TOMORROW'S CHALLENGES

HOW COMPANIES FAIL – AND WHAT THEY CAN DO ABOUT IT

THE CHALLENGE OF BALANCING SHORT TERM AND THE FUTURE FOR BUSINESSES

By IMD Professor Knut Haanaes

IMD
Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11
Fax: +41 21 618 07 07
info@imd.org
www.imd.org

Here are two ways your company can fail. Keep doing more of the same. Or, if you'd prefer, start doing only what's new.

You want it to thrive so you need to take the trickier middle way; you need to find the right balance between exploring new ideas and exploiting existing ones. That is, between creating new services and products that push frontiers despite the inherent risks, and using the knowledge that you already have to make something that is good even better.

It's easy to find examples of companies that go under because they were unable to imagine any future beyond business as usual. Take Facit, an office equipment manufacturer that was established in Sweden in the 1920s. It was known for making the best mechanical calculators in the world – "everybody" used them. Then the electronic calculator came along. And how did Facit respond? By continuing to do exactly what it had always done: manufacture mechanical calculators. Its engineers recognized the value of electronic calculators – they bought some in Japan and used them to double-check the accuracy of their own products – but that did not change the company's strategy. It is so difficult to change when you are so competent! Within six months the firm lost not just its place at the top of the pyramid, but everything. It collapsed completely.

It's obvious in this example that Facit failed because it focused its efforts far too strongly on exploiting what it had to the exclusion of developing new ideas, but out-of-control exploration can be just as dangerous to corporate existence. I saw this first hand a few years ago when I worked closely with a brilliant European biotech firm that had applications that promised to diagnose, or even cure, some forms of blood cancer. The company was extremely innovative; every day was about creating something new. And not just creating it but making sure that it was absolutely perfect.

But the sad thing was that before these ideas became perfect – before they even became good enough – they became obsolete. The company spent so much time coming up with ideas that it wasn't able to exploit them.

So, we can see that exploitation and exploration both carry significant risks when they're taken to extremes. It's obvious that a balance is needed. Companies that find that balance see huge pay offs. Think of Nestlé's creation of Nespresso, Lego's move into animated films and Toyota's creation of hybrid vehicles.

But getting that balance right is much harder than simply saying we need to do it. In fact, our research suggests that only about 2% of companies successfully manage both exploration and exploitation in parallel. Why is it so difficult? Largely because there are numerous traps that keep us where we are. Two of the biggest are the "perpetual search trap" and the "success trap".

The first of these arises when a company discovers something but does not have the patience or persistence to stick at it and make it work. It doesn't put in the time or the effort needed to turn an exciting idea into commercializing a new product or service. Instead, it moves on to the next discovery – which it will treat in just the same way. This is how the biotech firm I mentioned earlier ended up failing. Successful exploration requires patience and persistence.

The success trap, meanwhile, is what caught Facit out. The company was so good at making mechanical calculators that they simply didn't want to change. It stuck with what it knew well despite the need for change. In the short term doing more of the same is not risky, in the medium term not changing is detrimental. As Bill Gates said: "Success is a lousy teacher. It seduces us into thinking we cannot fail."

There are at least four things we can do to avoid or escape from these traps. First, get ahead of the crisis. Ready yourself for the next battle. Any company that can innovate is buying an insurance policy on the future.

Next, think in multiple time scales. In any one year innovation typically accounts for only about 30% of a company's value. Across 10 years, however, innovation and the ability to renew accounts for 70%. Executives need to fund the journey and lead the long term.

Third, invite diversity of talent to challenge you. Balancing exploration and innovation is a team sport. It requires people who are willing to challenge the company and its strategy – and a corporate board that will accept and listen to that challenge.

Finally, be skeptical of success. Learn from history. Roman generals celebrating a triumphant victory were accompanied by a companion telling them "Remember, you're only human".

Whether you are an explorer by nature or someone who prefers to exploit what you already know, don't forget that beauty is in the balance.

Knut Haanaes is Professor at IMD business school. This article is based on his TED talk "Two reasons companies fail – and how to avoid them".

Related Programs

ORCHESTRATING WINNING PERFORMANCE - http://www.imd.org/owp

Create your own learning journey
Program Directors Michael Wade and Dominique Turpin

- Get exposed to the latest management thinking and to practical and innovative solutions for your business
- Anticipate global business trends
- Boost your performance, broaden your perspectives and expand your global network
- Design the program that suits you and your team
- Become a complete executive through activities that develop your mental, physical, and emotional health