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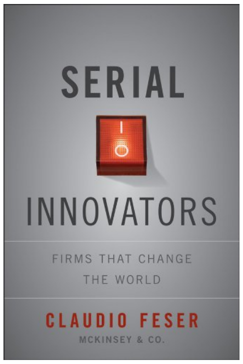

Serial Innovators

Firms That Change the World

by Claudio Feser
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202 pages

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Take-Aways

- Approximately half of all businesses don't survive beyond a decade; only 15% live for 30 years and of those, only 5% make it to their 50th anniversary.
- But for companies, unlike for people, death isn't always inevitable.
- A lack of "self-efficacy" can keep people from persevering and achieving their goals.
- Individuals suffer from "mental biases" that can derail their success.
- Research in neuroscience points to the brain's ability to readjust to new data and behaviors. Organizations also can adjust and become innovative.
- People and firms develop "rigidities" that limit their capacity for innovation and renewal.
- Dense bureaucracies and a sense of futility can stymie a business.
- A corporate culture that values performance and the right mix of incentives can spur employees to excel and evolve.
- The status quo can keep a business stuck in the past; use smart risk taking to build new capabilities quickly.
- Organizations that endure over the decades share similar traits, including encouraging constant learning, fostering optimism and promoting a performance culture.

Rating (10 is best)

Overall	Applicability	Innovation	Style
9	9	8	8

Relevance

What You Will Learn

In this Abstract, you will learn: 1) Why, like all people, most businesses mature, age and die; 2) How behavioral economics, psychology, sociology and neuroscience provide clues to extending corporate life; and 3) How "serial innovators" defy the odds to survive and thrive for decades.

Recommendation

Businesses, like people, follow a natural life cycle: They're born, they grow, they live and they die. Only 15% of all firms reach 30 years and only 5% make it to their 50th anniversaries. Yet some organizations defy the odds, continue to produce and contribute many decades beyond an expected life span. These "serial innovators" go through a constant series of changes, perpetually reinventing and adapting themselves to shifting markets and environments. McKinsey executive Claudio Feser delves into economics, sociology, neuroscience and psychology – one chunk at a time using the connective framework of an engaging business novella. He sets out to help you understand what drives long-lived companies to outperform and outlast their competitors. Feser's personable story of Carl Berger, a bright CEO who reshapes his firm, illustrates how leaders can apply the latest findings – explained here – in management, personnel practices, cognitive science and corporate longevity. *getAbstract* recommends this imaginative, wide-ranging book to executives seeking a strategy for discovering the corporate fountain of youth.

Abstract

Extending the Corporate Life Span

When new CEO Carl Berger arrived at American Health Devices (AHD), an international corporation, he found a fragmented management team, lagging innovation, declining earnings and pending lawsuits. His wife, Gwen, led him to a friend who was researching corporate longevity.

"Life is ephemeral even for firms."

If you compare a list of America's top 50 corporations in 1960 and the top 50 in 2010, you will see that two-thirds of the firms ranked in 1960 don't appear on the 2010 list. Stronger, more agile newcomers overcame several of the vanquished firms – Mobil, RCA, General Foods. Like humans, most companies follow a natural life span of birth, growth, maturity and death. Half of all publicly listed companies die within a decade; only 15% of all firms reach 30 years and only 5% make it to their 50th anniversary. Those firms are "serial innovators." This picture of corporate mortality aligns with Joseph Schumpeter's "creative destruction" theory of economic evolution. Yet corporate death isn't necessarily inevitable. The remains of declining firms often hold the seeds of new growth and new businesses. If you understand what causes deterioration, you can develop reasonable clues about how to prevent it and how to secure a longer, more productive life for your business by making use of the newest information.

"Sometimes the path to success is paved with difficulties, but eventual winners are resilient and persevere against great odds."

Facing the Danger of "Rigidities"

Carl told his executives about his ideas for quality improvement, innovation and expansion, but they weren't in sync. He turned to behavioral economics to help him align his ideas.

"As firms age, they struggle to keep up with changing markets, and in today's dynamic markets, slow adapters often become big losers."

As companies age, they develop rigidities that block them from changing and adapting. A firm that tastes early success tends to create "mental models" that keep it operating in a rut and may prevent it from evolving. Firms with "rigid organizational constructs" – hierarchy, bureaucracy, rules and processes – stagnate. This codified approach can lead to "ossification" and "inertia." Rigidities tend to begin at an individual level and then morph into "organizational rigidities" that mire companies in the past, paralyzed, blind to the changes necessary to survive. To bring about real change and innovation, managers first must understand what prompts employees to behave as they do. Three "individual rigidities" hamper people's thoughts and actions: "mental biases, lack of (task-specific) self-confidence and inflexible brain connections."

Imperfect Thinkers

Carl had his team gather fresh data from clients. He replaced executives and launched an "Open" sourcing strategy. It faltered because staffers were locked into old ideas.

"Competitive advantage erodes over time, and most firms end up being taken over by younger, more innovative companies."

Neoclassical economics sees the participants in the economy as "perfectly smart, perfectly informed and perfectly selfish." However, research in behavioral economics now gives a clearer view of human beings' "bounded rationality." People's access to information, their intelligence and their "naturally altruistic inclinations" limit their thoughts and actions. The mind uses "judgment heuristics" or mental shortcuts to make sense of the world. People refer to known information to make decisions or comparisons. This is called "anchoring." To make choices, they rely on "availability" (recent experiences) and "representativeness" (stereotyping). As members of a group – such as a corporate executive team – individuals share common experiences and develop mental models that allow them to categorize information and react quickly to events. But these shortcuts also lead to errors in thinking. Cognitive biases and their remedies include:

- **"Optimism bias"** – Experience is not a great guideline for action in unusual situations, so people view unprecedented events more positively than warranted. Fresh, outside viewpoints can combat overly optimistic judgments.
- **"Loss-aversion bias"** – Most people fear losing more than they welcome winning, so they remain tied to old ways. To lessen their resistance to risk, assess employees' effectiveness by gauging their overall results, not their individual decisions.
- **"Status quo bias"** – Your mind tends to stick with what it knows and to resist change. To spur action, remove the option of the status quo from your decision making.
- **"Representativeness bias"** – To combat routine, stereotypical thinking, build a diverse workforce. Cultivate innovative approaches by encouraging job rotation.

"The CEO changes the culture by applying and embedding new tacit assumptions and core beliefs...into the values and norms of the culture."

"Self-Efficacy"

Carl proved the Open strategy's merit by putting together a lab renovation project that won back a big client and built confidence among AHD's managers and workforce.

"The achievement of ambitious goals builds confidence and gets people to set even higher goals for themselves."

Most personal and business successes demand persistence and strength in the face of obstacles. Those who encounter setbacks may react to defeat with individual rigidity, unless they have self-efficacy – that is, confidence and strength. Self-efficacy is not an inborn trait but you can learn, nurture and reinforce it over time. People who persevere and overcome difficulties tend to believe they can accomplish more in the future, so their work performance improves. As they achieve more, they set grander goals and work hard to attain them. Their self-confidence grows as continual "enactive mastery" boosts them to higher skill levels. Learning from role models (using "vicarious experience") plays a similar role in helping people believe they can succeed. Learning from good role models is a powerful tool for increasing self-efficacy. "Verbal persuasion" also adds to employees' self-confidence and persistence.

"The brain changes, or gets rewired, throughout life. It gets rewired as a result of where it focuses its attention, the insights it develops and the experiences it has."

"Rewiring Brains"

Despite success with the new system, AHD's people kept reverting to old behaviors – like dieters who lose weight and yet go back to eating fatty foods. Carl had to figure out why.

Changes in behavior and thinking start in the brain, where connections change and grow all the time. So, contrary to past belief, old dogs – and people – can learn new tricks. Learning a new skill or fresh data influences how you see the world and modifies your brain circuits to include new experiences. For instance, a banker and an attorney experience the same reality differently; their respective educations and environments have rewired their brains. Working under extreme stress breaks the routine of mental habits and inhibits the brain from adapting. During stressful situations, human behavior resorts to its instinctive reactions, undermining rational knowledge. Leaders can use neuroscientific findings to address staffers' personal rigidities and resistance to behavioral change. Effective cures include positioning workplace issues in a "positive frame" to reduce stress, giving workers "learning sessions" where they can discover ways to improve processes and building self-efficacy by letting staffers solve problems that affect them.

"Rigidities – both individual and organizational – are man-made. They originate in two areas: in the human brain and in organizational constructs composed of human beings."

Organizational Rigidities

Carl electrified AHD's change process by putting 50-person working groups in constant touch with customers. This real-world contact led to a breakthrough in sales and morale as AHD conquered the five kinds of rigidities that plague organizations:

1. **Bureaucracies** – Hierarchical bureaucracy gets a bad rap. While "dense organizational structures" can impede the flow of ideas through large firms, hierarchy and bureaucracy do play useful roles in corporate life. Hierarchies initially form to enable faster decisions and processes. Imagine how impossible it would be to speak to every senior manager before you could move ahead on a project. In that sense, "the alternative to hierarchy is chaos." Yet, as firms grow, they develop excess layers of management that slow their operations. Draw the best from hierarchies while using agile procedures. To create an "adaptive organization," first rank your objectives by analyzing your long-term goals. Set priorities with five-year horizons, and focus on simplicity. Designate ad hoc teams to handle fast-moving or unexpected events. Second, use "self-managed performance cells." Give teams the autonomy to work as "notional companies," like the branded divisions of General Motors. Third, "build on standards" to allow flexibility and independence. Use reliable "standardization" in job descriptions and corporate policies.

"The question isn't how can we prevent rigidities from developing but rather how can we contain them and how can we complement them to maintain organizational adaptability and to cultivate innovation?"

2. **Loss of purpose** – A sense of purpose fulfills an innate human need that originates in the brain and drives people to achieve and to belong. People's spiritual instinct emanates from the right side of the cerebral cortex, which is larger in humans than in animals, giving people an understanding of the concept of the future and a need to seek meaning in their lives. The brain uses story telling to classify data and environmental stimuli. To engage staffers fully, use motivational stories and cater to their need for purpose. A firm's ideology should be "altruistic," appeal to people's quest to serve to and inspire "visible commitment" from staffers.

"Incentives are important in steering behavior and adaptation."

3. **Change-resistant corporate culture** – Corporate culture is made up of the rules – written and unwritten – under which employees operate. Culture communicates through visible "artifacts," "tacit assumptions," and stated "values and norms." A

"Ill-designed incentive schemes that focus people and organizations on short-term objectives can create disincentives to investing in the future and adapting for the long term."

strong culture can complement a firm's structure, lessening the need for regulations. To create an "execution culture," foster values, norms and unspoken ideals that encourage achievement. To institutionalize innovation, encourage mental flexibility, inventiveness and openness. Cultural change begins at the top with the CEO, who should exemplify the firm's values through stories, metaphors and "role modeling."

4. **Poor incentives** – Money can't buy happiness or inspire your staff. While financial rewards matter in recruitment and earnings calculations, such incentives retain people only in the short term. Monetary rewards can deter staffers from cooperating, undermine "moral behavior" and even encourage deceit. Psychological research says that incentives tied to "social recognition, performance feedback and...intrinsically attractive tasks" provide as much satisfaction as money and instill greater motivation. A mix of financial and nonfinancial incentives works best. For nonmonetary rewards to work well, administer them promptly, positively and visibly.
5. **Adherence to the status quo** – Some firms enjoy "defining capabilities" in operations, abilities or specific assets, but those advantages can become restraints, pinning the firm to its past and preventing it from experimenting in order to grow and prosper. Four types of capabilities – "operational skills, privileged assets, growth-enabling skills" and "special relationships" – can limit how a business reacts to new challenges and opportunities. To accelerate growth, organizations can "fast-build" or invest in new, untried strategies. Management must welcome testing and investigation to keep staffers thinking creatively.

"Serial innovators, firms that adapt and thrive in dynamic markets, are created by leaders. They are the result of company creations and transformations led by company leaders."

The Fountain of Corporate Youth

As AHD succeeded, Carl faced a health threat that made him rethink his long-range goals. He saw that as a serial innovator AHD could have a lasting legacy. Such firms, which thrive beyond their expected life spans, share seven common pursuits:

1. **"Cultivating the desire to make a difference"** – Fulfill people's yearning to give to a greater cause, serving their community, staff and clients as well as their stockholders.
2. **"Building a team of learners"** – Top executives should be self-assured, have a strong desire to learn, share diverse philosophical approaches and enjoy teamwork.
3. **"Positively framing the vision"** – See the future in an optimistic way; deal with the issues of today.
4. **"Building on self-managed performance cells"** – Let staffers contribute by working on independent "lean teams" to bring innovation to the forefront. Use evaluative metrics, help teams organize themselves and allow new learning to flourish.
5. **"Promoting the firm's drive to perform and grow"** – Set stretch goals, but make them attainable. Balance financial and nonfinancial rewards; develop future leaders.
6. **"Investing in capabilities"** – Adapt readily to the pursuit of the right opportunities, and have strategies in place for adding to core competencies.
7. **"Cultivating a culture that fosters execution"** – Stay fresh and current by maintaining an open culture that welcomes creativity and new ways of thinking.

"Developing a legacy is building an organization that builds human passion, self-confidence, values and capabilities."

About the Author

Claudio Feser is a director of McKinsey & Company. He heads the company's CEO Network, focusing on executive training and coaching.