Todd Zenger, STRAT 6070, 5.2 - Creating a Corporate Theory of Value-Creating Growth

We've spoken to this point about the unique challenge of corporate strategy, which is to relentlessly accumulate positions of advantage to constantly find new sources of value, and we visually depicted it in this way. In this lecture we want to talk about how I might go about doing that and in particular focus on this concept of composing a corporate theory. Corporate strategy is really about constantly recomposing the firm. In many instances, it's about adding to the firm, although in some instances it may be about removing elements of the firm. But visually is you've got this infinite array of activities and assets that you could access. Strategy, as we've talked about is about assembling those in a unique way, but corporate strategy is about finding ways to do this on an ongoing basis that are value creating. Very often this is about adding additional business' activity assets to this enterprise. As we'll talk about in later lectures, it's also about how you organize those in different ways. But at this point I think it's useful just to think about how does one drive and orchestrate this process of recombining, reshaping the organization in ways that perpetuate value creation. Just as an aside note that this corporate strategy activity is in some sense a design activity, it's figuring out how to recompose and design an enterprise, dynamically over time that creates value and that that design activity is not unlike any other design activity. I love this, although it's not perfect English, but this quote from Steve Jobs describing what design is, he says, designing a product, in this case, we're talking about designing a business, is keeping 5,000 things in your brain, concepts, fitting them all together and continuing to push to fit them together in new and different ways to get what you want. Everyday you discover something new, that is a new problem or a new opportunity to fit these things together a little differently. Now, I don't think that corporate strategy is about every day finding some new way to recompose the organization in some new way, but it is true that this is a relentless process of finding new problems and new opportunities to add value to the enterprise. That it's not this imagery that we've talked about in business strategy at this point of finding a position that you can hunker down and exploit. Instead it's about redesign, it's about recomposing, dynamically changing the enterprise in pursuit of increased value. The real question then becomes, how can a strategic leader navigate this process of relentlessly creating value for shareholders and other stakeholders? I want to focus on this concept of theory that an effective firm that perpetuates growth composes a corporate theory, and I want to talk about what a theory is. We know what academic theories are, that these academic theories help reveal valuable experiments, they allow people to see things you think about. That it was only through Galileo's unique theory that he envisions the fact that the Earth is rotating around the sun as opposed to what everybody else was seeing, which is the sun rotating around the Earth. Or it's only through a theory that Newton sees that light is color filled rather than colorless. Or it's only through the lens of Einstein's theories that a wide range of evidence accumulates about a variety of phenomena that would otherwise go unseen. Academic theories help people see things and accelerate knowledge creation. Corporate theories reveal also better experiments, here strategic experiments paths to value creation, and in that sense, accelerate an organization's value creation. Strategies then become experiments that you're going to pursue, that are consistent with that theory, consistent with the hypothesis, or hypotheses that emanate from the theory that you have composed about the path to value creation. A corporate theory is then a logic that managers are repeatedly using to select, and reconfigure, and assemble from among a vast array of possible assets and activities and resource combinations that exist out there. Many of these opportunities exist outside the firm, that you're then trying to compose these into bundles and choices that are value creating for the firm. A corporate theory is not really a strategy per se, but rather it's a guide to the selection of a sequence of strategies over time that will fuel value creation for the enterprise. This theory becomes something that's guiding these choices that you're making about what to put inside the firm, or perhaps in other instances, what to take away and extract from the firm. Let me give you an example of a great business theory. Walt Disney, as you know, is famous for his pioneering work in animation as well as his conception of this remarkable theme park, Disneyland. But I think in many ways his greatest contribution to business was as a business theorist, and his capacity to not just conceive of and pioneer a particular business, but to really see how to architect a corporate theory that would guide the growth trajectory of this enterprise for the better part of 80 years and actually continues, and perhaps will in perpetuity, guide the kinds of strategies that this enterprise pursues. This is a picture that was printed in 1957 that shows the connections among the businesses that Disney was in at the time, and you see squarely in the middle here theatrical films, in particular these are animated films, and then radiating around this are businesses like music and publications, and comic strips, and Disneyland, and character merchandising, TV business, TV commercials, other kinds of films, and each of these little arrows has a label, a description. Talking either about how this central core asset fuels value for these other businesses that radiate around this central asset, or perhaps how they further infuse value into that central asset and in some cases, other links between these peripheral businesses. But in this graphic, you see the essence, this causal connection between the businesses, the kinds of choices that this company has made over time, and really I think is a remarkable graphic depiction of a corporate theory. Of course this Disney set of businesses builds out over time as they pursue experiments consistent with this theory, most of them work but not all of them. For instance they proposed starting a ski resort in California that was unsuccessful. But in almost all cases, you can pin back a competitive advantage in these peripheral businesses that emanates from this central core asset. For instance, in publications, this is a company that can create a best-selling business book by simply taking graphical animated foils and images from their movies, putting some relatively mindless texts to this or simply taking the narrative out of the movie, and immediately they have a best selling book. Their competitor that's trying to create a best selling children's book has to come up with a beautiful story line and a wonderful illustration and sell that book on its individual merits. Here, they're able to at a much lower cost, generate a very successful book. Similarly, in a business like hotels, they are able to charge significantly premium prices simply for the characters that they're able to parade through those hotels or their ability to have to be adjacent to the theme parks. That there is this tremendous value that either from a cost standpoint or from a differentiation standpoint, is infused into each of these peripheral businesses. Of course, they expand and really follow this theory over time and pursue other kinds of assets, but in the back driving all of these decisions is this consistent corporate theory. Effective corporate theories also allow you to see and observe opportunities that others that lack that theory are unable to see, Einstein I think wonderfully captures this in his own quote about scientific theories. But you see this in Disney's history that they're able to see value in things like moving Disney into producing Broadway shows and actually the buying real estate near Times Square. When that was originally pursued people really questioned whether that was wise to pursue, but in light of their theory, they see value that no one else saw. Similarly, decisions to expand into China or decisions to move into retail stores, people were very skeptical of that decision at its outset has proved quite successful. Cruise lines, not an obvious match at the outset, and yes of course this has been a runaway success for Disney. The decision to purchase a Marvel as well, I think it is that through the lens of his theory, allows them to see value and exploit value that no one else simply has access to or can see. These theories are providing vision that enables this company to accumulate value and hopefully perpetuity. But, constantly delivering unique ways to increase the value of an enterprise. There are really three components of an effective theory that provide this vision or site, one is that good theory has foresight. That it reflects some foresight you have regarding the evolution of the industry, its demand for products and types of products and taste it might have foresight about evolving consumer and customer tastes. It might reflect foresight about the underlying technology associated with that particular industry. It's very much looking ahead, what's the future that you see that others don't see? A good theory also has insight that is it deeply understands what unique assets you possess or what unique assets you want to build, what are the unique resources and activities that are currently housed, or you want to build within this enterprise. This is looking within, what are the strengths that we possess, or that we should develop that others don't or can't develop. Finally, a good theory has cross-site that it's revealing unique assets that exist or unique value out there, in available assets and opportunities that others don't see. This is Disney going into Broadway shows or cruise ships, it's cross-eyed seeing how you can leverage what you currently possess to create value that others don't have access to or simply don't see. This is looking around whereas value that we can unlock that others simply can't. One can think about this as 3D vision. You have this three-dimensional site that's embedded in your corporate theory that others lack. What's Disney's 3D vision? Family friendly fantasy worlds will have vast appeal. This is what Disney saw that no one else really saw, and that animation is this ideal vehicle for composing these fantasy worlds. They can be kept current, they can be kept well manicured and dressed and always appropriate, and can be visualize worlds that simply one can't compose in reality. An insight that they had this early lead in animation, that animation could be timeless, that they could create these unique characters over which they would have complete control. Not just to control their behavior and actions, but also complete control in terms of ownership. If you create a live action film and create a movie star, that is extraordinarily successful. The next time you want to contract with them, you're going to pay them a much higher sum. If it's an animated character that you own, as Warren Buffet famously said that mouse has no agent, and these characters have no agents that you're having to contract and negotiate with, you own those assets, and so remarkable insight about the real value of creating these characters. Then finally, cross-sight this capacity to look broadly at other entertainment opportunities, films, cruise lines, Broadway shows, even retail stores, they've explored other experiments such as the theme park, they've tried local video game, I think those two were not successful but they're constantly looking at other entertainment assets through this lens of how can we leverage, what we are recurrently posses. Let me switch gears a bit and talk about how one goes about building a theory through a familiar example. At the outset of the personal computer industry even before the original or early Apple II gets introduced, there were things that they called personal computers. They were built by four geeks, and they didn't even have a monitor typically. In many ways this early Apple II that Steve Jobs and Wozniak introduce is a dramatic step. Ahead, and while it doesn't look elegant and beautiful and simple, the early seeds of this theory that emerges for Apple, is even evident than that early device. In fact, the advertising that they use to tout this product is, simplicity is the ultimate sophistication introducing the Apple to the personal computer. So this message of simplicity, and although it doesn't look too elegant there, it is relative to this prior product. This sense of elegance as well. Shortly after, about four years after the Apple II gets introduced, IBM enters this space with the IBM PC. This open architecture product that becomes a runaway, that seller really dominates this space very, very quickly. As an artifact of them pursuing this strategy within very open architecture, it also invites a bunch of imitators to step in. This precipitates what was known in the industry as the Clone Wars, firms cloning the IBM PC, bundling together similar hardware, same DOS operating system from Microsoft. Producing a product with exactly the same functionality. Bunch of competitors enter this space and everybody has the same theory about how you pursue value creation, which is it's all about speed, storage, capacity, and price. [inaudible] he enters, but Michael Dell enters this space and really comes up with a brilliant theory about how to do that better than anyone else in the industry. Meanwhile, this system that IBM originally pioneered and developed was very unreliable. It was really clunky to use, it was really a nightmare to install software or to connect peripheral devices, printers, and plotters, and things to that product. There was also no connection between what you saw on the screen and what actually came out on paper. I know that's hard for you to imagine, but you were having to embed controlled characters in order to shape what actually came out on the printer. You embed these control characters into the computer on the monitor, and that would then shape what would come out on the paper. Apple, although it started in 1977, Steve Jobs is now trying to figure out how to compete with this new juggernaut competitor IBM. It's important to understand his background a little bit. He was a dropout from Reed College. Reed College was known for its calligraphy space, and so he had a real appreciation, took these calligraphy classes, a real appreciation for fonts and graphics, he was an aesthetic and loved art and design. So this all becomes important elements in his way of thinking, and ultimately that his theory of value, that is initiated with the Apple II, but really takes its full shape the with the Macintosh that gets introduced. As they are trying to figure out how to compete, he's beginning to develop this theory about, well, the problem to be solved here is all the defects of the IBM PC. It's clunky, it's hard to use, you don't see what you're going to get on the paper. So he develops a theory and executes that theory in part by discovering some remarkable technology that Xerox's research center, Palo Alto Research Center had pioneered. He discovers this technology and with this, he is able to build this remarkable product, the Macintosh. His theory of value is then very, very different than the IBM PC theory of value. It's a closed system. It's about design elegance, it's about ease of use, it's about simplicity, it's about ergonomics. It's not that these aren't important factors, but it's not about speeds, storage capacity or price. Its prices were dramatically higher than anyone's selling an IBM PC clone. It was really focused on something dramatically different. It looked different, it felt different, and it incorporated this technology that they've been able to discover through this unique theoretical lens that they had. They found this at Xerox, which enabled them to introduce a mouse that dramatically reduced or enhance the interface that you had with this computing device, the bit mapping technology that allowed you to generate images on the monitor that precisely match what you're going to get on paper. So he's able to identify this theory and really execute it with tremendous success and his foresight in this theory, you think about the 3D vision is foresight was that computers will become a consumer good even as back as the time he introduces the Apple II, he has this vision that computers would become a personal device, a consumer good. So part of this effort is to make that happen, and that in order to make that happen, his theory is that consumers are going to appreciate aesthetics, they're going to appreciate ease of use. We've got to create something that grandma can easily interface with and use successfully. Then that's about design. He recognizes, looking inwardly that there's a set of capabilities are going to be critical for doing that. One is design capability, aesthetics. That vertical integration really owning a lot of the control of this experience that the customer has would be important, and as a consequence of that, having this open system where you just deliver a platform and others put whatever they want on that platform was not going to work. He needed something that was much more seamless, much more integrated and tight control would be essential in delivering that user experience. Initially, the cross-site here is to see value in the technology that he's able to discover in particular at Xerox. Eventually though, this theory that he composes becomes critical in building out a wide range of other products and pushing Apple into domains that are completely unexpected at the time that certainly the Macintosh gets introduced. It's interesting that Steve Jobs faced enormous pressure to abandon this theory of value that he had developed. In fact, although the Macintoshs technically very successful and delights a certain set of customers, the IBM PC standard, it was such a juggernaut that it was really difficult for them to compete, and he is so doggedly focused on this theory and refuses to depart from it, that he eventually is banished from Apple. He then returns about a decade later and still faces relentless pressure to abandon that theory that he'd adopted. In particular, he faces pressure to unbundle the Macintosh and is in some sense take the technologies that he had developed and use them to put on the IBM PC platform. Many could have argued, in fact, I was a business school professor at the time and probably argued it myself. But Apple should have unbundled, that had they done it, they could have become Cisco in networking or HP in printers, or clearly could have been Microsoft in terms of generating the operating system. The Microsoft operating system becomes Microsoft Windows in large part because Steve Jobs refuses to port the Apple operating system to the IBM PC, and as a consequence of that, Microsoft just chooses to do that on their own. But instead, he doggedly sticks with the theory that he had, and eventually, this leads to a string of new products that we're familiar with. The iPod, iTunes, the iPhone, iPad, Apple Watch, Apple TV. Who knows what other services and features await us in the future. Just to summarize, Disney composes a remarkable corporate theory that fills its ongoing value. Apple composes a very different corporate theory. A theory that says consumers will pay a premium for ease of use, reliable, elegant computing products, and ultimately other consumer products. That Apple will deliver these and market them through an unrivaled design capability achieved through relatively closed systems, significant vertical integration and tight design control. Of course, they have written this corporate theory from the precipice of bankruptcy when Steve Jobs comes back after 10 years of being banished to now the most valuable corporation in the world, a title they jockey back and forth with a couple of other entities like Amazon and Microsoft today. There's some critical attributes of valuable theories. One is that they're novel, that you can see value that others can't see within, that is they provide some unique sight that others don't have access to. They're also, you'll notice with both Apple and with Disney, that they're somewhat general in the sense that they give you a capacity to solve an array of problems. In the case of Disney, an array of problems in the entertainment industry, and in the case of Apple, an array of challenges and problems in the consumer electronics space. They are also clear in that they tell you what not to do. There are a bunch of businesses that they would signal this is not what one should be doing because they're inconsistent. We certainly saw that in the case of Steve Jobs and complete unwillingness to pursue a set of strategic paths that many were pushing him to do because they were simply inconsistent with his theory about value that it needed to be integrated and tightly designed and orchestrated. What was being pushed on him was a set of strategic actions that were inconsistent with that theory. Similarly, you could think about ways in which the Disney characters could be exploited across a wide range of other businesses. One could think about putting animated characters in casinos and yet one would say that's a horrible thing to do because it would damage the value of those assets in the current activities that they are leveraging them in. So it clearly tells you what not to do as well. One could think about arraying companies based on how good their competitive advantage is, as well as how useful their corporate theory is or whether they even have one. I think there are lots of examples of companies that build a great competitive advantage. Think of recently or in the last several years GoPro develops its remarkable technology in cameras. They go public and they fizzle out because they can't figure out what's next. They haven't really developed a corporate theory to guide their ongoing path of growth. Despite continuing arguably to some degree to enjoy a competitive advantage in that space, although it's probably eroded somewhat, phone cameras have become so remarkable. But nonetheless, they clearly did not come up with a corporate theory of value. I would argue that Microsoft for a long period of time, struggled with that as well, and only more recently have they been able to successfully move to the right, build a corporate theory that is fueled on going value creation. Other enterprises like Apple, Disney, company that you're probably not that familiar with, Danaher have been very successful in building corporate strategies that have fueled long periods of remarkable growth in enterprise value. There are clearly consequences of not having a theory, and one of my favorite examples of this is the struggles of AT&T as they have tried to build a corporate theory over the years. In 1984, AT&T gets broken up, the baby bells, the regional bell operating companies get broken off from AT&T, and they emerge as a company focused on just providing long distance service and telecom equipments. They decide on the backs of the tremendous revenue that's being generated in those two businesses that they should expand and they try to come up with a corporate theory about doing that and this leads them to expand into broader business services, as well as they purchased national cash, NCR, and move into the computing space, they also dabbled with a wide range of other industries. In fact, in my days as a doctoral student, I did a little project with one of my advisors, having them explore the training industry is a possible area for their expansion, something that they ultimately and appropriately decided not to do. But ultimately, this doesn't prove successful. They sell off NCR and they end up spinning off the telecom equipment business into Lucent. Then, AT&T is again back much more focused on their long distance business in their services business, and then they decide, new corporate theory, we're going to expand into broadband, cable industry, they make a huge acquisition in that space, and then, of course, they move into wireless and the market doesn't really reward them much for this, their share price plummets around the time that this is being pursued. One of the things that really aches them is the fact that if you looked at pure play wireless companies, that is firms like Sprint or something and their competitors that were only in the wireless space, their performance in the market was doing quite well. Similarly, the cable and broadcasting industry, those firms were also doing reasonably well. Here, AT&T though was this compilation of fixed line long distance businesses, broadcasting, cable, and wireless, and their aggregate business was underperforming, all three of them, including pure-play fixed line long distance companies. As a consequence of this, they say okay, abandon that strategy. We're going to spin this off, wireless and broadband. They talk about issuing a tracking stock for their long distance business. Then they abandon that and they decide to sell off the broadband, and they abandon the tracking stock, and they spin off and they decide to sell off wireless as well. Then, they go back to being just the pure play long distance business. Over this period of time, they're definitely doing the recomposition exercise, but they are dramatically struggling to figure out a real coherent path value. They're really struggling to compose theory of value. Their woes are extraordinarily well captured by this short video clip from a Steven Colbert segment that I think you'll find entertaining. [NOISE] Meanwhile, big news and the telecom industry Cingular is changing it's name to AT&T is a crushing blow to those of us who've come to love the Cingular trademark, whatever the hell that is. [LAUGHTER] As you know don't remember, Cingular was co-owned by BellSouth and SBC which had been Southwestern Bell and Ameritech which before that had been Illinois Bell, Wisconsin Bell, Michigan Bell, Ohio Bell, and Indiana Bell. All of those used to be AT&T. Couple of years ago, Cingular bought AT&T Wireless and renamed it Cingular, but then SBC bought AT&T and changed his own name to AT&T, [LAUGHTER] then that new AT&T bought BellSouth changing it's name to AT&T, making only logical to turn Cingular into AT&T [LAUGHTER] and down here too. [LAUGHTER] In other words, thanks to America's anti-trust efforts, the country has gone from this to this. [LAUGHTER] [APPLAUSE] AT&T is the T 1,000 of corporations, no matter how many pieces you break it into, it always comes back together. [LAUGHTER] Buy AT&T? No, hell no. [LAUGHTER] Instead, buy the old Cingular signs that the retail stores are throwing out and re-purpose them to start your own business, like Curl Again, [LAUGHTER] a trendy hair salon or New Garlic, a fusion Italian restaurant, or You Can GIRL, [LAUGHTER] a chain of stores for the self-empowered female pikler. [LAUGHTER] [APPLAUSE] All right. I hope you enjoyed that. Strategic leaders compose theories that provide ongoing vision and a path to sustain value creation. Valuable theories are novel, allowing you to see what others can't see or providing with clarity about what you can access because of your unique resources that others cannot access. Valuable theories are built around these 3D vision, these concepts of these three sights; foresight, insight, looking in internal foresight looking out, out outside and cross-sight, looking around at other available assets and opportunities that you can pursue leveraging your insight, your current capabilities, as well as your vision about how this industry is going to evolve. Strategic actions you should think about as experiments that are consistent with your theory, they are reflective of hypotheses that you have. We think that by pursuing these actions for these logical reasons, it's going to create value for our shareholders and stakeholders. Finally, sustained value creation requires more thinking and not just more doing. There's a whole lot of focus today on lean startup and just getting out there and getting feedback, acting, moving, doing, learning. I would push organizations to think more deeply first, and only then go out and run experiments, not all of which are going to work, but the ones you choose are much more likely to be effective if you thought long and heard about the underlying theory of value.