(13) Theory of the business

- What to do is increasingly becoming the central challenge facing managements (especially those of big companies that have enjoyed long-term success)
  - The root cause of nearly every one of these crises is not that things are being done poorly.
  - It is not even that the wrong things are being done.
  - Indeed, in most cases, the right things are being done—but fruitlessly.
- The assumptions on which the organization has been built and is being run no longer fit reality.
  - These are the assumptions that shape any organization's behavior, dictate its decisions about what to do and what not to do, and define what the organization considers meaningful results.
    - These assumptions are about markets.
    - They are about identifying customers and competitors, their values and behavior.
    - They are about technology and its dynamics, about a company's strengths and weaknesses.
    - These assumptions are about what a company gets paid for.
- Every organization, whether a business or not, has a theory of the business.
- Indeed, a valid theory that is clear, consistent, and focused is extraordinarily powerful.
- Whenever a big organization gets into trouble—and especially if it has been successful for many years people blame sluggishness, complacency, arrogance, mammoth bureaucracies.
  - But rarely relevant or correct.
- A theory of the business has three parts.
  - First, there are assumptions about the environment of the organization: society and its structure, the market, the customer, and technology.
    - The assumptions about environment define what an organization is paid for.
  - Second, there are assumptions about the specific mission of the organization.
    - Sears, Roebuck and Company, in the years during and following World War I, defined its mission as being the informed buyer for the American family.
    - A decade later, Marks and Spencer in Great Britain defined its mission as being the change agent in British society by becoming the first classless retailer.
    - AT&T, again in the years during and immediately after World War I, defined its role as ensuring that every U.S. family and business have access to a telephone.
    - An organization's mission need not be so ambitious.
    - GM envisioned a far more modest role—as the leader in "terrestrial motorized transportation equipment," in the words of Alfred P. Sloan, Jr.
    - The assumptions about mission define what an organization considers to be meaningful results; in other words, they point to how it envisions itself making a difference in the economy and in the society at large.
  - Third, there are assumptions about the core competencies needed to accomplish the organization's mission.
    - For example, West Point, founded in 1802, defined its core competence as the ability to turn out leaders who deserve trust.
    - Marks and Spencer, around 1930, defined its core competence as the ability to identify, design and develop the merchandise it sold, instead of the ability to buy.
    - AT&T, around 1920, defined its core competence as technical leadership that would enable the company to improve service continuously while steadily lowering rates.
    - Finally, the assumptions about core competencies define where an organization must excel in order to maintain leadership.
- It usually takes years of hard work, thinking, and experimenting to reach a clear, consistent, and valid theory of the business.
- **Four specifications of a valid theory of the business**
  - The assumptions about environment, mission, and core competencies must fit reality.

- The assumptions in all three areas have to fit one another.
- The theory of the business must be known and understood throughout the organization.
- The theory of the business has to be tested constantly.
  - It is not graven on tablets of stone.
  - It is a hypothesis And it is a hypothesis about things that are in constant flux—society, markets, customers, technology.
  - And so, built into the theory of the business must be the ability to change itself.
  - Some theories of the business are so powerful that they last for a long time.
  - The first reaction of an organization whose theory is becoming obsolete is almost always a defensive one.
    - The tendency is to put one's head in the sand and pretend that nothing is happening.
  - The next reaction is an attempt to patch, as GM did in the early 1980s or as Deutsche Bank is doing today.
    - But patching never works.
  - Instead, when a theory shows the first signs of becoming obsolete, it is time to **start thinking again**, to ask again which assumptions about the environment, mission, and core competencies reflect reality most accurately—with the clear premise that our historically transmitted assumptions, those with which all of us grew up, no longer suffice.
  - There is a need for **preventive care**—that is, for building into the organization systematic monitoring and testing of its theory of the business.
    - There is a need for **early diagnosis**.
    - Finally, there is a need to rethink a theory that is stagnating and to take effective action in order to change policies and practices, bringing the organization's behavior in line with the new realities of its environment, with a new definition of its mission, and with new core competencies to be developed and acquired.
- There are only two **preventive measures**.
  - But if used consistently, they should keep an organization alert and capable of rapidly changing itself and its theory.
  - The first measure is what I call **abandonment**.
    - Every three years, an organization should challenge every product, every service, every policy, every distribution channel with the question, If we were not in it already, would we be going into it now?
  - The second preventive measure is to **study what goes on outside the business, and especially to study noncustomers**.
    - But the first signs of fundamental change rarely appear within one's own organization or among one's own customers.
    - An organization must be market driven too.
- To diagnose problems early, managers must pay attention to the warning signs.
  - A theory of the business always becomes obsolete when an organization **attains its original objectives**.
    - Attaining one's objectives, then, is not cause for celebration; it is cause for new thinking.
  - **Rapid growth** is another sure sign of crisis in an organization's theory.
  - There are two more **clear signals** that an organization's theory of the business is no longer valid.
    - One is unexpected success—whether one's own or a competitor's.
    - The other is unexpected failure—again, whether one's own or a competitor's.

- Traditionally, we have searched for the **miracle worker with a magic wand** to turn an ailing organization around.
  - To establish, maintain, and restore a theory, however, does not require a Genghis Khan or a Leonardo da Vinci in the executive suite.
  - It is not genius; it is hard work.
  - It is not being clever; it is being conscientious.
  - We can't rely on miracle workers to rejuvenate an obsolete theory of the business any more than we can rely on them to cure other types of serious illness.
  - And when one talks to these supposed miracle workers, they deny vehemently that they act by charisma, vision, or, for that matter, the laying on of hands.
    - They start out with diagnosis and analysis.
    - They accept that attaining objectives and rapid growth demand a serious rethinking of the theory of the business.
    - They do not dismiss unexpected failure as the result of a subordinate's incompetence or as an accident but treat it as a symptom of "systems failure."
    - They do not take credit for unexpected success but treat it as a challenge to their assumptions.
    - They accept that a theory's obsolescence is a degenerative and, indeed, life-threatening disease.
    - And they know and accept the surgeon's time-tested principle, the oldest principle of effective decision making: A degenerative disease will not be cured by procrastination.
    - It requires decisive action.