More thought, less analysis

How a creative approach can boost shareholder value

Academics and consulting firms have done much to help managers understand how to measure value created for shareholders. Managers have also become better at choosing between strategies according to their value-creation potential. However, say DENIS KILROY and MICHAEL MCKINLEY, to create value for their customers and shareholders over the long term, managers need to develop thinking skills and decision processes which make use of both creative and analytical abilities.

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Most business executives understand that maximising the value of the capital with which they have been entrusted by their shareholders is one of their most fundamental responsibilities.

Most also know that:
- value is the present value of future cashflows;
- the difference between market value and book value (ie, value created in excess of book value) is the present value of future economic profits; and
- shareholder value will only be created through management generating and sustaining economic profits in excess of current stockmarket expectations (by growing positive-spread businesses where the return on investors’ capital exceeds the cost of capital, or by increasing spreads).

Figure 1 shows that an initial analysis of business performance according to these principles can lead to clear insights and often to remedial action. However, while managers can create value through actions such as the divestment of businesses for which a value-creating strategy cannot be found, once this action has been taken, the path forward is less clear.

Although analytical tools can help managers to understand the mechanism by which value is created, or the value-creation profile of a business or a group of businesses, they usually do not provide much guidance in actually creating that value for their customers and their shareholders over the long term.

Most analytical tools simply measure and display value creation. They are not the source of value creation. The source of value creation is management thinking.

The stockmarket values the ability of a management team to stay ahead of the competition over the long term, and to make the strategic and operational changes necessary to grow the business and to continue to earn returns in excess of the cost of capital.

We use the adjective fit (meaning vigorous and robust) to describe an organisation whose management has developed the ability to do this. Ultimately, the market values organisational fitness, and at the core of a fit organisation lie superior thinking skills.
HYBRID THINKING – A MORE PRODUCTIVE PROCESS

Hybrid thinking, in which the thinker alternates between analytical and creative modes of thought, is far more powerful than the purely analytical approach that prevails in most organisations. Hybrid thinking, which offers enormous potential benefits to most business organisations, has been responsible for most of the major breakthroughs in understanding throughout human history.

Plato believed that the process of thinking and learning consisted of four stages:

- unsubstantiated imagination;
- believing in a possibility;
- hypothesising a path forward; and
- dialectic reasoning or argument about whether it was the right path or not.

Aristotle had a less expansive view, and sought to focus the thinker’s energy on the fourth activity – rational argument.

Plato was postulating a hybrid thinking process consisting of creative or intuitive (non-linear) thinking, and rational or logical (linear) thinking. Aristotle’s focus was on linear thinking alone.

Most managers employ a linear system of thinking that has evolved from dialectic reasoning. It includes data-gathering, analysis, judgment, argument and criticism. The increasing processing power of computers has entrenched the prevalence of linear thinking, particularly in the business world.

Linear thinking works reasonably well in a stable environment – but only a small proportion of the managers we encounter are working in business environments which could be described as stable.

If we allow ourselves to operate only in a left-brained, analytical or rational mode, we tend to restrict our vision to things we can analyse, measure or prove empirically. Integrating analytical or linear thinking with creative or non-linear thinking produces a much more potent process. In fact, experience suggests that the best management strategies are developed through a combination of logic and intuition. In some cases, strategies developed in this way have led to a doubling of the economic value of the business.

An experienced manager may intuitively know the best path forward for his business without having any analyti-

Figure 1: Typical value-creation profile for a major listed corporation

Figure 2: A hybrid strategic thinking framework
The process begins in one of two ways. Either data is gathered, and from that information a series of possibilities arise; or we already have a series of possibilities in mind and obtain the data we need to inform and refine these possibilities.

To deal with the information side of this step, we need a combination of data-gathering and data-processing skills. To manage the possibility side, we need both linear and non-linear thinking skills.

Possibilities can arise through linear thinking. We can deduce that an opportunity exists simply from a straightforward analysis of data. Similarly, we can deduce from a series of specific observations that a wider opportunity exists.

However, it is likely that the best possibilities will arise through non-linear thinking or a combination of linear and non-linear thinking – allowing the creative juices to flow and permitting intuitive insights to emerge.

**ALTERNATIVE BUSINESS STRATEGY DEVELOPMENT**

The next step is to begin to formulate alternative value propositions (ie, combinations of product offer and price) or business strategies (combinations of value proposition and operating configuration) as illustrated in Figure 3.

There are three fundamental ways to formulate alternatives, using rational and logical thinking skills, perceptual thinking skills and intuitive thinking skills.

**The perceptual path**

This is where insights begin to add value. We see the same data as others do but we perceive an opportunity where they see nothing. It is generally inductive in nature.

An example of this is a perception of the existence of a new market segment, or an opportunity to reposition an existing product in a different segment.

Another might be to achieve a high-level realisation that the path forward for a particular business is more likely to be through re-positioning its product range around the aesthetic and functional benefits they offer the end user, than through continuing a strategy of dominating through price-based long-term distribution contracts and lower-cost production.

**The logical path**

When we pursue the logical path, we implicitly assume that our logical analysis of the data will suggest to us the "way to go". This path rarely leads to any major breakthroughs, but it can and often does lead to value-creating enhancements to an existing value proposition or business strategy. It is generally deductive in nature.

The decision to raise price in a segment in which our return is below the cost of capital, but in which demand is well in excess of supply, is an example of this type of thinking.

It is important to recognise that it will not take long for competitors to arrive at the same conclusion. The data is available and the logic is usually apparent to all.

**The hybrid strategic thinking framework**

The hybrid strategic thinking framework consists of three principal steps:

- information and possibilities;
- alternative business strategy development; and
- analysis and evaluation.

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The intuitive path
The intuitive path is where we can make the cash register ring, if we get it right.

We cannot use this path alone, as we can the logical and (to a lesser extent) the perceptual paths. An intuitive insight needs to be grounded with logical or rational analysis, but it may give us a different starting point for that analysis.

It often demands the application of abductive logic or “breakthrough thinking” to establish whether a feeling or an insight is helpful or worthy of further investigation.

We are forced to pose the question: “What must I believe or be able to demonstrate to be convinced that this feeling I have is correct?”

An example of an intuitive insight is the “feeling” that a pipe product which has been offered to the water, sewerage and drainage market could be turned on its end and sold as an architectural column in an entirely different market.

Once the creative insight is on the table, the rational analysis necessary to ground it in reality becomes relatively straightforward to design and complete.

ANALYSIS AND EVALUATION
The final step is to determine the best – the most value-creating – path forward. To do this, it is necessary to think in terms of value creation for both customers and shareholders, since the objective is to win in two markets:

- the market for products and services; and
- the market for shareholder capital.

Figure 4 illustrates the interdependence of these two markets.

Winning in the market for products and services usually means being able to create more value for customers than the competition by offering a superior value proposition.

Winning in the market for shareholder capital means creating more value for shareholders than the competition, usually by delivering that superior value proposition more efficiently than the competition.

DEVELOPING HYBRID THINKING SKILLS
It is not difficult to develop hybrid thinking skills. For most managers, it means unlocking a creative capability that has been long-suppressed, and integrating this capability with already well developed analytical thinking skills.

Some excellent work on the development of thinking skills has been done in recent years by Barbara Minto, Edward de Bono, and Professor Loris Malaguzzi, preceded by some sound philosophy recorded long ago.

The analytical tools used in strategic analysis and strategy development should be viewed as just that – tools to help managers unlock the knowledge they often already have. They should not be seen as solutions or sources of solutions.

Creating value for shareholders is a creative act, not just an analytical process. It requires hybrid thinking skills.

Only by adopting a hybrid approach to thinking will we be able to respond to complexity with simplicity, escape the seemingly endless demand for more and more analysis, and create value instead of merely developing more and more sophisticated ways of measuring it.

NOTES
1 The term value proposition was coined by Lanning and Phillips. See “Strategy Shifts Up a Gear”, Marketing, October 1991, pp. 9-14.
2 The logical, perceptual and intuitive paths were identified by de Bono.
3 IQ tests often include questions such as: What is the next number or letter in the sequence 1,1,2,3,5,8 or O,T,T,F,F,S,S? These questions test the respondent’s ability to perceive a path forward.
4 Professor Loris Malaguzzi (1920-94) was a leading thinker behind the approach to early childhood learning and development pioneered in the schools of Reggio Emilia in Italy. His works point to the perils of separating the heart (intuition) from the head (rational thinking).

REFERENCES
de Bono, Edward, 1994, Parallel Thinking – From Socratic to de Bono Thinking, Penguin, London.