survive and thrive

winning against strategic threats to your business

A Rotman Strategy Book

Edited by Joshua S. Gans and Sarah Kaplan

Toronto, Canada

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introduction: strategic threats to survival

Joshua Gans and Sarah Kaplan

"And the winner is," said Warren Beatty as he handed the envelope to Faye Dunaway, "*La La Land*!" It was a moment that would define the Academy Awards ceremony in 2017 because the winner of the premier best picture award was not *La La Land* but the breakthrough movie *Moonlight*. Instead of celebrating the achievement of an African American-centered film about discrimination along multiple dimensions, the Oscars had become a farce. The scene was like a nightmare sequence, specifically for one firm: PricewaterhouseCoopers.

For decades, the accountants had been charged with keeping the list of Oscar winners safe and secret to be revealed at precisely the right moment. Every year, the two accountants given this important task were shown on television, purposely nerdy, purposely boring. Their job was to remain boring. The things that kept them up at night all involved getting too much attention.

Beatty had the wrong envelope (somehow for Best Actress rather than Best Picture). Thoughts of who was at fault immediately turned to PwC. The nightmare was real. The two accountants would never attend another ceremony. And PwC's careful branding was in tatters.

To be sure, nightmarish though this was, it was not of existential consequence. The accountants involved lost only their dignity but not their jobs. PwC would at worst lose the Academy as a customer. This was nothing compared to the destruction that had befallen Arthur Andersen more than a decade and a half earlier. Its errors led to the complete failure of the ninety-year-old company.

In 2001, Arthur Andersen was one of the big leading accounting firms. Those firms had an overwhelming share of the main corporate giants. In Andersen's case, that included one of the top ten most valued companies in the United States: Enron. Enron was an energy trading and finance company that had grown off the backs of energy deregulation in the 1980s and 1990s. It had a "go for broke" company attitude that made it the darling of many a popular management guru. But as it turned out, its financial foundations were weak. When these were exposed, Enron promptly failed. But as with the Academy Awards, attention turned quickly to the designated caretakers—in this case, the auditors: Arthur Andersen.

Overnight, other corporations lost confidence in the accounting company, employees in the thousands left to other accounting firms, and before any investigation was completed, Arthur Andersen was effectively no more; 85,000 employees and almost $10 billion in annual revenue went elsewhere. This was more than just a bankruptcy; there was simply nothing left.

It turned out that Andersen had left behind some years before the meticulous practices that had made it what it was. In other words, the failure was a symptom of a slow-moving and then long-standing problem. That problem, as it turned, out threatened their existence. So, unlike with PwC, the nightmare of Andersen was not one of embarrassment and the loss of a single client but went to the core of the firm itself.

This book is about these kinds of existential threats to businesses. It is about those potential crises that keep corporate leaders up at night. And, the problem with these threats is that they come from every direction.

Some actually come as a result of success. In the very week of PwC's Oscars debacle, Amazon faced a crisis of equal proportion and far great consequence. Aside from its highly successful online retail business, one of Amazon's most profitable divisions is the largest provider of cloud computing hosting services in the world. Amazon Web Services (AWS) powers not only myriad small start-ups but also many larger firms, from media outlets to Netflix to Google. It is everywhere.

On the morning of February 28, 2017, Amazon's Simple Storage Service (S3) team were engaged in routine debugging to fix a problem with their billing system. What was supposed to be a command to remove a small number of problematic servers had a typo in it that instead led to a large number of servers being removed, which then caused a cascade. Virtually the entire system went down. It was out for most of the day. With it, the Internet around the world shut down as businesses were unable to access stored data.

The system was eventually restored and Amazon promised to make changes so such an event would never occur again, but this reminded the world of its dependence on Amazon. While Amazon surely reaps some benefits—efficiency and competitiveness—from economies of scale, this incident may cause customers to diversify away from Amazon. In this case, Amazon did not face the loss of confidence that Arthur Andersen did, but the event did put Amazon on notice. What was supposed to be an unexciting, if lucrative, part of Amazon's business became far less so.

Technical issues will keep managers up at night, and as their businesses grow, managers will need to rise above the day-to-day crises and work out whether something more endemic is going on. That may be the case of AWS, but it was certainly the case for Uber, who, the very same week of the AWS crisis, revealed a problem of gender discrimination in its ranks.

The crisis—at least publicly—was triggered when an engineer, Susan Fowler, penned a blog post describing discrimination and harassment throughout the year she worked for Uber. This included a threat of dismissal when she reported these issues to Uber's human resource department. Such a dismissal would have been illegal. What the blog post revealed was not just a cultural problem within Uber but a formal structure that was aligned to perpetuate that cultural problem. This led to a new round of consumer boycotts to "#DeleteUber," as well as major legal issues and investigations.

Uber's strategic threats were baked into the organization. This was not a problem that could be fixed overnight, and it would require major changes. But for managers everywhere, the story should be a warning. If you have to wait until the crisis becomes public, it is too late; you have lost the ability to manage change on your own terms.

This book examines myriad strategic threats like those we have described above that could harm a business's existence:

- Despite detailed safety systems, BP's Deepwater Horizon well exploded, leading to the worst corporate environmental disaster in history and a $50 billion clean-up bill. (Chapter 2)
- Escalating healthcare expenses for current and former employees eventually contributed to bankrupt-

ing GM, as costs per car reached more than $1400. (Chapter 3)

- Walmart spent millions and suffered major reputational damage in the face of a 1.6-million-person class-action lawsuit filed for gender discrimination across the United States. (Chapter 4)
- A hotel's reputation was besmirched by potentially false TripAdvisor ratings, and bookings dropped precipitously. (Chapter 5)
- Disruptive innovations drove Blockbuster, Nokia, Kodak, and even the mighty Encyclopaedia Britannica out of business. (Chapter 6)
- The US nuclear industry faded to unimportance, with not a single plant breaking ground in the United States between 1977 and 2013, in part because of too-early lock-in on an inferior technology. (Chapter 7)
- A Toronto-founded startup, Atomwise, failed to get the funding and resources it needed because it did not locate in the right ecosystem and therefore had to move to Silicon Valley to succeed. (Chapter 8)
- Eli Lilly's performance declined sharply because of overinvestment in one growth model, even when that model had become counterproductive. (Chapter 9)
- A specialty foods venture—Evan Kristen Specialty Foods—lost financing because it focused exclusively

on the competitive dynamics in one segment of the value chain (consumer demand), at the expense of another (suppliers). (Chapter 10)

As the chapters in this book will demonstrate, the inability of companies to anticipate and respond adequately to these threats comes from some common organizational mistakes:

- **Mistake 1: Failing to appreciate interactions within systems.** Managers often appreciate only the superficial relationships between actors or events, without examining how interactions might compound problems in unexpected ways.
- **Mistake 2: Getting stuck in existing ways of doing business.** Companies become successful by honing their strategies and operations. In times of crisis, companies are often tempted to double down on these practices rather than seek out new responses, new growth models, or new methods.
- **Mistake 3: Falling victim to cognitive biases.** Despite the growing awareness that managers' judgment can be shaped by all sorts of biases, it is still exceedingly hard for managers to break themselves out of these traps. These biases can lead companies into crises and make it exceedingly hard for the companies to respond when crises hit.
- **Mistake 4: Getting derailed by short-term incentives.** The economic incentives to act—particularly

those driven by customer needs or demands—may blind organizations to risks that may arise.

The news we bring is that despite the acuity of these kinds of threats, companies can survive and thrive.

anticipate what you can; prepare for what you can't

The key is what we call structured anticipation: that is, understanding the risks and then building capabilities to ensure that when threats materialize, action is possible. Although crises may be far from pleasant, they do not have to create existential threats.

In the face of the organizational mistakes identified above, the chapters in this book suggest that two actions and two cautions form an approach to structured anticipation.

- **Action 1: Develop structured practices for anticipation.** Risk reviews, after-action reviews, anomaly-reporting systems, and the like can make the identification of potential risks more feasible. Without these structured practices in place, key information signals from the organization and the market will be lost.
- **Action 2. Create an organizational culture that encourages dissent.** Systems don't operate effectively without a supporting culture. A crucial way to anticipate risk is to look for anomalies and to

avoid discounting information and criticisms that don't fit with the organization's existing ways of doing business. Diversity of thought can be supported by diversity in teams and by safe spaces to bring up controversial ideas or information.

- **Caution 1: Beware of risk compensation.** Just as with increased safety features in cars, the temptation that comes with increased anticipatory practices is to take even more risks once the practices are in place. The goal of structured anticipation is not to encourage potentially foolish risks, but to anticipate internal and external threats while pursuing organizational performance.
- **Caution 2: Don't look for the easy way out.** Some companies want to buy their way out of problems. Others want to just do something that fits their existing way of doing business. More likely, the action necessary to fix the problem will obsolete or leapfrog today's practices and will require radical organizational change.

In each of the chapters in this book, you will find these themes recurring. For instance, while disasters such as oil spills and financial trading meltdowns can seem just like systems gone awry, Chapter 2 shows that organizations can prevent the occurrence of disasters by using systematic procedures to learn from smaller incidents and by creating cultures that allow anomalies and criticism to arise.

Where healthcare costs erode organizational productivity and corporate performance, Chapter 3 shows that these challenges can create innovation opportunities for those companies that can redefine health as prevention rather than medicalization.

With the increasing attention on the challenge of diversity and inclusiveness in organizations, companies can turn this challenge, as Chapter 4 argues, from a problem of compliance to an opportunity to win the war for talent.

In today's world, a poor review can spread quickly, bringing reputational damage just as quickly. Such damage can be perpetuated by managerial indecision about how to react when that damage occurs. Chapter 5 shows that by having a clear policy for managers to follow, companies can respond quickly and confidently implement corrections before things get out of control.

Although disruption has become a catchphrase as well as a "scary" concept for leaders of successful businesses, Chapter 6 shows that the classic disruptive innovations—those that appeal to a niche before invading your core space—can invariably be subject to a managed response. Firms with proactive capabilities can acquire firms that are competitive threats or can divert resources quickly to innovate on new paths.

For cases in which the development of complex, often breakthrough, technologies can be hampered by individual firms pursuing short-term incentives, Chapter 7 demonstrates how firms can coordinate to mitigate these incentive distortions and avoid lock-in on inferior solutions.

Where technology clusters provide crucial resources for innovation, Chapter 8 shows how firms both large and small can make the "do or die" decisions about where to locate their businesses in order to innovate, survive, and grow.

When companies must constantly reconfigure their resources to remain competitive, they can use systematic decision processes—as argued in Chapter 9—to select the best growth mode so they don't get stuck in old ways of doing business.

Finally, Chapter 10 shows that when it comes to competitive threats, with planning, competition can work for organizations as much as it might work against them. By realizing that your company is of value to other businesses in your value chain, you will be able to form coalitions with a broad group of partners to react when competitive threats arise.

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This book is meant to be consumed all together or as individual chapters, according to the reader's interest. Across the chapters, you will find a wide variety of examples of strategic threats faced by companies. These crises often jeopardize the survival of the company, and the potential for these crises to emerge keeps leaders awake at night. Our goal with this collection of perspectives is to offer you, the organizational leader, some principles and practices for surviving and thriving in the face of strategic threats.