Quick takes

Larry Goodson

These brief summaries highlight the key points and action steps in the feature articles in this issue of Strategy & Leadership*. Larry Goodson, an* S&L *contributing editor, is a veteran strategy consultant based in St. Louis, Missouri. He is a Partner at LDGA Consulting, which offers Lean operations and strategy development services (ldgoodson@msn.com).*

Interview

Ron Adner: Strategic guidance for a new world of "ecosystem disruption"

Brian Leavy

Great innovations often fail because their promoters do not take enough account of the critical co-dependencies in the innovation's overall ecosystem, observes strategy and innovation expert, Ron Adner.

In his latest book, *Winning the Right Game: How to Disrupt, Defend and Deliver in a Changing World*, Professor Adner examines disruptive innovation, which in the digital age is no longer just about "industry disruption" but now the even more extensive phenomenon of "ecosystem disruption."

Strategy & Leadership: You note that, "Classic disruption was industry disruption. Modern disruption is ecosystem disruption." What is the essential difference between these two?

Ron Adner: Classic disruption was focused on dealing with the challenge of new technologies – new ways of creating your current product or service. In contrast, ecosystem disruption arises when new value propositions redraw boundaries – automobiles to mobility platforms; banking to fintech – these transitions change the core of what is being done.

Strategy fundamentals for analyzing ecosystem disruption

S&L: At the heart of your book's approach is the notion of "value architecture." What role does this new analytical tool play?

Adner: To see this new kind of disruption – ecosystem disruption – we need a new way of understanding competition. "Value architecture" captures the design of a value proposition from the perspective of the firm, rather than the perspective of the end customer.

S&L: Why does your new approach require "a critical revision of our view of complements"?

Adner: The key difference between classic disruption and ecosystem disruption is that the source of the threat does not start as an opponent but as a benign co-creator of value.

Implications for ecosystem and company leadership

S&L: You caution corporate leaders not to succumb to the "ego-system trap."

Adner: The "ego-system trap" arises when companies define their ecosystems around their offering, rather than their value propositions.

S&L: How should company strategists think about the pursuit of "ecosystem leadership" differently from traditional "industry leadership?"

Adner: In industries, leadership is measured by your own competitive outcome—relative market share, profits and brand strength. In a successfully aligned ecosystem, all participants—leader and followers—win when the promise of the value proposition is realized.

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Rethinking the M&A model: give value to get value

Roger L. Martin

Six of the seven top years all-time for M&A activity were 2015–2020. But the track record is notoriously bad. Very few M&A deals create value and those that do generally require enlightened management and a new model for understanding what drives the value of the acquired company.

So why do so many companies persist with M&A as a strategy? To be blunt, existing business development models are extraordinarily persistent in the face of ineffectiveness.

The secret is to think of M&A as a meeting of minds, in which the acquirer helps the target to fully realize its value-creating potential by making new opportunities available, offering smarter management and providing access to new and complementary capabilities. Four ways to promote such opportunities are:

1. Be a smarter provider of growth capital
   Being a better investor gives scope for creating value.
2. Provide better managerial oversight
   The second way to enhance an acquisition's competitiveness is to provide it with better strategic direction, organization and process disciplines.
3. Transfer valuable skills
   An acquirer can also materially improve the performance of an acquisition by transferring a specific—often functional—skill, asset, or capability to it directly, possibly through the redeployment of specific personnel.
4. Share valuable capabilities
   The fourth way is for the acquirer to share, rather than transfer, a capability or an asset. In this case, the acquiring company doesn't move personnel or reassign assets; it merely makes them available.

So why do executives keep the boom going?

The system in which CEOs operate is biased in two ways in favor of playing the M&A lottery. First, with the rise in stock-based compensation since the 1990s, the value of a successful acquisition bet is greatly enhanced for the CEO. If the acquisition gives the stock price a positive "pop," the personal benefit to the CEO is huge.

In the United States the second bias started with an unlikely source: the Financial Accounting Standards Board. Before 2001, intangible assets were written off over a forty- year period. The FASB later decided that in the future a company's auditors would declare whether intangible assets were impaired. This change makes acquisitions more attractive because the acquiring company's earnings would no longer be suppressed every year by an automatic write-off.

Adopting the new model

But if you change your thinking about M&A, it can be a very successful way to grow. The secret is to stop thinking about acquisitions as if targets were jewels to be mined. Think of M&A rather as a meeting of minds in which the acquirer helps the target to fully realize its value-creating potential by making new opportunities available, offering smarter management and providing access to new and complementary capabilities.

Employing lesser-known corporate development strategies while avoiding problematic blind spots

Joseph Calandro , Jr.

The Art of War by Sun Tzu "is the longest existing and most widely studied military classic in human history." Many of its insightful strategic axioms have relevance for business strategists involved in acquisition conflicts.

- "The ultimate achievement is to defeat the enemy without even coming to battle.
- "In all kinds of warfare, the direct approach is used for attack, but

the oblique [or indirect approach] is what achieves victory.

- "In war it is winning alone that matters and there is no merit in prolonging a campaign."

A central tenet of Sun Tzu's approach is that the best action is always the most resource efficient. However, in the tug-of-war of corporate development and M&A, the superior strategic actions are the most "hyper-efficient."

Regrettably, the strategic logic of hyper-efficient resource utilization has rarely been popular. Similarly, all too often M&A deal making falls into the trap of head-to-head competition that drives valuations to "sky-high" levels. Fortunately, four lesser-known corporate development strategies offer lucrative alternatives to engaging in a bidding war:

- Achieving a strategic objective without competition.
- Combining direct and indirect actions.
- Supplier credit positioning.
- Achieving quick pay-offs.

Blind spots

Good strategists often take advantage of lesser-known strategies such as those profiled above when they're considering a deal. But what differentiates truly great strategists? Crucially, they do not repeat what has failed in the past. They make strategic moves where they are least expected against vulnerable competition.

To compensate for strategic blind spots when considering a deal, firms will be more likely to identify hyper-efficient opportunities if they assign a senior corporate development executive to specifically and consistently look for them. The truly strategic acquirer understands that such head-to-head competition resulting in "sky high valuations" is a dangerously unwise risk to be zealously avoided.

Lesson learned

The business equivalent of wasteful military frontal assault is bidding and other price-based "warfare," which pits competitors in head-to-head competition. A better way is to invest in areas where competition is the weakest, and preferably nonexistent, while bypassing areas where competition is the strongest.

Rethinking the M&A process: Learning private equity's secret to outperforming corporate strategic acquirers

John Gilligan and Timothy Galpin

When private equity (PE) fails, it often fails with a big bang. It has become a familiar narrative that when a PE firm takes control of a company, draconian cost cuts follow while at the same time the company is saddled with unsupportable debt, ultimately leading to disastrous results, including mass layoffs and eventual bankruptcy for the business.

Though many view PE firms as value-destroyers, various peer-reviewed studies have found that PE-backed firms have a surprisingly favorable record.

Corporate strategic acquirers too often destroy shareholder value

After the lull caused by Covid-19, merger and acquisition (M&A) activity has come roaring back for both "strategic buyers" – companies that endeavor to use M&A to supplement or grow their operations. For example, a broad analysis of 2,500 deals found that more than 60 percent destroyed shareholder value.

Private equity firms create value for their investors

In contrast, PE firms, whose business model is predicated upon repeating

M&A, have a better record of creating value for their investors. The average annual return to investors across 1,297 U.S. private equity funds was 14.23 percent after management fees over a 25-year period through Q2 2021 compared with 9.69 percent for the Russell 3000. [9]

Private equity's programmatic approach to value creation

PE employs two basic strategies within their business model to create value for investors.

- The first is to increase the value of the "stand-alone" assets they acquire by increasing the cash flows of those businesses through standard operating cost reductions and revenue enhancement activities.
- The second approach – analogous to a strategic buyer approach – is for a PE firm to grow an acquired asset through a "buy and build" or "add on" strategy of several subsequent acquisitions to expand operations, generate value and increase returns.

The PE playbook

Based on over three-decades of advisory work with various private equity firms in Europe and the US, an unmistakable characteristic is commonly noticeable across the industry: PE firms' approach their deal-making as a repeatable process driven activity, especially when employing a buy-and-build strategy.

Strategic buyers should take lessons from the PE playbook

Although the history of M&A value destruction presents a challenging picture for corporate strategic buyers, the news isn't all bad. An analysis of 228 bank mergers found that applying tacit and codified M&A knowledge during deals, implemented by seasoned dealmakers who utilize repeatable playbooks enhanced deal performance.

Takeaways

PE firms' success can be attributed to employing experienced dealmakers who consistently apply a transaction "playbook" across their deals, a practice corporate strategic buyers should adopt.

Crafting a performance-focused strategy of "Deep Purpose"

Stephen Denning

At a time of growing concern that corporations are not truly acting as good corporate citizens, Professor Ranjay Gulati's new book, *Deep Purpose: The Heart And Soul Of High-Performance Companies* and the *Harvard Business Review* article "Purposeful Business the Agile Way," by Bain senior partner, Darrell Rigby, and colleagues, rethink how firms can integrate a responsible mission with their business model.

The concept of "Deep Purpose"

Professor Gulati's book and his *HBR* article, "The Messy but Essential Pursuit of Purpose" introduce the concept of "deep purpose." His research found that leading firms integrate it into operational processes and treat "purpose as an existential intention that informed every decision, practice and process.

Clarifying the concept of deep purpose

Professor Gulati offers a two-part definition of firms that exhibit deep purpose.

- First, they delineate an ambitious long-term goal for the organization.
- Second, they give that goal an idealistic cast, committing to the

fulfillment of broader social duties.

Distinguishing deep purpose from convenient purpose

A second strength of Professor Gulati's book and article lies in contrasting deep purpose with "purpose as a tool," "convenient purpose," "shared purpose" and "virtue signaling."

Many firms adopt idealistic purpose statements, take a range of actions to serve society and yet continue to sell products and services that cause serious harm to stakeholders.

When purpose is unclear, decision-making is confused

"Etsy, the online arts-and-crafts marketplace . . . founded in 2005 . . . [had] always been defined by its purpose of giving 'makers' a venue and tools for marketing their wares and creating their own small businesses. By 2012, under a new CEO, Etsy had adopted a more ambitious mission—'to re-imagine commerce in ways that build a more fulfilling and lasting world.'"

Not surprisingly with such a vague goal, customers became short-changed. Staff benefits mushroomed. Profits declined. After the CEO was fired, Etsy got back to its primary purpose of co-creating value for customers and operating with a clear focus on delivering value to its "maker" customers.

The alternative: the potent goal of co-creating value for customers

Fortunately, there is another way. In the first two decades of the 21st century, the most successful firms – including Amazon, Apple and Microsoft – addressed the problem of purpose by embracing a different primary goal: customer primacy.

Bain senior partner, Darrell Rigby, described the prioritization among stakeholders: All stakeholders are important, but not all stakeholders are equal.

- First and foremost, the objective of any business must be to help its customers achieve their goals.
- Second, it is to help employees achieve their full potential.
- Third, there should be benefits to the communities that the firm serves.
- Fourth, and finally, a firm must be financially able to maintain operations.

A key to achieving successful implementation of the stated goals is ensuring that metrics and rewards are aligned with these goals.

Are post-COVID return-to-growth plans gaining priority over transformation?

Cindy Anderson, Christian Bieck and Anthony Marshall

Previous surveys of executive sentiment by the IBM Institute for Business Value in 2020 suggested that the common theme among many organizations was that organizational agility and digital acceleration emerged as essential, or even existential, drivers. But with COVID-19 in its third year, it is time assess whether the conclusions of past reports remain relevant for the situation in 2022.

Have leaders really learned the lessons of 2020?

Before the pandemic many organizations extolled "becoming a digital enterprise" as their strategy aspiration, but relatively few had moved in that direction. The pandemic exposed that gap. Consequently, 66 percent of leaders we first surveyed managed to complete initiatives that had

encountered resistance before the pandemic.

Renewed focus on growth is consistent

Two years ago, the major benefits executives were seeking from digital initiatives were productivity gains and cost reductions. Today, their goals have shifted to workforce flexibility and new markets, both of which previously appeared in the bottom half of their wish list. When CEOs were asked in which areas their organization would be allocating investment, "growing revenue" and "accelerating innovation" were priorities.

Equipped with this direction from their chief executives, CIOs are responding with expanded technology investment to promote growth rather than prioritizing digital transformation.

Value of ecosystems grows

Our recent analysis reveals that organizations that gain and maintain a strong ecosystem positions in their markets benefit from growth rates that might be up to six times higher than that their less ecosystem-focused competition.

The power of ecosystems – and their growth potential – is especially significant when combined with enterprise transformation. Executives that identify their organizations as ecosystem leaders report being almost 60 percent further along in their transformation efforts than their peers.

Technology is foundational, but the human element is more important than ever

On the workforce side, the "Great Resignation" has left its mark on HR strategy. "Improving employee engagement" is among the top four most important business objectives going forward for CEOs.

Return to strategic focus is fueling change

CEOs now report strategic planning horizons have shortened by roughly 25 percent – from a median horizon of four years down to three, with the planning refresh at two years. This is consistent with the fact that a majority of CEOs favor flexibility and reaction speed for their strategic approach over prediction and preparation.

Make the new normal work

Whether the main enterprise priority is transformation or growth, a combination of both in a platform- and ecosystem-driven strategy is the superior and essential path forward.