



# The Innovators

Conversations

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## Interview with Stuart Read IMD faculty member, author, entrepreneur



Stuart Read is Professor at IMD. His research is focused on effectuation, the heuristics of expert entrepreneurs. He is a lead author of *Effectual Entrepreneurship*, how people make decisions and take action in situations of true uncertainty. He has been published in the Journal of Marketing, the Journal of Business Venturing, Strategic Entrepreneurship Journal, Organization Studies, the Financial Times, and Strategic Management Journal.

Stuart has nearly twenty years of industry experience, having participated in the creation of six high technology start-up firms, two of which went public and four of which were acquired by industry leaders including Sun Microsystems and Lotus Development Corporation.

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Interview conducted by Doug Berger, managing director, INNOVATE [doug@innovate1st.com](mailto:doug@innovate1st.com)

Doug: There is a particular approach to entrepreneurship that you and your colleagues at IMD are developing that is quite distinct from other approaches around entrepreneurship. What are some of the underlying premises where your approach is distinct?

Stuart: It is one of the great ironies of business - every entrepreneurial company wants to be big and every big company wants to be more entrepreneurial. Since every company we know and love was once an entrepreneurial company, I sat with my co-authors, and one of questions that seemed important was "What makes entrepreneurs unique?" Not just any entrepreneur but what makes expert entrepreneurs different from the rest of the population? What we found is that in the course of starting up new ventures and dealing with all kinds of uncertain situations around new products, there were a collection of heuristics - things that they had learned to do differently. We have assembled those under an umbrella that we call effectuation. It is the logic of expert entrepreneurs.

When we look at the bulk of what is taught in business schools, it is based on a causal, sequential logic. You look at what happened in the past and you try and draw some inferences, and you use that information to hopefully make better than random decisions. You see this evidenced in everything from the way that finance does things like weighted average cost of capital and net present value, to market research on unmet customer needs, to the way that strategy does scenario planning. All of these tools are based on information that happened in the past or events going on right now. In the entrepreneurial setting, this causal logic implies

beginning with searching and identifying an opportunity followed by tasks to exploit the opportunity.

Effectual logic is a different approach to entrepreneurial activity, associated with operating in an environment of high uncertainty, and suggests how entrepreneurs generate rather than select new opportunities. Often the final product or service was not anticipated at the start of the venture. For an effectual entrepreneur, the past or even the present might not be that relevant to what happens in the future, because they believe that their actions will change the trajectory. We see the expert entrepreneurs taking action against things that will create an effect, create an outcome. Together with committed stakeholders they transform their capabilities into new goods and services. That is the way that they basically shape the future or create the future instead of trying to predict it. That is the source of the word *effectuation*.

Doug: In your book you refer to widely-held myths around entrepreneurs and entrepreneurship.

Stuart: Yes, and the myths are tied to each of the effectual heuristics that we picked up from expert entrepreneurs.

Myth #1: Entrepreneurs are visionaries. There's the lore of the epic entrepreneur who one day woke up, had a vision, and then there was Microsoft. When you actually go back and retrace the steps of entrepreneurs, you realize that big successes at the end of the story are more retrospective than intended at the beginning of the story. What actually happened is a lot messier than the explanation. In many cases, the person – the entrepreneur - got up in the morning and started with the things that they had readily available. Then it changed into something else. Then they partnered with somebody, and ultimately after a number of iterations and small failures, etc., etc., it then became Microsoft.

The effectual heuristics are an inversion of that visionary myth – entrepreneurs start with what they have, their existing means. They start with: Who I am - my traits and abilities. What I know - my training and expertise. Who I know - my social and professional networks. From these means the entrepreneur begins to imagine possibilities and take action.

Myth #2: Entrepreneurs are very outrageous risk takers. When we actually look at how entrepreneurs take risks, they actually take less risk if anything than the general population. What is really interesting is how they formulate risk. We teach people to think about risk from the upside. But the expert entrepreneur looks at risk from affordable loss. This allows for cheap failure and learning that can be applied to the next iteration of the opportunity. By focusing on the prospect of the negative, entrepreneurs manage risk down to what they find personally acceptable.

Myth #3: Entrepreneurs analyze the environment, particularly the competition. The goal of traditional business planning is to find a good positioning spot and that is where you should be successful. Yet, if you are creating something that has never existed before or at least is very different, it is hard to look at the environment and know who the customers and competitors will even be in advance. How do we create something new in the first place?

Effectual entrepreneurs engage the environment generally through partnership, not competition. So we observe expert entrepreneurs focusing on the people who will partner with them and collaborate with them and co-create. They take the idea to the next potential customer or partner and some of these will self-select into the

process of building the venture. The expanding network determines to a great extent which market the company will eventually end up creating.

Myth #4: Anticipate surprises so that you can avoid them. As you look at a lot of the innovations in the world ... they are the result of surprises turned into unexpected products or services or even companies. Creating a company or innovation is a very uncertain process so surprise is bound to happen. Instead of trying to manage around these unexpected events, expert entrepreneurs leverage surprise and use it to take the business in new directions.

Those are the four main myths and the corresponding effectual heuristics.

Doug: Let's look at a different context, one of corporations looking to incorporate these ideas into expanding their growth portfolio. Why are corporations coming to IMD to learn about entrepreneurship?

Stuart: The first reason is the clear desire for growth and differentiation. The lifespan to take advantage of an innovation or a new product is becoming shorter and shorter and so is your ability to extract rent from that innovation. To be able to systematically create new markets or offerings that are differentiated and premium priced is reason number one.

Reason number two is that people come because they don't really know what entrepreneurship means. I think that once they discover what it means, some of them take a deep breath and say "Gosh, I'm not quite sure we're really ready for that." When people say that they want growth, often what they don't say is, "We want growth under the same conditions that we manage our existing business." They don't realize that the people who create new products, new markets, and new offerings have a substantially different set of heuristics from managing an ongoing operation.

Doug: How are you orienting people to these heuristics around entrepreneurship so that they can apply them to actually achieve growth?

Stuart: There is no single clean answer because every organization has its own starting point, its own means, and every organization responds differently to inputs. There are exemplars that people can learn from. Nestle is an operationally excellent organization, very causal, and it somehow managed to create a market for espresso at home. The question is how did that happen and what did it take for that to happen? When you take the case study apart, you realize that the only way it possibly happened is that they took the entrepreneur and they sent the entrepreneur away from Nestle headquarters. They gave him no money and said, "It's sink or swim for you." He really took and built the thing on his own, very much in spite of the corporation.

Once you do a few of those, people start to scratch their head and say, "I kind of understand and this is a pretty big change for us." Then it's easier to say which pieces of this do you think you can manage? Do you really think you're up to it? That's where the conversation goes.

Doug: In the book you ask thought provoking questions and you advocate going down exploratory pathways - not just external market exploratory pathways, but pathways that are designed to enlighten about one's own thinking, means and capabilities. When you're working with senior people from companies coming into IMD, are you also having them explore for themselves their own orientations, so that it really is a personal journey of entrepreneurship as opposed to more of an academic journey?

Stuart: Terrific insight. The answer is, absolutely! One of the exercises which I love to do with executives, and which I highly recommend, is to put executives into the physical situation of having to do it. A great example is cooking. You can cook causally with a recipe or you can cook effectually, which means that you open up the refrigerator and you have to make do and create something interesting with what you find. I take a group of executives out of the classroom and across the street to our restaurant. I turn them loose in the kitchen with no support other than technical support from the chefs. They have three hours to create something with no menu, no recipe and no plan, using only what they find and of course their own creativity. I have an IMD program person who wanders around and films the whole thing.

We see people having various conversations with each other. "I have an onion." "Oh, I have sour cream." "What are things we could do with onion and sour cream?" When you play that back the next day, it is so obvious how you take pieces of technology and knowledge and networks that the corporation already has, and you continue to reassemble them in interesting ways to create something which has never been created before. Things that couldn't be anticipated when you first walked into the kitchen.

Doug: What are you finding that people apply back in the corporate setting?

Stuart: I try and facilitate the conversation looking at what the differences are between where they are today and what they see in an expert entrepreneur. You cannot do all things at once, so the question is where do you think you're furthest away and where is going to be your highest leverage point? Let me give you a couple of examples of the abstract problems and then a couple of examples of the implementations.

Every one of the principles that we talked about implies a very significant shift that an organization has to make. The natural inclination for an organization is to spend money, not to use their means in new, original ways. Taking advantage of surprise and even embracing failure is another element of entrepreneurial heuristics, which is completely antithetical to the way a big company operates.

Being here at IMD we see people from all over the world. The attitude towards failure in the United States is ..."well, too bad, but it's not the end of the world." Attitudes toward failure here in Europe are stronger in terms of the penalty for failure. The cultural attitude toward failure in Asia is a very high penalty. So part of the diagnosis is thinking about the cultural aspect and saying, "Okay, if we are going to have people out there, trying things and they're going to fail, how can we protect them and how can we deal with that?"

On the attitude around failure, one CEO sat down and he wrote an email about his biggest failure and what he learned from it, with the aim of setting the company up to view risk differently. It was a very important symbolic gesture. It said, "Hey, look. Even though I'm the CEO I fail, and when I fail what happens? I have to think about what I learned. I hope I don't get fired but I can't hang my head low. I should take that learning and turn it into something useful."

We work with a company called Veolia, which you might not know in the U.S. They are one of the largest private contractors to public utilities in the world. They handle a lot of waste throughout Europe. They have a program where they bring their executives to IMD to create opportunities based on waste. They start with the waste that they know and do transformations on it, and think about realistic ways of turning it into potential businesses.

Another company, UPM, is one of the world's largest suppliers of paper and processed wood products. They discovered through this process that they don't work with anybody. They do everything themselves. Now, what they're doing for their top 300 is described as interactive leadership. "A lot of the world is co-created and we want you as leaders to set an example of not hierarchical dictation, but of engaging interactively."

For each of those organizations the intent is not to turn the organization upside down right away or even ever. It's simply to move the needle a little bit. And that's okay, because it is important to appreciate that there is much more patience required due to the scale of these organizations than there is for the individual entrepreneur.

Doug: At the end of the day executives want growth that moves the dial. These heuristics say that at the outset we don't know how big something could be. If executives only aim for things which they know can be big, they may miss opportunities that could become big but aren't predictable.

Stuart: This conversation always comes up and I try to bring it out. It is important to appreciate how it manifests in terms of strategy. When you step back there are three dominant strategies across industries. They consist first of R&D, where innovation is delegated to a department. Secondly, wait for the market to determine what a good innovation is and to pay a premium to gain access through acquisition. The third, effectual entrepreneurship is where everybody is a potential source of opportunity. I have yet to see a company who is successful at running two of those strategies at the same time. When you look at WL Gore and 3M, you know that effectuation is working. At places like Dow or DuPont you know that the R&D department can turn out very strong but perhaps incremental innovations. You look at Cisco and you know that there might not be any need for R&D at all. That you can simply wait for the market and you let it decide, and you break out your checkbook.

That said, you are hard pressed to find examples of successful companies that are good at more than one of those things. That is a hard thing for people to swallow.

Doug: Effectuation and the approach that you advocate do need to exist in a leadership and cultural context.

Stuart: You should be very conscious about how you select an effectuation strategy knowing that you will get something transformational out of this, but that the predictability is pretty low. If you're willing to make that trade-off, here is how to do it and if you're not, no problem. There are plenty of other strategies out there.

