Business is sent back into the classroom

Over the past few years, innovation has taken a back seat as business leaders have faced a period of recession, a crisis in governance and the growing challenge of terrorism. Nonetheless, the long-term health of organisations has always depended, and will always depend, on innovation. Competitors relentlessly copy great products, creative services and best practices. The only way to avoid becoming old is continuously to create the new.

People love good stories. Those about innovation glamourise the solitary, brilliant and heroic inventor. And they magnify that light bulb moment, when an idea for a better product or solution appears, as if from nowhere. It is a story with undeniable popular appeal.

In truth, ideas are cheap. In fact, encouraged by a wave of consultants preaching the need to “break all of the rules,” corporations have become much more skilled at engaging their workforces in identifying new opportunities. But an idea only marks the start of the innovation journey and numerous barriers stand between the initial idea and profitable business.

Leaders that believe too much in the romantic version of the innovation story spend far too much effort on the search for that one elusive earth-shattering idea. The real challenge of innovation, however, is making the most of the “maybes”. This requires constant experimentation, learning from these experiences and then adapting accordingly.

Many managers will not like the sound of this. After all, shareholders demand reliable, predictable results from corporations. They loathe uncertainty. It is, therefore, essential when experimenting with new ideas to learn from experience as quickly as possible. Spending on experiments that grow in promise can quickly be doubled. On the other hand, spending on those that do not can be suspended just as quickly.

Where corporations succeed in learning – and fail

Some companies have recognised the value of the scientific method. For example, Toyota excels in continuous process improvement by training factory-floor employees in the scientific learning approach and encouraging mini-experiments aimed at improving production steps. Each employee understands how to state a hypothesis, create an experiment to test the hypothesis, and collect data to validate or invalidate it.

Part of the reason this approach works, however, is that experiments
that Toyota encourages tend to be inexpensive, quick and unambiguous. They either succeed or fail based on identifiable and clear measures. However, many promising business innovations simply cannot be tested at such a low expense, with such rapidity or with complete clarity. In other words, companies must continue to grapple with the challenge of learning from much more difficult experimental environments.

Certain groups within the business community have well-established traditions of scientific experimentation. For example, market research departments have perfected approaches to test potential new products, and research departments use scientific methods to develop and commercialize new technologies.

But this leaves a gaping hole. It is in testing entirely new business models – in learning from strategic experiments – that companies struggle. Consider the dotcom environment of the late 1990s. Companies large and small threw millions of dollars at new opportunities with unproven business models. Results were far from immediate and verifiable. Evidence supporting or not supporting the sustainability of each new business experiment arrived in a piecemeal fashion, over periods of several quarters or even years. There was no single measure of success. Instead, there were partial data along multiple dimensions that somehow had to be sensibly interpreted.

This is far from the ideal experimental environment. It is more akin to say, the science of evaluating the health effects of a new pharmaceutical (which might involve multiple measures over several years), than to the science of validating automotive safety features. Nonetheless, these are difficult tasks; much data can be reduced to a few key measures, and is available immediately.)

This is not to say that a scientific approach to evaluating and experimenting is out of reach. But it is, perhaps, a bit unnatural. General managers view themselves primarily as administrators and rarely, if at all, as scientists. Nonetheless, they are capable of scientific inquiry despite the unfamiliar environment. They must also be aware of the need for it and understand how organizational realities and the demands of scientific conflict.

**Barriers to learning from strategic experiments**

Resources allocated to new business experiments are often significant but with no guarantee of a successful outcome. The high personal consequences – either in compensation or career trajectory – that can distort the process of interpreting results. Managers within organizations, over power or over resources, can make the situation worse. Several interpretations of results are possible, none of which can be fully proved or disproved. Thus, the likelihood that interest or influence will distort the learning process is high indeed.

Back-room political maneuvering makes for a vivid narrative, but there is an even bigger demon tainting the learning process – one that is cleverly disguised as something routine and administrative. That demon is the general management planning process.

When testing experimental new businesses, the planning process and the learning process (planning method) are closely related. It is through the planning process that a hypothesis about the future of the innovative business in demand, and, at some later point, outcomes compared with predictions. Analysis of this comparison guides whether or not the hypothesis is refuted or strengthened.

Fortunately, most CEOs insist on a rigorous and disciplined planning process. Many CEOs specify key do so in such a way that is incompatible with learning. Conventional planning practices are based on two premises that simply do not apply when testing experimental new businesses.

The first is that of reliable predictability. Plans are assumed to be accurate. In fact, in many industries, the basic culture is that you perform up to plan – or else. A “performance-oriented culture”, in which managers are held accountable if they fail to deliver results that meet or exceed their targets, is often cited as a hallmark of successful companies. But in experimental businesses, too much is unknown for such strong demands to be made of managers. The hope should not be to bring performance in line with accepted standards, it should be to learn what standards are possible.

The second premise is an ongoing concern. In mature businesses, each quarter looks much like the previous one. Thus, a snapshot view of the business that looks at one period only tells a great deal about performance. It is either improved over the previous period or it is not. Experimental businesses, by contrast, are dynamic. Every quarter is different. Sensible analysis of results relies a great deal on the ability to diagram theories.

Many CEOs cite an approach to planning and accountability as a cornerstone of their organization’s success. Nonetheless, there is a reason to be a reasonable chance of learning from strategic experiments. In fact, because of the two faulty premises, seven specific key do so in such a way that is incompatible with learning. Conventional planning processes must be changed for strategic experiments. We call the new approach to planning theory-focused planning (see box).

**The innovation imperative**

The twin forces of globalisation and the digital revolution are reshaping the economy at a remarkable rate. Just as these forces make past business models obsolete, they open up new opportunities for pressurizing within organisations, over power or over resources, can make the situation worse. Several interpretations of results are possible, none of which can be fully proved or disproved. Thus, the likelihood that interest or influence will distort the learning process is high indeed.

The organisations most prepared to face the future are those skilled at learning from experiential evidence. These are managers who make the move from learning to learning from experiments with new business models – most troublesome are conventional planning practices.

Using the seven principles of theory-focused planning greatly improves the odds of learning quickly.

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**The Seven Principles of Theory-Focused Planning**

- **Principle 1 Minimise detail.** Typical plans within mature businesses include breakdowns of the revenue forecast by product line, region and month. This makes it easier to troubleshoot problems. For example, it helps to identify that red widget sales in the north-west sub-region declined because several experienced salespeople unexpectedly left the company.

- **Principle 2 Focus on theory, not numbers.** In most planning documents, with sophisticated statistical analyses you will find endless tables of numbers offering detailed predictions of future performance. But in new businesses, the theory used to produce the predictions is far more important than the predictions themselves – which are nearly always wrong anyway.

- **Principle 3 Hold innovation leaders accountable for learning.** This is not to say that a scientific approach to evaluating new business opportunities with unproven business is developed, produces adequate predictions. Adequate predictions are much more helpful. Some practitioners manage cringe at the word “theory.” It sounds like the opposite of “practical”, but it is not. New businesses are gambles on a theory about what can work in future markets. An investment in a new business is a bet on the theory. Therefore, a systematic approach to testing the theory is sensible protection of that bet.

- **Principle 4 Examine and experiment.** Unfortunately, most CEOs insist on a rigorous and disciplined planning process. Many CEOs specify key do so in such a way that is incompatible with learning. Conventional planning practices are based on two premises that simply do not apply when testing experimental new businesses.

- **Principle 5 Identify non-financial performance measures.** Plans for mature businesses focus heavily on reliable predictability. Strategic experiments cannot benefit from such detail. Instead, plans should focus on identifying key outcomes – that companies struggle. This enables thorough comparisons between predicted trends and actual outcomes. Significant disparities serve as evidence to debunk the theory on which the business is based. Analysis of these disparities drives the learning process. In turn, these lessons alter former impossible companies to focus on a winning approach.

- **Principle 6 Identify non-financial performance measures.** Plans for mature businesses focus heavily on reliable predictability. Strategic experiments cannot benefit from such detail. Instead, plans should focus on identifying key outcomes – that companies struggle. This enables thorough comparisons between predicted trends and actual outcomes. Significant disparities serve as evidence to debunk the theory on which the business is based. Analysis of these disparities drives the learning process. In turn, these lessons alter former impossible companies to focus on a winning approach.

- **Principle 7 Hold innovation leaders accountable for learning, not results.** Once a plan is in place, leaders within organizations often view their duty as implementing the plan and showing its success. But principles one to three reduce demands on planners, so extra time should be available to revise plans often.

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