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The New Psychology Of Strategic Leadership

Cognitive science sheds fresh light on what it takes to be innovative. *by Giovanni Gavetti*

Michael Porter opened his classic "five forces" article with these sentences:

"In essence, the job of the strategist is to understand and cope with competition. Often, however, managers define competition too narrowly."

It would be difficult to imagine a more appropriate opening here. In this article, I argue that today's dominant ideas about the practice of business strategy—defined by Porter in these pages three decades ago—hinge on a specific and therefore partial interpretation of competition. The result is an equally partial picture of the strategist's job.

The problem lies not in what strategists are trained to do: Porter's perspective is powerful—so powerful that it has dominated both the teaching and the practice of business strategy for 30 years. The problem lies instead in what strategic leaders are *not* trained to do. In caricature, Porter's view casts strategists as practitioner economists who expertly analyze and manage market forces. I suggest that strategic leaders must also be practitioner psychologists who expertly analyze and manage their own and others' thought processes. To broaden the strategist's role in this way, I pursue an interpretation of the competitive game that differs from Porter's. Let us see how.

In thinking about the strategic leader's job, competition is a natural point of departure. Intense competition makes it difficult for companies to gain attractive returns on investments. This general truth implies that strategists should search for opportunities where competition is weak. Porter's great insight was that companies compete not only with their direct rivals but also with their customers and

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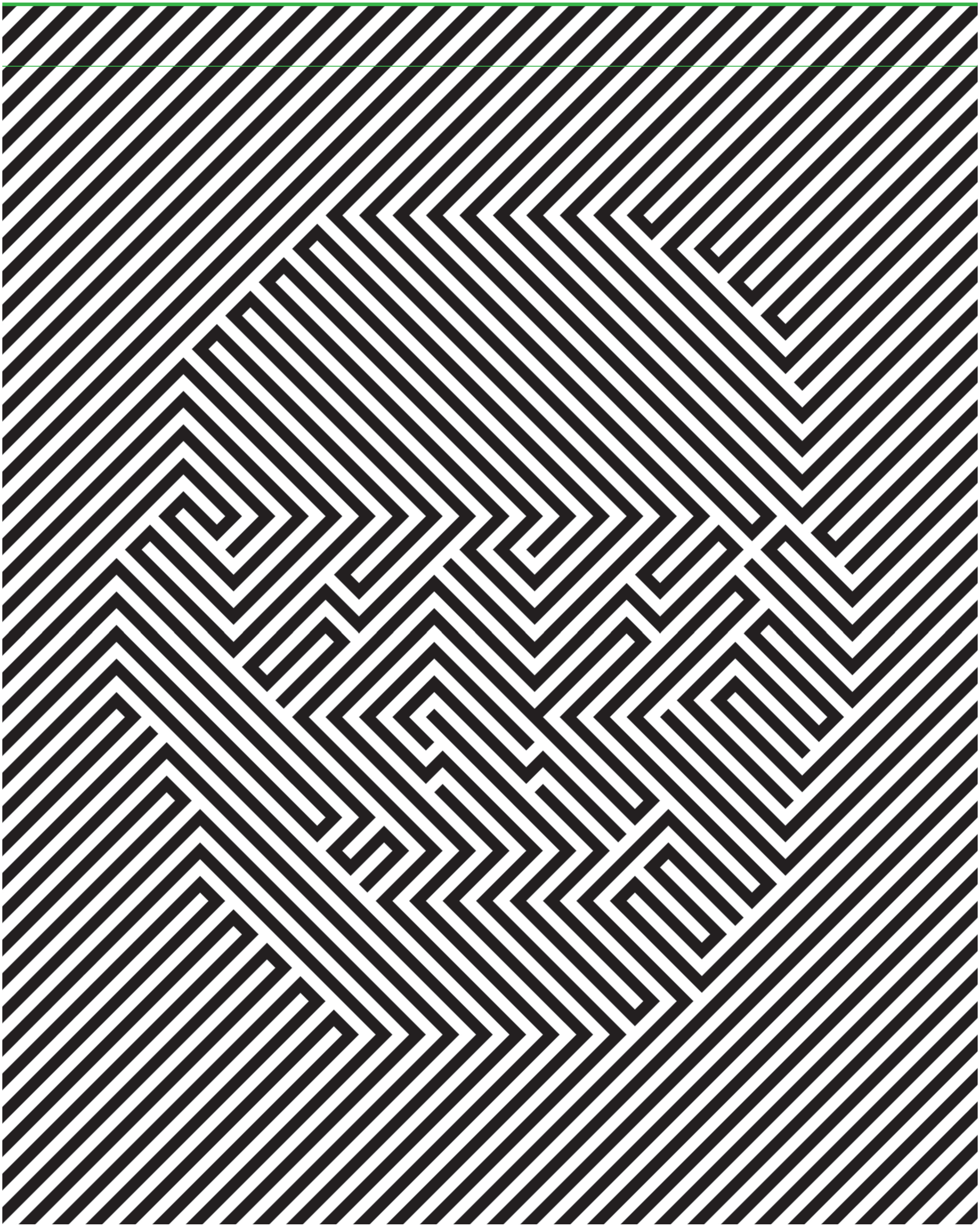


The difficult quest for distant opportunities requires strategic leaders who are good economists *and* good psychologists.

suppliers. All these players create value—and compete for a piece of the pie. To identify the best positions, the strategist must pay attention to the entire vertical chain of economic activity. This more-comprehensive picture greatly helps strategists identify successful strategies—which, as Porter asserts, are those that are "different, unique, and distant from the status quo."

Now let's look at competition from another, strategist-centered perspective. The strategist must still search for opportunities where competition is weak. But the intensity of competition that a firm faces isn't considered in the context of how vulnerable the firm is to market forces in the value chain. Instead, it's considered in the context of how hard it is to identify superior opportunities and deliver on them. An opportunity might be free of competitive pressure precisely because no strategist has been able to conceive of it, or lead the organization toward its execution. Following this logic, the best strategic opportunities are those that are the hardest to spot and execute.

Let's follow this logic more closely. Imagine a business landscape with numerous opportunities and competitors. Imagine that all these firms are led by omniscient leaders who can see the full landscape of opportunities and easily move their troops toward the desired positions. What would happen in such a scenario? All superior positions would be quickly competed away. But in the real world, strategic leaders are not omniscient, which means superior opportunities remain available. What's more, because in most businesses strategists have similar mental representations, they perceive and pursue the same opportunities—and overlook the same attractive opportunities.

These overlooked opportunities, which I call "cognitively distant" because recognizing them requires a mental leap, are not only hard to spot. They're also hard to act on because they often require changes in a firm's identity, which employees generally resist. And they're hard to legitimize because they contrast with the representation of the company that key external stakeholders, such as financial analysts, maintain. This way of thinking suggests that a crucial component of strategic leadership is the mental capacity to spot opportunities that are invisible to rivals and to manage other relevant parties' perceptions to get them on board.

A famous business story highlights the differences between the two perspectives. In the late 1930s, Charlie Merrill took the banking community by surprise with a strategy that extended banking services to a vast new middle-class market and made Merrill Lynch one of the most successful companies in the history of corporate America. Through Porter's lens, this opportunity existed because one competitive force (customers) was vulnerable to another (banks, as reconceived at Merrill Lynch). Other competitive forces were strong, but customers were weak, and Charlie Merrill capitalized on this vulnerability. Merrill was a great leader, Porter's lens tells us, because of his superior ability to read the fundamental economics of the business.

But through the lens I'm proposing, a different picture emerges: The opportunity Charlie Merrill discovered—banks as "financial supermarkets" offering an array of products to a variety of customers—had not been exploited earlier because nobody had been able to conceive of it, even though many bankers were frantically scrambling for profits. In other words, Merrill didn't just read the economics of the business—he reconceived it through an analogy that contained a great insight that other bankers did not have. What's more, he persuaded both internal employees and external stakeholders, such as customers and capital lenders, that his idea had merit. Merrill was a great leader because of his superior ability to manage mental processes—his own analogical reasoning, which led him to envision the financial-supermarket strategy, and the thinking of others, helping them embrace the reconceptualization of the business and bringing stakeholders on board.

The shift in perspective is radical. It's a shift from markets to minds, from strategic leaders who need to understand and cope with market forces to ones who also need to understand and cope with mental processes. This shift does not diminish the economic approach to business strategy—an in-depth appreciation of market forces is a crucial component of the strategist's job. Rather, it mitigates an unintended consequence of the dominance of Porter's lens: inadequate attention devoted to the strategist's noneconomic role, especially to the psychological aspects of strategic leadership.

In the pre-Porter era, sophisticated knowledge about market forces existed, but it had not been interpreted through the lens of what it takes to achieve superior performance. It was thus not a useful, actionable guide to competitive strategy. Porter's key contribution was to develop this lens, using a framework that linked superior opportunities to the intensity of market forces, and showed strategists how to search for vulnerabilities in those forces and exploit them. Today, advances in behavioral and cognitive disciplines give us new knowledge that can usefully expand the strategic leader's role. Again, we need a lens that helps strategists interpret this knowledge as it relates to the pursuit of superior performance. The lens I propose links superior opportunities to strategic leaders' ability to spot, act on, and legitimize them. I use recent work in the cognitive and neurological sciences to illuminate how strategic leaders can manage relevant mental processes and overcome their own and others' cognitive limitations in pursuing distant opportunities.

Porter's framework and the one advanced here cover different ground. Despite their differences, the two approaches converge on the idea that the best opportunities lie far from the status quo. They are thus complements, not substitutes. The difficult quest for distant opportunities requires strategic leaders who are good economists *and* good psychologists.

The Trouble with Cognitively Distant Opportunities

In laying out this new perspective, the first step is to explore what makes it especially hard for strategic leaders to do their three key jobs: spot opportunities, act on them (get employees engaged), and legitimize them (get external stakeholders on board). The limitations all result from the challenges of managing the mental representations through which people interpret the competitive landscape.

Spotting opportunities. Research tells us that managers are fairly good at identifying opportunities—and predicting the outcomes of actions—that are cognitively close to what their companies are already doing. Walmart's expansion into suburban territory is an example of a "close" opportunity. The company's original strategy was to locate stores in rural areas only, so the move did represent a big, complicated change: Walmart's cost structure and operational organization shifted; on top of that, the company needed to respond to the very different habits of suburban shoppers. Nonetheless, the move was incremental in the sense that Walmart was changing only one of its many strategic pillars. Its executives were able to recognize the opportunity easily and evaluate it skillfully.

We also know that in most industries companies cluster around a relatively small number of strategic positions and within each cluster hold similar conceptions of how to compete. Consider the motorcycle industry, which has two major clusters of firms. The Japanese manufacturers—Honda, Yamaha, Suzuki, and Kawasaki—compete on technical innovation

Idea in Brief

Firms typically cluster around a few strategic positions, leaving others unoccupied.

The intense competition on those occupied mountaintops makes it hard for firms to gain attractive returns. Superior opportunities lie on the unoccupied mountaintops. Because they are "cognitively distant"—far from the status quo—they're hard to recognize and act on, and therefore competition is weak.

Strategists are trained to analyze economic forces when they want to identify superior opportunities. But analytics usually won't uncover the kinds of ideas that overturn the status quo.

Recent research on human cognition suggests that leaders would do better to use associative thinking to spot, act on, and legitimize distant opportunities. They should learn to make analogies with businesses in other industries, for example. Reinvention, it turns out, draws on intuition as much as it does on rationality.

This article explores ways to jump-start associational thinking—and to bring stakeholders along on the journey.

and lower costs. The Harley-Davidsons and Ducatis of the world view their business through a very different lens—as entertainment. Here's how Federico Minoli, the CEO and chairman of Ducati from 1996 to 2007, described his decision to build a museum celebrating the firm before he repaired a damaged factory: "Ducati is not, or not only, a motorcycle company. We sell something more: a dream, passion, a piece of history." Analyze most industries, and you'll find a similar situation: two or three groups of companies jostling for position upon the same two or three competitive mountaintops. Now consider the major U.S. airlines. They all struggled for many years in cutthroat competition around the same position until Herb Kelleher of Southwest Airlines saw a different, low-cost way to compete.

It is unlikely that truly superior close opportunities exist that have not been spotted. Within each position, we have many firms with myopic managers who all wear the same lenses. They see well what is close to them, and they view the competitive landscape the same way. To the extent that superior opportunities exist, they will be those that are cognitively distant. The challenge for strategic leaders is, therefore, to learn how to see them.

Let's revisit Charlie Merrill's concept of the financial supermarket. This truly radical idea broke numerous industry conventions: It focused on middle-class rather than wealthy Americans; it adopted low-cost, high-volume merchandising; it introduced the chain of outlets concept; and it offered a great variety of products. How was Merrill able to spot this cognitively distant opportunity? It turns out that he thought quite literally about supermarkets when he developed the idea. (A 1941 *Fortune* article reported it like this: "The theory was that, if it is good business for a grocery chain to offer the purchaser of vegetables a choice of meats, then it should be equally sound for Merrill Lynch to offer a commercial hedger a chance to invest in a new issue or to open a stock account.") It was only when he reimagined the managed investment business as a supermarket business that a new way to compete became visible to him.

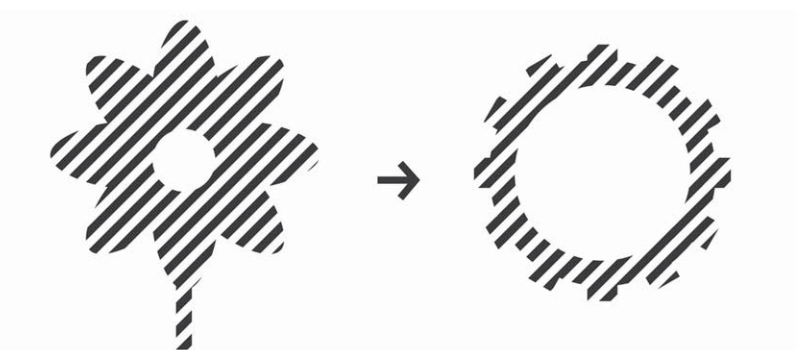
Acting on opportunities. The fact that a strategic leader is able to make the cognitive leap required to see a distant opportunity does not mean that the rest of the organization is also able to make the leap. Getting others to see what he or she sees—and embrace it—is extremely difficult. (It's much easier to persuade an organization to pursue incremental, less risky opportunities. In fact, that's what organizations are set up for.) When the cognitive shift requires a change in a firm's identity, the resistance is even more stubborn, especially when the identity has a long history and is infused with moral value. In the words of Stanford's James March, a living legend in the study of organizations, "If a leader tries to march toward strange destinations, the organization is likely to deflect the effort."

When George Fisher took the helm of Kodak in 1993 (having just led a spectacular turnaround of Motorola), he realized that the firm's greatest opportunity was in digital cameras. He envisioned a radical strategic redirection. The problem was, the organization held an entrenched view of the photography industry and its own position: In photography, there were cameras and there was film. The organization firmly believed that Kodak was a film company. Thus, even though Kodak had about the best digital-camera technology available worldwide, the organization couldn't make the leap to seeing itself as a camera company. When Fisher launched his strategy, he probably did not sufficiently appreciate the distance between his vision and Kodak's sense of

What Is Associative Thinking?

The more that cognitive scientists study our mental processes, the more evidence they find that the primary way we make sense of the world is by comparing unfamiliar things with things we have already experienced and classified in our long-term memory. Our minds do this intuitively, without conscious prompting.

Because associations are fundamental to human cognition, managers who use associative thinking in the work of innovation and strategy can gain a difficult-to-imitate advantage. Developing disciplined approaches to matters of human cognition is no easy task—we're only beginning to understand how they work in managerial settings. But it is possible to structure exercises in associative thinking—for example, case-based reasoning, analogy, and pattern recognition—that help managers combine intuitive associations with rational analysis.



itself. The company's managers, especially its middle managers, complied superficially but ultimately resisted Fisher's redirection. As a result, despite his strategic acumen and managerial ability, a frustrated Fisher left the company a few years after his arrival.

Persuading a workforce that the company's historical identity needs to be reconceptualized is the most difficult of the many hurdles a leader may need to clear in bringing along internal stakeholders. For instance, a firm may have to acquire unfamiliar capabilities or key talent, and those activities, too, are problematic.

Legitimizing opportunities. External stakeholders are, if anything, even more reluctant to accept a new conceptualization of a company's identity or of the strategic possibilities inherent in an industry. Their reluctance often feeds back into the company and can cause managers to abandon promising new directions prematurely.

For instance, in the early days of internet portals, at least two business models competed for legitimacy. Some firms, including Lycos and Infoseek, saw themselves as high-tech competitors in a technology industry. Others, including Yahoo, viewed themselves as media companies; this group was especially proactive about communicating with industry stakeholders. The alternative representations competed for attention and resources. Ultimately, external stakeholders—financial analysts, specialized press, potential customers, and so on—endorsed the media representation. As a result, most companies in the business started to compete as media companies. by MIT's Ezra Zuckerman shows that the further away a new strategy takes a firm from its historical identity, the more the strategy is discounted by financial analysts and other institutional players. And this negative reaction from external stakeholders affects firms' competitive behavior: Research by the University of Minnesota's Mary Benner suggests that when firms meet such resistance, they tend to shy away from their intent to pursue the new initiative.

The Power of Associative Thinking

Limitations on strategic leaders' ability to spot, act on, and legitimize distant opportunities stem from a common root: the challenges of managing one's own and other people's mental representations. Charlie Merrill's competitors scrabbled for a position atop the same mountain, failing to come up with new lenses on banking that would reveal distant opportunities. George Fisher failed to persuade Kodak employees that their representation of the company as a film company was outdated. And Lycos abandoned a good strategy because it could not persuade Wall Street that its conceptualization of the new business was best. In each case, the failure was directly related to whether strategic leaders could manage their own and others' mental representations.

> It was only when Merrill reimagined financial services as a supermarket that a new way to compete became visible to him.

The arguably better strategy remained untapped, not because companies failed to spot it and act on it but because they failed to legitimize it in the eyes of external stakeholders. When Google entered the business a few years later, it made a resounding case for the technology strategy, and we know how that story unfolded.

Why is it difficult for external players to accept a new strategic landscape? The problem, again, is with cognitive processes. The stakeholders have a set way of organizing and interpreting the industry. Research

Associative thinking can help strategic leaders manage mental representations. When we are faced with a new situation, our brains automatically search for and retrieve from long-term memory past experiences or types of experiences (that is, categories) that have some similarity. Once evoked, these mental structures move to the front of our consciousness. (Douglas Hofstadter, a major contributor to the research on analogy, describes it this way: The mental structure moves from "being asleep in the recesses of long-term memory to gaily dancing on

How to Teach Associative Thinking

All mental processes, including associative thinking, are difficult to manage, for several reasons. They're neither visible nor tangible. They usually operate below the threshold of awareness. Repetition makes them habitual, ingrained, and almost hardwired. And it's difficult to make rigorous inferences about outcomes they might cause.

To address these challenges with my students, I designed my MBA course The Psychology of Strategic Leadership to be experiential. Here are a few exercises I lead to show how mental processes can be managed more effectively.

1. Prove to students how much they rely, consciously or subconsciously, on their own biases and associations. Most students—indeed, most people—mistakenly believe that they (alone in the world) are free from biases. In my experience people won't truly internalize how much biases affect their thinking until they have incontrovertible, personal evidence. One way to provide this evidence is to administer the Implicit Association Test (IAT), which demonstrates the extent to which implicit attitudes—those that are unconscious—affect people's behavior.

2. Immerse students in the practice of associative thinking. Even though most of our thought processes involve elements of thinking-by-association,

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Associative thinking is a natural mechanism for intelligent reasoning about contexts that are novel and ambiguous.

the mind's center-stage.") They become the basis on which we represent and interpret the new situation. Brain research shows that associations are central to thinking—and are influenced by biases, attitudes, and emotional states.

Why are associations so useful in identifying distant opportunities? Let's return to our two main perspectives on strategic thinking. The first is to use logical, deductive reasoning. Porter's five-forces framework exemplifies this approach: It imposes discipline and simplifying assumptions that help the strategist identify likely future scenarios and deduce an appropriate strategic solution. The second approach is centered on associations. Here, the strategist compares a business situation with something else she has experienced directly or indirectly. She then forms a new mental representation that recasts the current situation in terms of the older one. Whereas deductive reasoning is extremely information-thirsty, associative thinking requires only that the strategist identify a few parallels between two situations. Thus the deductive method is particularly powerful in relatively familiar contexts—as with Walmart's expansion into suburban markets. Analogy is a more natural mechanism for intelligently reasoning about contexts that are novel and surrounded by substantial ambiguity. (See the sidebar "What Is Associative Thinking?")

There's a second, and in my view more important, reason that associative processes are, in certain situations, a more powerful basis for identifying distant opportunities. Analytical frameworks like Porter's are used widely by corporate strategists and strategic consultants alike. The problem is, they result in shared mental representations that lead companies to the same places: Industry players identify and act on the same opportunities. To break this equilibrium, the strategist must cultivate genuinely novel representations of the competitive space, as Charlie Merrill did for banking. He started out with the traditional one (banking as a buttoned-down service for the wealthy). He then created a different picture of that reality for himself (a supermarket, with a variety of products and customers), which allowed him to reinterpret the competitive landscape in a new and powerful way. By using an analogy to bring previously distant ideas ("bank" and "supermarket") into relationship with each other, he was able to see opportunities that were invisible to his competitors.

Clearly, the annals of business contain a boundless source of strategic contexts that managers can tap to create new representations. What makes analogy especially powerful vis-à-vis other less-structured forms of creative thinking (for example, brainstorming or recombination) is that it's quite possible to create disciplined processes to guide this kind of thinking. (See the sidebar "How to Teach Associative Thinking.")

Associative thinking also supports the work of persuading an organization or external stakeholders that a new opportunity makes sense. Human beings are walking associative machines. Employees responding to a strategic leader's new idea will make associations whether they're aware of it or not. They're going to categorize the idea—to classify it as making those associations conscious and deliberate is not intuitive. In my class, students are asked to consider a fairly standard strategic problem set in a semi-mature industry. In considering alternative opportunities, they come to realize that without making associations with other settings or industries (especially the kind of re-categorization that led Charlie Merrill to his strategic insight), it is very hard if not impossible to identify untapped opportunities.

3. Reinforce the difference between a superficial analogy and a profound one. The comparisons we make automatically—that is, without conscious thought—are dangerously random. But it's possible to teach people to make profound rather than superficial analogies. I often ask students to analyze a case study that presents this question: "Should oil company X drill in Russia or the Gulf of Mexico?" Some students are given a neutral version of the case. Others receive a version in which the locations, names of executives, and other superficial cues are designed to be reminiscent of Enron. The circumstances are otherwise identical. The students' responses differ dramatically depending on which version they read. The exercise demonstrates that associative thinking happens almost automatically—and also that superficial cues are enough to change, quite radically, the way people approach a problem.

similar to something else they know or have experienced. Categories embody value judgments: Some categories we like; others we don't. Some of them we consider to be right; others wrong. When an idea is categorized, it is immediately imbued with those judgments. If the category connotes something negative, people will resist the idea. A key imperative for a strategist is therefore to keep people from making associations that are heavily charged or contentious. Evoking the wrong category can have disastrous consequences on a persuasion effort.

Let's go back to Kodak and employees' simple categorization of the photography business. For them, film was good, and cameras were bad. Fisher had a great strategy for Kodak. But his rhetoric—we're a picture company, not just a film company—is likely to have touched the wrong nerve, evoking the film-camera dichotomy and pushing his strategy to the wrong side of that divide.

The Strategic Leader's Role

To discover distant opportunities, the strategist must identify appropriate re-representations of the business. The best way to do that is by using associative thinking techniques. But make no mistake: It's hard to use associative thinking properly. Strategists often draw superficial similarities between novel situations and past ones. (Jan Rivkin and I wrote about this problem in "How Strategists Really Think: Tapping the Power of Analogy," HBR April 2005.) This tendency is exacerbated by the human mind's confirmatory nature. Deep experiences in one industry might predispose a strategist to look at another industry through the same lens, even if the two aren't similar in relevant ways. Strategists often look selectively for evidence that supports the analogy, instead of searching for cues that support *and* undermine it. Emotional factors can also skew thinking. Good strategists must recognize and counter these tendencies.

When it comes to acting on and legitimizing a distant opportunity, a strategist is navigating a difficult course. Simply raising the possibility of a change will evoke associations in internal and external stakeholders. (Many of these will be unconscious, but no less powerful for that.) The leader must find metaphors, analogies, and images that elicit the associations he hopes for. To achieve this unfailingly, the strategist would need a near-perfect understanding of how stakeholders' minds work. Although that is clearly an impossibility, the good news is that research into the psychology of categorization has made enormous progress in the past few decades, and great strides are soon to be made in applying this work to the competitive situations that are relevant to strategists.

STRATEGISTS ARE often exhorted to "think outside the box." Indeed, a lot of what is strategically relevant is cognitively distant. But the idea that people can simply decide to think differently from the way they have in the past, or from the way their competitors do, is delusional. They need tools that bring a new dimension of psychological insight to the strategist's role.

Using structured associative thinking, leaders can learn how to deal with the cognitively distant and develop techniques for reconceptualizing a business. They can learn how to induce others to make similar reconceptualizations by evoking the right associations. With this new psychological conception of strategic leadership, the cognitively distant is within reach.

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