

# **Strategic Management Center**

## **Members Meeting**

**15<sup>th</sup> June 2021**

### **Minutes of Meeting**

#### **In attendance**

Philip Meyers	ABF
Paul Titcomb	Atkins
Francesca Louise Quinn	Atkins
Gavin Jackson	Babcock International
Alex Manisty	D S Smith
Yitzchak Grant	D S Smith
Jiri Beca	D S Smith
Russell Turner	D S Smith
Patrick Scherrer	Helvetia
Wouter de Klein	Shell
Tom Ford	Rolls Royce

#### **From the Strategic Management Centre**

Stephen Bungay  
Rebecca Homkes  
Jo Whitehead

#### **Guest Speaker**

Will Bunker, GrowthX

#### **Rebecca Homkes and Will Bunker: Strategy and Innovation – Ideation, Growth and Scaling: Learning Better Lessons from Startups**

Over the past 15 months or so, Rebecca has been working with clients on her Survive, Reset, Thrive (SRT) model. She began the meeting by giving us a brief report on developments and the lessons learned.

In high uncertainty, the challenge is to make good decisions when you cannot make good predictions. This involves a shift from planning to preparing. Paradoxically perhaps, periods of uncertainty are a great time to grow and to create more value by widening the gap between the cost to serve and

customers' willingness to pay, which is what strategy is all about. For some of Rebecca's clients that implemented the SRT approach, 2020 has been one of their best years, despite or even because of, all the uncertainties caused by coronavirus.

One of the first lessons has been that 'survive', 'reset' and 'thrive' are not phases in a linear process, but instead these form a loop. Companies can get stuck in the 'survive' phase of managing the crisis period and stay there. Some of the common tropes of the early period of the epidemic such as 'you will never regret cutting too deep' have shown themselves to be untrue. Some companies are now regretting the severity of the cuts they made.

Nevertheless, the basics of the 'survive' phase which Rebecca identified a year ago have shown themselves to be sound. Repurposing people and capabilities has added value; taking communications and engagement to a new level has usually been a no-regret move; and making tough calls early has been vindicated. Making cuts fast rather than waiting was more important than how deep they were. In fact, the faster such decisions were made, the less damaging they had to be. As a case study of making deep cuts in a transparent and empathetic way, Brian Cheskey at Airbnb offered substantial support to their hosts in March 2020, and that has allowed the company to come through despite the cost of the offer.

However, companies that are now thriving did not stay in 'survive' mode, but moved quickly through to 'reset', and are now going through the whole cycle again. One member commented that their company was indeed doing just that.

Although in 'reset' you need to revisit everything, you do not need to change everything, and different part of the business often move at different speeds. What matters is to re-orient, not by asking 'Are we on track?' but 'Has the situation changed?' This involves re-examining trends, beliefs, assumptions and the implications.

A useful way of doing this is by going through the value chain to look at trends, (using a tool such as PEST), and then decide which trends to act on by mapping out which ones are important to the industry and which are critical to the strategy. Trends are visible changes in the outside world. For each of these trends, there needs to be a debate about what management believe the implications to be. A belief is a best guess on what this means going forward. From these beliefs, explicit assumptions are extrapolated which are embodied into the strategy. An assumption is testable and needs to be monitored.

For example, an airline might observe that providing food that is safe and clean is a priority for customers. A plausible *belief* is that individually packed meals are here to stay in the medium term, although that conflicts with long-term efforts to reduce packaging in airline food, especially plastic. The *assumption* could be that effort should be put into finding new sustainable, low-cost forms of packaging.

The top trends are put into a tracker so that they can be updated as more information comes in and each new piece of information is given the status of

either underpinning or questioning the belief. This should typically be done quarterly with a small team and half-yearly with an extended team.

One member observed that timing and testing are critical. They invested in virus-free protective packaging but development was very slow. They finally discovered that customers did not care.

The next element of 'reset' is to define success in terms of the compass heading to set, the intent, and the boundary conditions. Rebecca illustrated the difference these can make by contrasting the vaccination policy in Israel, where the intent was to vaccinate the population as fast as possible and the boundary conditions were to be safe and not to waste any vaccine – with the US, where the intent was also to vaccinate in the population as quickly as possible but the boundary condition was to following the order of priority. Having started its vaccination programme at about the same time as the US, by the end of January 2021, Israel had covered over 40% of its population while the US had covered 6%.

The next step is to define where to play, which will often change, and how to win by developing capabilities which are valuable, rare, inimitable and non-substitutable. Finally, you need to consider what could stop you in terms of internal and external challenges.

The core of the 'thrive' phase is testing and building back to intersect with the other two phases, not in order to rebuild old businesses but to re-assess each old assumption. Growth will typically be unbalanced, so toolkits like balanced scoreboards or even resource allocation are not helpful. Some things will matter more than others, and leaders need to embrace that.

Finally, Thrive organisations are those that employ disciplined flexibility and combine strong balance sheets (from survive), strategic insights (from reset), and operational agility (from thrive).

One member asked why one person's beliefs should be better than any other's. The short answer is that critical beliefs are turned into assumptions which are testable. Without testing, beliefs are just religion.

Rebecca then introduced Will Bunker. They began their association because they had observed that many companies are not learning the right lessons from startups, and many are not adapting their execution approach to the one needed for innovation.

A mythology has grown up around entrepreneurs that has led to some ideas about how to work with startups which are either misleading or downright wrong. They need to be replaced with quite different ones.

Two of these myths relate to ideation from your current business model:

1. The myth: you should act like an entrepreneur – instead you should question fundamental assumptions and look for exponential changes in costs and capabilities.

2. The myth: startups are sexy, so get sexier – instead you should be structured and methodical.

Two further ones relate to ideation from new places:

3. The myth: you must innovate or die – instead you should get ahead of the curve and encourage exploration
4. The myth: you should focus on finding the best technology out there – instead, you should focus on dramatically improving your ability to identify and solve high friction customer problems.

Disruptive innovation changes fundamental assumptions. For example, Kodak failed to participate in digital photography because early digital photos were of poor quality and Kodak believed that customers wanted quality above all else. Likewise, Will had believed that investment deals could only be done face-to-face until during the pandemic he managed to raise \$147m in seven days using Zoom.

You therefore need a structured process for challenging assumptions that have to be true for the business to be successful. This can be hard, and you need to be very honest. Having identified these critical assumptions you should design a way of testing their validity in a safe environment (or sandbox). A distinctive quality of successful entrepreneurs is first principles thinking.

Related to this is the need to be structured rather than sexy. Go through the P&L and ask what would happen if someone were to find a way of delivering the biggest item in your cost structure at 10% of the cost. Today, as AI capabilities increase, a standard question would be where humans are making decisions that a machine could take.

The third myth is that innovate or die is a universal rule. Actually effective innovation depends on timing. You should look for declines in cost and increases in capability which change from incremental to exponential. The time to invest is just before the two lines intersect. Too early and no value will be created. Too late and you will be left behind. The drivers are not always the visible phenomena.

Will illustrated this principle and the fourth one of solving customer problems from his own experience as a founder of the company that became part of Match.com.

In the mid-90's Will had noticed that the number of people connected to the internet, though low in comparison to today, had started to grow exponentially. This observable phenomenon was driven by exponential declines in bandwidth and hardware costs. He did not know what the business opportunity would be, but did know that the internet had the potential to cut communication costs to something close to zero, which would be of high value to most of the population. So the capability curve was rising fast as well.

In deciding what the business should be, he was not driven by any vision or a desire to change the world, but analyzed what data he could find. He worked out the specifications of the business in the way that engineers typically approach problems, focusing on the principles that have to be fulfilled to make it work and the boundary conditions that it has to satisfy.

The largest ISP at the time was AOL, and 50% of its revenues came from chat rooms in which the main topic was dating. The dating business was also very lucrative for conventional newspapers. So Will and his partner decided to create something in that area. The internet meant that an underfunded startup could take on wealthy newspapers in serving a customer need – dating – that currently involved compromise. Jeff Bezos had a similar insight about the internet but decided to target book selling.

Will gave further brief examples of the kind of thinking involved.

In 2000, many believed that China's economy would grow rapidly, though this was not completely obvious then. Will asked himself what the consequences would be if it did. He did some research that revealed that the first thing people do when their incomes rise is to eat more meat. So he invested in farmland in the US, which since then has multiplied in value.

A corollary relates to water. A lot of unproductive land can be turned over to farming if water is available. Water becomes plentiful if desalination is inexpensive. The cost of desalination has already started to fall. The current explosion in 'greentech' is driven not only by need but in exponential cost reductions which started long after the basic technology was put in place. Solar power has been around since 1839, and the first windmill was manufactured in the US in 1854. The first electric car was invented in 1884. Several related areas have to experience radical cost reduction and capability increases to make changes possible. In the case of electricity, they include power distribution – the UK's National Grid was only created in 1935 – and storage – battery costs have declined by almost 90% in the last ten years.

Covid-19 has clearly changed behaviour, but it is not clear how permanently. The question therefore is what trends it might have accelerated. Online retailing was only 16% of sales in the US in 2019 and grew by 15%. In 2020 it was 22% of sales and grew at over 40%. The way to analyze trends is to start with the customer perspective of the problems they have to solve to accomplish the real job to be done, and then work through the value chain. Ideas can be tested in a company sandbox.

One member company has developed ideas in a sandbox, but found they were in conflict with the core business. For example, people wanted to buy packaging in smaller quantities, but the core business relied on scale. Will contrasted that with Amazon which lost money to test physical stores with no staff, despite

being a purely online retailer. The sandbox is not the innovation pipeline, but a way of testing ideas that address customer problems.

Will then returned to the story of his internet dating business One-and-Only to shed further light on acting to learn in order to accelerate learning velocity.

Will grew up on a farm, but he was trained as an industrial engineer. He worked in a factory (and hated it) before getting his first real job with Arkansas-based oil & gas company N B Hunt, which sent him on a series of journeys across Russia in 1993-4.

While there, he found that making a phone call took five hours, whereas an emerging technology called the internet enabled him to communicate. The machine he used to access it reminded him of one used by a local John Deere dealer in Arkansas. He therefore became very interested in the internet because it provided a radical solution to a serious problem he had personally encountered, and looked as if it had the potential to used universally, not just in Russia.

A second formative experience was an interlude mining and transporting gold in Nicaragua, which involved levels of personal risk he had never encountered before. This made him more tolerant of risk in general.

In 1995 he left Hunt, went to Dallas and teamed up with a friend to set up an internet business.

The largest ISP at the time was AOL, and 50% of its revenues came from chat rooms in which the main topic was dating. The dating business was also very lucrative for conventional newspapers. So they decided to see whether dating was a behaviour that would migrate to the internet early and generate positive cash flow.

They were faced with major financial constraints. Dallas had a very small VC community and they only had around \$5,000 of their own money. So they modelled out everything that had to be true for the business to work and then tested those conditions in ways that their budget would allow.

They identified a set of critical assumptions that they had to test:

1. How many people would put personal details on the internet?
2. Could they find enough sites to advertise on?
3. How would they charge (e.g., using email, advertising or subscription)?
4. How could they generate a positive return per visitor?

At the time, they were skeptical that people would put personal details on the internet. They spent £2,000 to create an innovation engine and discovered that 5% of the population would do so. In creating experiments, they did not measure payback, but time. They had to get results inside three weeks.

So whilst the scepticism was justified, 5% was enough to create a business. They protected privacy by creating a web form that only e-mailed responses. They initially manually created and uploaded each profile. Match.com were ahead with 20,000 users, but they thought they could catch them.

Finding enough sites to advertise on was hard and involved hundreds of calls, but they found that online web chat sites off of AOL were the answer. \$5 of advertising would generate one profile. They got 2,000 visitors a day.

In deciding on a charging model, they observed that people were using 900 numbers, so they built a tracking system to measure revenue depending on which model they saw and after 18 months decided on subscriptions. Each visitor cost 5 cents and generated 0.1 cents of revenue.

Only minimal resources were committed until they had proven the business model. It was very lean. Their backer wasn't in a position to give them \$10m – he was Will's boss in his day job. They had a hypothesis that the revenue would scale with the number of profiles and estimated from that that they would need 20,000 profiles, so raised £100,000 to achieve that, by which time revenue per visitor had risen from 0.1 cents to 18 cents. They called the business One-and-Only.com.

Match.com had raised \$10 million to reach 20,000 users, but went on a national branding campaign, which was a waste of money. The key was to learn the right things efficiently. The difference in cost was a factor of 100.

In 1999, Match.com was bought by Ticketmaster (now IAC), and the same year Ticketmaster also bought One-and-Only for \$47m and merged it with Match.com.

The costs of the innovation engine were driven down by digitization. Instead of arguing about what would work, they just tested features. 80% of the features either did not increase or actually decreased revenue. A core feature of this method rather than running pilots is that individual variables are isolated and it was therefore possible to identify the value of each one. In that sense, the method was scientific. Will added that instead of a P&L account, innovators need a K&I account – Knowledge and Ignorance.

One member commented that they out-source experiments. Another noted that they do a lot of experimentation around their core activities such as drilling wells, but the challenge is tying the results back in to the whole company.

Will suggested that the real question is how you lower the cost of testing until it no longer matters if the test fails.

## **Future meetings**

The next Members' Meeting will be held from 14.00 – 16.30 on 30<sup>th</sup> September 2021. We are currently expecting it to take place virtually.

The topic will be a final wrap up of 'Corporate Stumbles' and will be led by Jo Whitehead and Neil Monnery.

Our next Seminar will be held virtually on 15<sup>th</sup> July, when the subject will be Strategy under High Uncertainty and will be led by Stephen Bungay.

Members are also reminded about our **Strategy Bootcamp**. Following a quick survey of preferences, we will now run this **virtually over five afternoons from 4<sup>th</sup> – 8<sup>th</sup> October. Members should contact Angela to book places.**