MANAGEMENT

AVOIDING THE MIDLIFE CRISIS

Are companies prone to midlife crises? New research by London Business School's Donald N Sull, Associate Professor of Management Practice, and Dominic Houlder, Adjunct Professor of Strategic and International Management, says things are not so simple.

The common perception is that companies, like people, pass through a series of life stages. Each firm begins with the experimentation and rapid-fire learning of a start-up, passes through a frantic adolescence as it scales its business model, matures into a reliable, albeit dull, middle age and finally lapses into inevitable decline. Extensive research shows this compelling metaphor is fundamentally misleading. Companies are not single entities that pass through a life cycle; they are composed of a portfolio of opportunities at different stages in the life cycle. There are no mature companies, only mature portfolios.

When executives recognise this, they can anticipate how their overall portfolio might evolve, paying particular attention to any imbalances. The first step is to map the four stages. Opportunities begin life as experiments. Like youth, the start-up stage involves constant experimentation. With the opportunity validated and the business model stabilised, the opportunity enters adolescence and scales up to seize market share. During mature adulthood, the opportunity – now a business unit – fights for market share against well-known rivals. The final stage is decline – typically when a substitute arises, consumer preferences shift or a low-cost competitor emerges.

At different stages of the life cycle, opportunities consume different levels of resources. In the start-up stage, you can tinker with an idea for years without spending serious money; declining businesses can consume significant resources as well as management time and energy. Understanding where current opportunities fit is therefore vital in considering how the portfolio might evolve. To avoid a midlife crisis, executives should recognise the following common portfolio pathologies.

No exit
In most large, complex companies, front-line employees identify and experiment with potential opportunities at little cost. But to scale-up requires sponsorship from a middle manager, putting his or her reputation on the line.

Although this process works well in promoting investment, it often stalls in reverse, failing to trigger disinvestment when opportunities do not pan out. The 'no exit' syndrome is a particularly thorny challenge in the scaling stage when it is hard to quietly kill opportunities, even if they are failing to gain traction.

Throwing out the baby with the bathwater
When an opportunity fails to scale, the temptation is to forget it and move on. But that is a big mistake. 'Failed' opportunities can be a source of valuable information, market insights or resources.

Sticking to the knitting
Finance theory encourages investment in projects that have a positive net present value and return surplus cash to investors. Value-based management puts a premium on credible cash-flow forecasts, and credibility results from investments in low-risk projects in known domains – sticking to one's knitting. But an investment process that values credibility and low risk above all else will penalise projects that have uncertain – if potentially successful – outcomes.

Letting a hundred flowers bloom
Sometimes the problem is too many opportunities. Consider 3M, for decades an icon of innovation. By the late 1990s, 3M's shareholder returns were lagging the market so, when James McNerney arrived as CEO in 2000, he started to prune 3M's overgrown garden of opportunities. Ultimately, it became acceptable to say no to funding opportunities.

One size fits all
Projects at various stages in their life cycles require very different management styles. Leaders responsible for an entire opportunity portfolio must select managers whose styles, competencies and enthusiasms match each stage.

Generation gap
Just as opportunities pass through life stages, so do the people behind them. Seasoned executives who decide which opportunities to scale often err on the side of loss aversion, protecting the mature businesses while avoiding risky bets on the future. This can lead to a series of portfolio choices that spark a midlife crisis. Companies must empower younger managers who have a large stake in the future.

Executives who understand that business opportunities – and not firms – pass through these stages have an advantage. But make no mistake: managing a portfolio of opportunities, and constantly re-jigging to maintain vibrancy, is hardly simple. Neglecting it, though, can easily lead to the corporate midlife crisis and organisational decline that so many executives mistakenly take for inevitable.

An article by the same authors in the Fall 2006 issue of *MIT Sloan Management Review* 48 (1) examines this research in more depth. You can order the article online from: http://sloanreview.mit.edu/smr/issue/2006/fall/08/