Ashridge Strategic Management Centre
Minutes of Members Meeting

28th November 2018

In attendance

Paul Barrett	Babcock
David Bowerin	Citigroup
Ricardo Filipe Carvalho	Sonae
Tom Ford	Rolls Royce
Philip Meyers	ABF
Lydia Ogilvie	National Grid
Patrick Scherrer	Helvetia Insurance
Leo Shapiro	Independent Consultant
Richard Torriani	MCI Group
Tassos Vlassopoulos	IMI Critical Engineering
Colin Wickenheiser	Shell

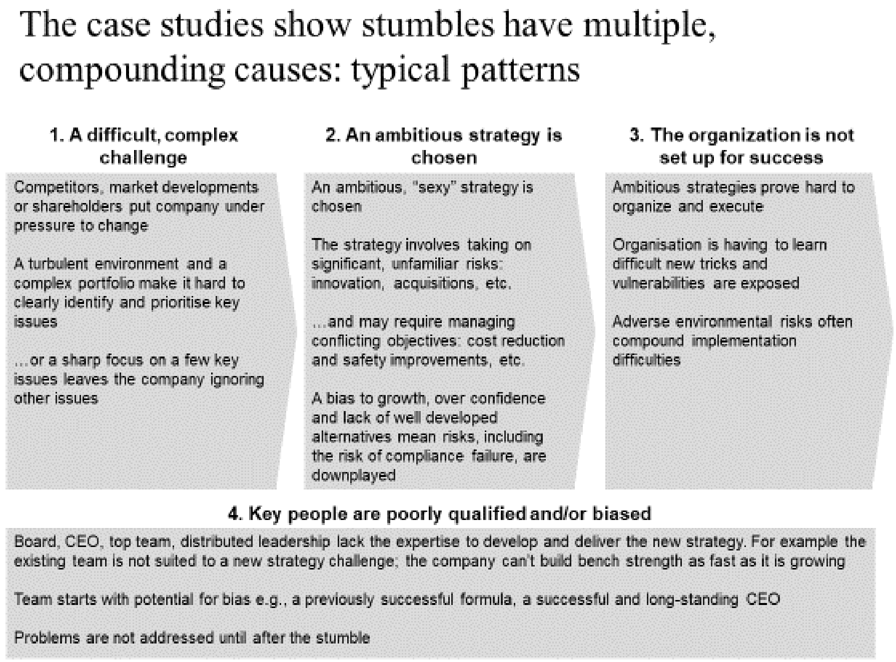
From Ashridge Strategic Management Centre

Felix Barber
Stephen Bungay
Rebecca Homkes
Neil Monnery
Jo Whitehead

Introduction to Stumblers

Research carried out by Felix and Jo of 268 large companies over a 10-year period showed that about 20% of them suffered a 'stumble' leading to their value dropping to 25% below the local index and the loss of the CEO. The original dataset has since been complemented by two questionnaire surveys, one about corporate planning processes and the other about techniques used to manage strategic risks.

The overall findings suggest that although there were usually multiple compounding immediate causes, a failed growth strategy was the prime or a major contributory cause in 84% of cases. They usually involved a company finding itself under pressure to take on a difficult, complex challenge, which led it to choose an ambitious strategy with a bias to growth which involved taking on significant unfamiliar risks. The organisation lacked the capability to deal with them, making it overstretched and vulnerable, and subsequent events exposed its weaknesses, resulting in failure:



Tesco was cited as a classic example of this pattern. The surveys further highlighted the role of the executive team and the CEO in particular as critical factors, and the bias to growth as a major concern.

One member asked whether this is only clear with hindsight or whether anyone in a similar situation dealt with it differently. There were in fact some companies which reacted to warning signs. Other cases show warning signs being consciously ignored. For example, BG knew it was expanding its portfolio without the capabilities to deliver the production from existing assets required to sustain its overall growth, but carried on without solving the production problem in order to remain a high-growth stock (and then stumbled because of a number of shortfalls in projected production).

Jo asked Members whether the pattern laid out above describes any stumbles they might have experienced.

One Member familiar with the brewing industry contrasted the slow and steady progress of Heineken with Anheuser Busch Inbev's acquisition of SAB Miller, bigger than any it had made before, which led to a significant loss of value. However, the database covers a wide variety of cases, and it is difficult to find common themes. For example, disruptive technology plays a role in some of them.

Jo and Felix responded by saying that disruptive technology only played a role in 7 out of 45 cases. The biggest group were companies with solid, stable businesses which took a big bet of their own free will. It is these cases which they are discussing here.

Another Member who had been at GE reflected that even this much-fêted company was currently facing its biggest ever stumble, and a push for growth was one feature of it. Problems had been building up for years, marked by $100bn of acquisitions in unfamiliar areas, some of which were divested at a discount. GE Capital was aggressively expanded until 2008 but was divested in 2015.

New tech companies show a different pattern. Different pressures arise because of the unfamiliarity of products, the market, the value proposition etc.

One Member asked whether lack of differentiation was a factor in the stumbles. Jo suggested that one implied lesson was to understand what you are really good at and focus on that. Goldman was criticised for not growing its retail business in the way that Morgan Stanley had, but its core competence is risk management, so refusing to follow the crowd was probably wise. Goldman has avoided any stumbles.

The case of Tesco suggests a similar conclusion. It was an extreme example of simultaneously firing every gun for growth. Whilst they were big enough to pursue multiple initiatives, they tried to do too much at once and took their eye off the ball. Terry Smith has argued that the warning signs were apparent more than 10 years ago. In the Leahy years (1998 – 2011) when Tesco was widely held to be highly successful and indeed became the largest UK supermarket, its ROCE declined from 19% to 10% and EPS growth was only supported by a vast increase in borrowings, from £894m to £15.9bn.

Ways to Reduce the Risk of Stumbling

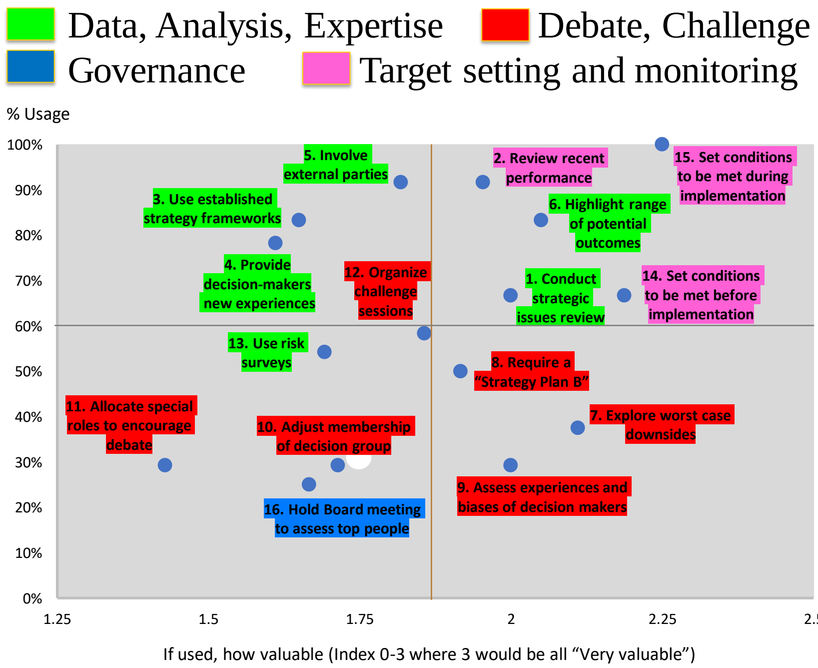
The four-box model above suggests a set of mitigating steps which can be taken to cover each box, starting with the strategy process. One Member suggested that there might be a 'Box 0' which avoids getting in to the situation where management is facing a difficult complex challenge and so under pressure to grow, and it would be interesting to explore that. The answer might be to adopt the principles of managing for long-term value.

If you are in Box 1 of the slide above, the following issues arise:

The planning process could be supplemented by additional measures which are occasional deployed, but are far from common. They include:

> The use of ‘markers’ to identify the highest risks. They were presented and discussed at the 2017 meeting on stumblers and briefly reviewed. They include factors such as moving away from the core business. Bain Capital use a set of markers to help them decide on their investments, although these require some knowledge of the company;
>
> Changing the profile of the Executive team to match the current challenges, or only accepting challenges which match the existing team’s capabilities. For example, the new CEO of GSK has hired new people to add relevant experience she herself lacks. The surveys suggested that top teams were critical, so Jo and Felix have developed an ‘Emperor’s Clothes’ test to act as a structured assessment of top management capability, containing questions with a simple ‘yes – no’ answer rather than general judgements.

There are then further sets of techniques which do not involve changing the team, analogous to the way to counteract ‘Red Flags’ as described in Jo and Andrew’s book ‘Think Again’. Jo and Felix have conducted a survey asking about the usage and value of sixteen representative techniques. Both usage and value varied widely. The techniques can be grouped into four broad categories as below:



According to the survey results, the most used and successful of the techniques enumerated (numbered 1-16 in the above slide) were ones concerned with setting targets and monitoring (in violet). Although they are often used to manage execution of already agreed strategies, it should be possible to use them when developing a strategy. For example, it would have been possible to use them to create 'gates' in the process of RBS' disastrous acquisition of ABN Amro, but they were not. They in fact tend to be used more in less critical situations.

The use of further data and analysis (in green) is very common, but has mixed results in countering biases. Doing so requires further debate and challenge, but these techniques (in red) are less frequently used and are also of mixed value. This may be because the strategy team lack the facilitation skills to make them work. The most effective of them is exploring worst case scenarios (number 7).

It was suggested that it is hard for an ExCo to get committed to a strategy and at the same time keep enough distance to challenge it. One way the military deal with this is their process for monitoring execution, whereby one staff officer's job is to concentrate on whether the team is trying hard enough and another's job is to question whether the plan is still valid. The reviewing officer can then withdraw with the pair of them to consider both aspects.

The only governance technique we included (in blue), in the form of Boards assessing the top people (number 16), is rarely used and not very effective.

A general problem is that companies have clear technical standards for assessing project risk, but there are no standards by which to assess the quality of a strategy. Another is that there can be little incentive to invest the time needed to use these techniques unless the company has already had a bad experience. Unfortunately, those companies most likely to need them are ones which have had a run of success and are therefore vulnerable to hubris. Culture plays a role here. Sometimes a potentially valuable technique can fail because of cultural factors such as deference to hierarchy. In one company the results of a wargame which revealed weaknesses were undermined by a senior manager who felt humiliated by having made several mistakes during the game. In other cases, wargames, being focussed on the dynamics of strategy which are otherwise hard to assess, have revealed risks from competitor activity and the need to muster a broader mix of skills in the team.

Interviews conducted in conjunction with the survey indicated some ways of improving the chances of a positive result:

Interviews suggest a number of tactics to boost focus and value-added and reduce resistance

- **Focus**
  - Introduce only when technique is of clear relevance; "I couldn't have suggested using this technique a year ago but now everyone sees the importance of understanding this risk
- **Value added**
  - Combine engaging activity to engage with biases and in depth information and analysis
  - Use to improve the business case (not just knock it down)
- **Resistance**
  - Adapt tools to focus on critical biases e.g., pre-designed wargaming offsite
  - Position new techniques as enhancement/extension to techniques already in use
  - Hold informal discussions with key actors to test and build the case for new techniques
  - Conduct early issues analysis to establish need for further attention to risks; "…before people adopt particular positions"
  - Apply techniques informally e.g., as a thought experiment, in conversation with members of the senior team
  - Apply techniques within the strategy team and bring the results into senior team discussions
  - Let others come up with the idea of introducing a technique by asking e.g., "What would we need to know to understand the downside and whether we could manage it"
  - Use the authority of the CEO (judiciously)

Members were then invited to reflect on techniques that they themselves had found to be particularly valuable:

- Talking to members of Exco individually, which allows them to be more open;
- Finding someone who is willing to push back;
- Being explicit about precisely what question you are asking and what decisions you need to take;
- People with strong biases do not react to data, so getting them to change their minds takes many iterations;
- Using wargames to allow people to discover answers for themselves. If the strategy function produces answers they are

rejected, so we use wargames every year, usually at the operational level. Each wargame ends with a set of actions to be taken;

- We work at two levels: sets of principles and guidelines. We then identify specific parts of the business which are not consistent with them;

- There are usually conflicts between individuals, so we try to foster debate until we get a shared common understanding;

- These techniques can be helpful with a lot of people, but the real problems are caused by people who are either very conservative or cowboys. They need the techniques the most but are least likely to use them.

There was some discussion of how it might be possible to avoid pressure for growth in the first place – is there a Box 0? People are often made hostage to their own promises, but it is not clear that analysts actually want to hear a growth message as opposed to a value one. Low growth is counter-cultural for most, and value tends to be equated – wrongly - with growth. Brokers were upset when W H Smith launched a value strategy which involved negative like-for-like sales. The strategy is now in its 13th year and W H Smith is one of the highest value retailers on the stock market. The tobacco industry tried and failed to find sources of growth for many years. When they gave that up and generated cash, they all became top-quartile performers.

Based on the discussion so far, Jo invited Members to form groups and discuss a strawman proposal which could form a basic toolkit to reduce the risk of stumbling, analogous to the practice of PE companies. The starting proposal from Jo and Felix was the following:

Strawman strategic risk management process

- **Integrate risk management in annual Board review of strategic issues and assumptions (T1+)**
  - Ensure awareness of the significance of stumbles (e.g. using article draft)
  - Review “Risk markers” (incl. T3) and carry out “Emperor’s clothes test” (T16)
  - Use wide range of inputs to challenge and update key assumptions and surface key issues (T4,T5)
  - Serves to set agenda for corporate strategy planning and top level HRM
- **…and in intensive strategy review for major individual threats or opportunities emerging**
  - Employ risk “process gates” in both strategy development and implementation
    - Lay out issues and options: identify risks and what it will take to evaluate them (T2, T6)
    - Create strategy plan: rigorous analysis of risks (T7, T13, T5)
    - Before starting implementation: conditions met (T14)
    - During implementation: establish staircase/roadmap and monitor and control (T15)
  - Where success cannot be controlled by stage gates, require low-risk “strategy plan B” (T8)
    - E.g. for big bets such as major acquisitions
  - Integrate behavioural strategy into strategic decision-making (T9,10,11,12)
    - Include skills in behavioural strategy in strategy team (in-house or external partner)
- **Overall process ownership with Board**
  - Chairman and non-execs in the lead on Emperor’s clothes test
  - Process management with Head of Strategy
  - Comply or explain principle

The figures in brackets (T3, T16 etc) refer back to the techniques enumerated in the slide above.

One group considered a case of moving from a regional to a global structure, which meant that the integration of risk management into an annual Board review would be critical. Few companies in the sample tripped up over an organisational change but it was felt that an Emperor's Clothes test would be useful, with a committee for each separate aspect, such as technology, product etc.

Another group also considered this technique to get big picture issues on the table from the first, and avoid being simply operational. There was a need to go beyond a strategy process which simply added up the numbers from the business units and to ask for big issues.

The third group felt that the incentive to follow an over-ambitious strategy was critical. Techniques such as wargaming could be used for re-sets, with others used every year. The strawman could form a basis, but the actual techniques used would have to be tailored to the situation.

We ended the meeting as usual with summary comments around the table:

- The interesting challenge is how to avoid getting into a Box 1 situation in the first place, and finding a sustainable Box 0;

- How do successful companies get people with the right expertise? Are there different patterns in their practices?

- We stumbled in 2014. Culture change failed, and accounting fog confused the market and created internal obfuscation. It would be interesting to find examples of companies noticing Red Flags and taking action;

- It is hard for CSO's to influence anything. Perhaps the most effective step would be to link executive pay to long term value creation;

- I agree with all the points, but it remains very hard to mount a serious challenge when you think a mistake is about to be made. Dealing with all the disruption going on around our business is more important than a dash for growth;

- It would be good to break down the elements of what is meant by 'the organisation is set-up for success';

- Trying new things is difficult. If you take people from the core and try to drive innovation by getting them to think about the future, they generally lack the process technique to do so well;

- Change is taking place faster now and the world is more uncertain, but most risks are known. The trouble is that people learn the wrong lessons from the past because sometimes they have just been lucky. Psychology is more important than structure.

Future meetings

The next Members' Meeting will be held from 13.00 – 17.30 on 6th March 2019. It will be held at the same venue, The Royal Horseguards Hotel, 2 Whitehall Court, Whitehall, London SW1A 2EJ.

This meeting will be devoted to the topic of Artificial Intelligence, and will be led by Felix Barber, who will be joined by two guests: David Dean, the former leader of BCG's technology practice; and Angie Ma, the Co-founder and COO of ASI Data Science which runs a fellowship programme for data scientists, a platform for AI, and works with companies such as Easyjet, Siemens, Tesco and the BBC to get value from AI.

Members are also reminded about the next Strategy Team Seminar. Each Member has two free places on these seminars. The next one will be held on **Thursday 24th January 2019**, 10.00 – 17.00 at De Vere Venues, Holborn Bars, 138-142 Holborn, London EC1N 2NQ. The subject will be Growth Initiatives and will be led by Andrew Campbell.

Please let angela.munro@ashridge.hult.edu know if you would like to reserve a place for members of your team.