popular tool is scenario-planning, which is at bottom a means of opening managers' eyes to the possibilities of different futures. The dominant view is clear: it is here, in the future, that opportunities for strategic breakthroughs lie, and it is on here that managers should learn to focus.

Yet this future-facing orientation ignores powerful grounds for thinking both that the past matters and that history is far from being an exclusively negative influence. "Anyone who wants to design for the future has to leaf through the past,"[10] reads a caption in the BMW Design Museum in Munich. The museum may be about the history of BMW, but one of its lessons is that the past is a fertile source of new ideas and innovation. As if to emphasize it, the firm has sited its innovation and technology division adjacent to the museum and the company archives. Research evidence, too, tends to support the common-sense idea that innovation often stems from capabilities inherited and nurtured from the past. As technologies change, firms possessing accumulated relevant experience and skills tend to innovate more than those that are not so equipped.[11] Alternatively, capabilities built up in related technologies may yield new combinations of knowledge as they are adapted in innovative ways to new technological opportunities. For example, the development of lighting systems was derived from the way in which gas was distributed.[12] In the same way, the TV industry was developed by radio manufacturers, not by firms starting with a technological blank slate.[13]

Implicit in the influential resource-based view of strategy is also that the past matters. In this view, competitive advantage lies in an organization's competences – sometimes referred to as "intangible assets" – that have accumulated over time and become embedded in an organization's culture. Managers should deliberately seek out opportunities that fit and build on those competences. But how easy is it for managers to take an objective, dispassionate view of these invisible resources? What we know about core rigidities, cognitive bias and organizational politics – indeed, strategic drift in general – suggests that such objectivity is problematic. Indeed, as enthusiasts of the resource-based view themselves acknowledge, there is an even knottier problem. A firm's historical culture can only be a source of competitive advantage if it is valuable, rare, and difficult to imitate. If it is easy to assess and manage, anyone can do it and it confers no lasting advantage. But the logical extension of this is that the most difficult competences for competitors to obtain or imitate are those that managers themselves do not explicitly manage, that are taken for granted – and this takes us back to the argument that it is these which are likely to become "core rigidities."

The overall lesson seems to be that managers need to be able to see the past in relation to the future and challenge one against the other – to ask what is relevant from the past that can help with the future, but also what the future demands but does *not* require from the past. At the same time, they must constantly be posing the question of how far environment and market changes are playing into the hand of their path-dependent capabilities – or not, as the case may be. In other words, managers need to develop a sensitivity not only to the historical capabilities that matter, but also to their relationship to an evolving environment. Less clear is how they can do this.

Build dynamic capabilities … based on what?

Another idea put forward is that a business's competences or intangible assets should not be thought of as static, as the resource-based view tends to assume. In a turbulent environment, or one in which the pace of change is accelerating, it is *dynamic capabilities*, or the capacity to *renew and recreate strategic capabilities* to meet the needs of a changing environments, that are key to success.[14] Dynamic capabilities can range from the relatively formal, such as systems for new product development or procedures for agreement on capital expenditure, to the informal ability, say, to speed up decision-making when a quick response is needed. Capabilities might include strategic moves, such as acquisitions or alliances as a means of learning new skills, or "organizational knowledge" embedded in the culture of the organization about how to adapt to moving circumstances, or how to innovate. So here again we meet the idea that capabilities that endow competitive advantage are lodged in the collective, accreted experience of people in the firm over time.

Some believers in "hypercompetition" go further, arguing that change is now happening so fast that the pursuit of sustainable competitive advantage is a chimera, and a dangerous one at that, diverting attention as it does from the reality that the only advantage is the ability to change more quickly than one's rivals – in other words, dynamic capabilities on steroids.[15] Less clear in both cases, however, is where the origins of such dynamic capabilities lie and how the latter might account for their positive impact, as opposed to the harmful influence exercised by other legacies of the past. This is perhaps not surprising: very few studies have attempted to uncover and explain such origins and their influence, and those that do have concentrated on the present rather than the past, and do not look at the promising but difficult-to-research informal and behavioral aspects of organizational life. So we end up with an interesting concept, but one that is not very useful in answering the question, “OK, so what do we do now?”

Organizational learning and the “learning organization”

The same objection applies to the related concept of the “learning organization”: the idea that organizations should regenerate themselves from within by continuously adding to and exploiting the knowledge, experience, and skills of their members around a shared purpose or vision.

The learning organization is a conscious challenge to the traditional conception of organizations as hierarchies and bureaucracies set up to achieve order and maintain control, for stability rather than change. Advocates of the learning organization[16] argue that the collective knowledge of all the individuals in an organization far exceeds what the organization itself “knows” and is capable of doing (“If only IBM knew what IBM knows”). One reason is the formal organizational structures that prevent the exchange of such knowledge and stifle creative responses to change. To loosen these constraints and improve responsiveness to opportunities and threats, it is preferable to think of organizations as social networks[17] rather than hierarchies, where different interest groups cooperate and potentially learn from each other, lessening the common risk of ideas arising in one part of the business fizzling out as they meet indifference or hostility elsewhere. In this process, managers would play a less directive and more facilitative role. The learning organization, then, is one inherently capable of change as it exploits a capacity for continual *organizational learning*.

Central to the idea of organizational learning is the need to recognize the value of multiple sources of strategy development within a context that is sensitive to them. Such a context is likely to be:

- *pluralistic*, surfacing and welcoming different, even conflicting, ideas, and making them the basis of debate. There is an emphasis on the importance of questioning and challenging received wisdom and custom.
- *experimental*, so that ideas are tried out in action and in turn become part of the learning process.

- *tolerant* not only of new and perhaps contradictory ideas, but also of the inevitable blind alleys and errors that following them leads to.

There are, however, at least two problems with organizational learning as advanced in the literature. The first is, does it actually exist? The logic seems to arise more from disquiet with traditional concepts and workings of organizations than from firm studies of what might work better. Given this, the second problem, unsurprisingly, is that it is unclear what organizations actually do to become learning organizations. In other words, organization learning looks more like a “wish list” than a practical guide to management action.

There have been a few management scholars whose research points toward the benefits of organizational learning and suggests ways in which this might occur – but they are few. For example, in the 1980s James Brian Quinn acknowledged that managers mostly manage strategy incrementally. They typically change by building on and amending what has gone before. However, he pointed to the potential benefits of this, arguing that in successful firms this took the form of what he described as *logical incrementalism*.[18] Managers in such firms have a general rather than a specific view of where they want their business to be in the future. Faced with the futility of attempting to reduce the uncertainty of the future by making accurate predictions, they try to stay attuned to environmental signals by testing changes in strategy in small-scale steps – building on acquired experience but also experimenting with “side-bet” ventures. This, then, is a positive view of incremental change – “a conscious, purposeful, proactive, executive practice,” in the words of James Quinn.

In many respects, both the idea of dynamic capabilities and the learning organization also correspond to the call by Gary Hamel for “resilient” organizations that continually reinvent themselves by refusing to take their success for granted and building the capability to imagine new business model.[19]

It’s down to good leadership

What emerges from all this is that the succesful management of strategy is indeed demanding. It is not enough for managers to be acutely aware of the – often hidden – legacy competences their organization might use to build competitive advantage in the present. They must also create or nurture dynamic capabilities – that is, the ability consciously to modify these organizational competences and thus construct new bases of compet-