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Sharpening Your Business Acumen

by Ram Charan

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A six-step guide for incorporating external trends into your internal strategies.

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Illustration by Harry Campbell

Lord John Browne, chief executive of BP (née British Petroleum), is perhaps best known for the gamble he and his company took in 1997. At that time, Lord Browne began to reposition the company in a more environmentally conscious direction, after famously arguing that "the time to consider the policy dimensions of climate change is…when the possibility cannot be discounted and is taken seriously by the society of which we are part. We in BP have reached that point." At first the stock price fell, but did the company suffer in the end? Hardly. In 2004, BP passed both ExxonMobil and Royal Dutch/Shell Group in gross revenues, to reach No. 2 on the Fortune Global 500 list (after Wal-Mart): It is the largest energy company in the world by this measure.

A similarly prescient corporate leader is Richard Harrington, CEO of the Thomson Corporation, a media company based in Toronto. When Mr. Harrington took office in 1997, the company was best known for its 55 daily newspapers in seven states. Business was good, but Mr. Harrington — with the full support of his board — began to divest Thomson's newspapers and its travel and leisure business, steering the company instead toward delivering information and services online to professionals in law, education, health care, and finance. Today, the company is thriving, while major newspaper companies, like Knight Ridder, are struggling.

This is the art of business acumen: linking an insightful assessment of the external business landscape with the keen awareness of how money can be made — and then executing the strategy to deliver the desired

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results. The word *acumen* means "keenness and depth of perception, especially in practical matters." Leaders like Lord Browne and Mr. Harrington apply a high level of acumen to business matters. They have the usual skills of successful executives, including the ability to deliver high performance. But they are distinguished by their ability to position their companies advantageously while operating within the same external landscape as their competitors. This is the source of their ability to achieve returns above the risk-adjusted cost of capital.

No single aspect of managerial skill is more important. If the company's assessment of the external landscape — how patterns of converging and diverging trends fit together — is inaccurate, the company's strategic positioning will likely be wrong. Decision makers will be tempted to develop the wrong capabilities, hire the wrong people, or enter the wrong markets.

Business acumen demands intense mental activity. Seeing how the landscape is evolving requires a high caliber of qualitative logic and the ability to frame, assess, discard, and adopt many assumptions at once. Because that landscape is continuously changing, the task is doubly difficult and always worth revisiting.

To be sure, change in the external landscape is nothing new, but it can be linear and continuous, or it can be exponential and abrupt. From the mid-1980s through much of the 1990s, change was relatively linear. Competition was fierce, but most businesspeople had a good idea who their competitors were and how to survive. Whether they could execute was a different matter.

Then, in the late 1990s, heavy investment in Internet-related technologies and companies began to create deep discontinuities in some industries. At the same time, the economies of China and India were stirring to life. China's efforts to join the globalizing world accelerated after the country signed a trade agreement with the U.S. in 2000; the process led to its historic agreement to join the World Trade Organization in 2001. And momentum for India's economic liberalization was spurred by recovery from the fiscal crisis it had experienced in 1991.

These trends built up until, as happens every few decades, they reached a tipping point, and the rate and depth of change accelerated abruptly. The effect can be seen, for example, in the U.S. current account balance, which was roughly in equilibrium in the early 1990s, but dropped to a $668 billion deficit in 2004; in the global glut of manufacturing capacity that is pressuring many industries; and in the new geopolitical realities that became tragically evident on September 11, 2001.

When such forces combine, they can uproot the competitive landscape of a worldwide industry. Suddenly, the moneymaking approach of that industry can be in jeopardy. Success depends on a leader's ability to recognize such moments of disequilibrium in advance — and to have the courage and business acumen to chart a new course in the face of them, as Lord Browne and Mr. Harrington did.

Seeing the Big Picture

At the time this article was written (in late 2005), the price of oil hovered around $60 per barrel, more than twice its cost about two years earlier. The rise was unexpected and rapid — OPEC's own price target remained $22 to $28 per barrel until early in 2005 — leaving oil-consuming developed nations to wonder how long it would be before inflation set in.

This type of change would drive many corporate

When small trends combine, they can uproot the competitive landscape — and put an industry in jeopardy.

leaders to reexamine their strategy. A typical thought process might begin with a look at cost structures: If oil prices stay at $60, how does it affect my costs this month? Or this year, if prices stay high? Should I hedge oil prices? Can I pass these costs on to customers? If so, can I get my sales force and pricing team together to resegment the customer base? Can we respond faster than our competitors to gain a small advantage until they catch up? Longer term, do we find substitutes for oil, develop new technologies, or initiate research with suppliers to increase energy efficiency?

Answering a series of questions like this may well be necessary for survival, but it is hardly sufficient. It misses the big picture. A different leader, one with sharply honed business acumen, might look at the potential impact of Chinese and Indian demand for oil on the patterns of global supply and demand, asking such questions as: How might geopolitics constrain the supply side of the equation? What might generate a resurgence of supply in the Middle East, Latin America, Russia, or the Arctic, or accelerate the exploitation of Canadian oil sands?

Going further, the executive might ask how different actors might respond: As China and India seek to control more oil and gas production or refinery assets, will they form political alliances with nations rich with such assets? How might high oil prices shift the balance of power between the government and oligarchs in Russia? Will developed-world consumers demand energy-efficient products — and be willing to pay a premium for them until economies of scale bring costs down?

The business leader might also wonder about the flow of capital: Where are oil-producing nations, flush with cash, going to park their funds? If those funds go toward U.S. Treasury bonds, will long-term interest rates remain low? Is more capital accruing among people with an interest in funding terrorism, potentially exacerbating global security problems? Will private equity funds, also flush with cash, invest in companies developing new sources of energy or revitalizing nuclear power, creating a new wave of change?

Questions like these are distinguished from simple woolgathering about current events because the answers have direct implications for every business decision. Until these brainteasers are thought through and understood, worrying about cost structure won't take the company very far.

This assessment is often qualitative, rather than quantitative. And uncertainties will be built in — after all, no one knows what the price of oil will be in a year, or in five years. A company's strategic choices are made today, without the benefit of knowing the future. Leaders have to be comfortable making decisions with unknown factors; survival depends on those choices producing viable outcomes whatever may happen.

The ability to construct and act upon the mental model of the big picture requires plenty of practice. The essence of the skill is to find patterns from among a wide variety of trends and to posit the missing ingredients that could catalyze convergence. Many great leaders began to practice this exercise when they were younger, in less complex contexts, and over the years they have developed the requisite skills and judgment.

One simple way to begin is by asking yourself a series of six questions, exploring the ideas with colleagues and peers:

1. What is happening in the world today?
2. What does it mean for others?

3. What does it mean for us?
4. What would have to happen first (for the results we want to occur)?
5. What do we have to do to play a role?
6. What do we do next?

What is happening in the world today?

1 The most significant trends affecting business transcend company and industry. They cross borders and infuse all areas of civil society. For example, the Internet has made it easy for corporations to link operations in Manhattan and Mumbai, and for consumers in St. Louis to purchase goods sourced from Shanghai. It is also exposing villagers in India to Western brands such as Dell and Levi's.

India's rapidly growing economy is another important trend. Its boom in IT-related software and services is well known, of course, but many executives are also watching carefully as the government gradually opens up other sectors of the economy, such as insurance, retail, and telecommunications, to foreign investors.

But will that day come? There are other trends to consider. Political forces are pressuring the Indian government to keep controls on the retail sector, to protect the livelihoods of family-owned mom-and-pop stores. This political pressure has weight: In 2005, it effectively blocked the government's plans to divest a portion of its ownership in Bharat Heavy Electricals Limited, a successful Indian manufacturer of power generation and transmission equipment. Thus, participation by foreign companies in retail, despite the government's stated intention, is no foregone conclusion.

As this example demonstrates, trends that may at first seem disparate are not unrelated; they must be considered in combination. Executives must learn to fill in the gaps and to iterate this mental process until a complete picture comes into focus. And the way to do that is not only to consider the direct effects of change on an industry and a company, but also to rethink the changes through the lenses of other industries and other players.

What does it mean for others?

2 Richard Harrington was able to see the big picture for the newspaper industry sooner than most because he saw the industry from the outside in. He reframed his view of the trends affecting the industry by putting himself in other people's shoes.

For example, Mr. Harrington recognized that the typical classified advertiser was finding new outlets like eBay for used goods and Monster.com for job listings. And it would only be a matter of time before national consumer product corporations would also shift their advertising online.

There are still other perspectives that newspaper executives might consider. The capital markets can move against a company whose strategy is not positioned for moneymaking; valuations can be affected sharply and quickly. For instance, several money managers publicly implored Knight Ridder to seek a buyer in November 2005, saying they were frustrated with its performance.

Governments play a role. For example, Google's Print Library Project initiative hopes to scan the contents of public and university libraries. Five book publishers filed suit against Google over what they perceive as copyright infringement. Will the courts side with the print publishers or with innovative new media produc-

Cultivating Acumen at BP

by Vivienne Cox

Given the speed and unpredictability with which the world is changing, a company cannot rely exclusively on its most senior people to make sense of the business environment. Someone who is 20 might make sense of signals very differently from the way a senior executive would. Moreover, people who are not necessarily senior in the hierarchy can become sophisticated about what it takes to get a deal signed in Russia, to grow a trading business in a new arena, or to evaluate a package of offers in the area of sustainable development.

At BP, we have found that business acumen can be cultivated. Several practices are critical. The first is setting an expectation that our people will make connections outside the company, not just for transactions and deals, but to explore broader issues outside the normal business relationships. As an example, BP has conducted an intensive weeklong executive development program at Cambridge University, where senior executives talk with people from a variety of backgrounds — astronomers, anthropologists, political historians, economists, and actors.

Businesses also need to open up conversations within the company. In my organization, we've held in-depth dialogues where people talk about the business they want to do, the context in which they want to do business, and what they're looking for from a company like BP. Then, it's important to give people the space to experiment: to construct and implement their own theories, let them get on with it, and be there to support them if they fail.

Another practice, which we ourselves sometimes miss, is sitting back and reflecting: "I tried something. It felt like a risk. What are the broader lessons?" We just launched a company called BP Alternative Energy, and we are scheduling time to talk about what we've learned.

These kinds of conversations can easily go off the rails unless the individuals involved are grounded, self-aware, and confident enough to admit mistakes or ask for help. Therefore, we deliberately invest in people's personal growth — not in a self-indulgent manner, but in a business context. People with higher levels of self-awareness are less likely to be limited by their own preconceptions when they look at the world around them. In our alternative energy business, for example, we gradually discovered that governments have a much more complex and subtle set of needs and objectives than we had originally expected. Meeting these needs requires a more nuanced and multidimensional approach to the business.

We want to help our people develop the kind of self-confidence that will allow them to wait long enough to make sense of external subtleties, instead of immediately jumping to an answer or theory. This is often the real test of whether our people are cultivating a more advanced understanding of the external world: Are they willing to wait, to tune out the daily "noise" of press announcements, to stay focused on the long-term fundamentals of the environment, and to act accordingly?

As people at all levels become more sophisticated and strategic in their outlook, strategy can move from an individual capability to an institutional capability. And with that transition, the quality and speed of our business improves as it increasingly reflects knowledge and insights from across the hierarchy.

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ers? Will Congress (and legislators in other countries) write new laws that affect copyright protections not just for books, but for news media as well?

Venture capitalists could direct money toward companies that are developing new technologies for media consumption, such as electronic books (e-books) and portable video players. Should those products catch on, they could place further stress on traditional media's approach to making money.

All of these potential responses matter. Leaders with well-honed business acumen keep looking at trends through different lenses and from the perspectives of other key players.

What does it mean for us?

3 Now, with greater confidence in their view of the big picture, executives can focus on their own company strategies. It's certainly plausible that a company need not change its positioning. However, it's far more likely that a leader will now see new market opportunities, investment priorities, or unpalatable risks.

Shortly after Jeffrey Immelt became CEO of General Electric Company in 2001, he publicly stated his intent to raise GE's organic growth rate from 5 percent to 8 percent per year, about twice the historical rate of U.S. GDP growth. That's a reasonable target for many companies, but for GE it presented a unique challenge: With the company bringing in $130 billion in revenues, it would have to generate more than $10 billion in new revenues per year to keep up that pace. And that $10 billion would have to be earned without sacrificing GE's margins, cash flow, or return on capital. Where could such growth come from?

Mr. Immelt and his team stepped back and thought through which markets might grow fast enough. One clue: Emerging-market economies, in general, were forecast to grow faster than developed nations. China and India, in particular, were large nations that were growing quickly and opening up their economies.

Of course, for any emerging economy to grow, its government and citizens would need to make enormous investments in basic services, including reliable energy, clean water, and multimodal transportation. GE had much to offer in each of these product and service areas.

Local energy investment is partly dependent on global energy markets. Although in 2001 few expected oil to double in price, many were certain that the price would rise if the Chinese economy opened up. Ditto for coal, which powers much of the Chinese and Indian power grids. In the long run, then, higher energy prices would go hand in hand with demand for energy equipment.

But another trend could affect energy investment. Environmental regulations were becoming more of a consideration as nations began to ratify the Kyoto Protocol. Even though emerging nations are excluded from Kyoto's emissions limits, many have stated the desire to maintain clean air for their citizens, increase energy independence, and reduce their exposure to volatile oil and gas prices. This could represent an opportunity to showcase GE's innovations in energy-efficient and low-emissions technologies. GE could even play a role if an alternative energy source, such as nuclear, wind, or hydrogen, leapfrogged coal, oil, and gas (much as mobile phones are poised to leapfrog wirelines in some emerging countries).

In these trends, Mr. Immelt spotted a moneymaking opportunity that offered the size and growth rate he needed to become a "general store for developing countries," as the *New York Times* put it. GE could supply many of the infrastructure-related products and services — coal and nuclear power plants, wind turbines, water purifiers, and locomotive and aircraft engines — that emerging nations needed to grow their economies.

This was the seedbed for a new strategy that Mr. Immelt brought to the GE board in 2003. He predicted that 60 percent of GE's growth rate might come from emerging markets in coming years. Indeed, by the end of 2004, emerging markets contributed $21 billion of GE's revenues — a 37 percent increase over 2003. This helped overall organic revenue growth achieve a pace for 2005 that exceeded Mr. Immelt's 8 percent target.

Only a leader with business acumen can effect that kind of strategic response. Mr. Immelt recognized macroeconomic trends, thought about the development needs of emerging nations, and factored in the potential political responses. Then he set GE on a path to take advantage of these new opportunities.

What would have to happen first?

4 For any future event, there are steps along the way, prerequisites, that enable that future to occur. Company leaders who want a particular future to unfold can identify such milestones and either watch for them to emerge or deliberately enact them.

For example, Apple Computer's wildly popular iPod digital music player, launched in 2001, was relatively easy to design and produce. Apple reportedly developed the player in just six months. The real secret to the iPod's success wasn't the hardware; it was the iTunes Music Store.

But it wasn't enough for Apple to conceive of an online source of downloadable music. For the iTunes Music Store to be a success, Apple CEO Steve Jobs rea-

GE CEO Jeffrey Immelt spotted an opportunity to generate growth by becoming a "general store for developing countries."

soned, three missing ingredients had to be added to the mix. First, consumers would have to be willing to pay for downloaded music. For years, college students and others had been avid users of file-sharing services, indicating that there was some demand for digitized music but not much willingness to pay. Then the legal travails of Napster and Grokster began to push mainstream consumers toward the ethical higher ground of paying for digital music — and one missing ingredient was in place. But this presumed that consumers could access all the music they wanted and that it would be affordable.

Thus the second and third missing ingredients were the broadest possible selection of music, and a price point at which both consumers and studios would be comfortable. With the iPod's "cool factor" and Apple's digital rights technology, the major music studios latched on to the service as a way to reach the online consumers left behind by Napster's court defeat. And buying songs for 99 cents each appealed more to consumers who were used to buying compact discs than did the monthly subscriptions that other online music services offered, while satisfying the needs of studios and artists to earn revenues. With missing ingredients two and three added, the iTunes Music Store launched in April 2003 — and Apple sold its 30 millionth iPod in November 2005.

Some missing ingredients are completely out of a company's control. They may lie in a government's hands, as when China negotiated for WTO accession or India held back on allowing foreign entrants into its retail sector. Others may fall under a market's control: The high price of a gallon of gas, for example, underpins the rising popularity of hybrid cars. A competitor's move may also tip the balance. Apple's agreement with Disney to offer downloads of ABC television shows for the video iPod spurred other networks to seek their own agreements for content on demand. Within weeks of the Apple/Disney agreement, NBC and CBS announced partnerships with DirecTV and Comcast, respectively. An executive who has thought about this question is prepared to recognize the potential impact of a competitor's small moves on larger trends, and to respond with appropriate speed (as NBC and CBS did).

What do we have to do to play a role?

5 For GE to become a general store for emerging markets, it had to recognize that selling infrastructure products and services in those countries was not the same as selling power plants to utilities in America. For one thing, a government's decision-making process is very different from that of a corporate buyer. Government agencies are often fragmented, and key people turn over regularly. And many nations have no financing. Each contract could entail a long process fraught with financial and political uncertainty. To succeed in this milieu, GE would need a mind-set, a set of competencies, and an organizational form different from those of its past.

So GE began to shape its business around marketing, selling, building, installing, financing, and servicing infrastructure products. In the summer of 2005, GE consolidated its 11 business units into six, including the newly formed GE Infrastructure, which combines the aircraft engines, energy, oil and gas, rail, and water technology businesses. Mr. Immelt also moved the requisite GE Capital financing skills into GE Infrastructure, recognizing that financing is a fundamental element behind selling big-ticket infrastructure solutions.

Verizon's rollout of fiber optics to the home is risky, but it's riskier not to make the change.

But creating a new organization means more than reshuffling reporting structures. For GE to be able to build a leadership pipeline uniquely qualified and experienced in emerging markets, many new hires had to come from within these markets themselves. With an increasing number of employees from non-U.S. locations, GE faces a new set of diversity issues that affect how the company hires, develops, rewards, promotes, and fires leaders. Today, half of the participants in the highest-level executive development class at GE's famed Crotonville leadership center come from outside the U.S.

Another important competency to build is risk management. GE Infrastructure faces risks such as delays caused by political machinations or the volatility of currency exchange rates over the five or 10 years that a contract might last. Incorporating GE Capital's expertise in risk management, the Infrastructure unit developed this competency, too. Few companies in the world can match the competitive advantage that General Electric is building, step-by-step, as it puts all of these competencies together.

What do we do next?

6 Whether it's lobbying European governments for uniform emissions standards, pinpointing acquisitions to build a financial-information provider business, correctly determining the pricing and digital rights of music downloads, or developing new competencies to operate in emerging markets, companies should begin to execute their new priorities with a plan for the coming 12 months.

The process of executing the new direction often begins with resource allocation. When Ivan Seidenberg, chief executive of Verizon, announced in 2004 that the company would make a huge investment — initially $2 billion — to replace the copper phone wires coming into America's homes with fiber-optic cable, *Fortune* magazine wondered if he was "pulling a megabluff." It was a risky move, but Mr. Seidenberg could see the big picture.

Technological change and deregulation in the telecommunications industry had changed every bit of Verizon's business. The phone business is no longer the voice business; telephone companies, cable companies, satellite television providers, voice-over-IP telephony services, and upstart technology firms had each begun to offer a wide portfolio of telephony, video, and Internet services — and content.

In addition, Verizon's sophisticated marketing metrics indicated that "we were losing control and influence with our customers," Mr. Seidenberg later recalled. Broadband fiber optics allowed so many attractive new applications that he saw "no end to the desire for speed, bandwidth, and customer choice — and the change only excites us to move faster."

This investment will not generate net profits in the next quarter's or even the next year's earnings statement, so Mr. Seidenberg had to convince investors and executives of the importance of the investment. He also had to lay out operating metrics for the fiber-optic build-out, a different set of measures from those used by other operating divisions. To monitor progress, the company had to learn to track and analyze answers to such questions as: When will the build-out be completed in specific areas? Is it on time and on budget? What are the customer adoption and churn rates? What is the pricing plan and what are customer usage rates? What collaborative arrangements are needed with whom regarding content? What competitive reactions from nontraditional competitors might there be, and when?

For Verizon, this is just the beginning. The $2 billion was only a portion of the investment that will ultimately be required to build out its network with fiber optics. Undoubtedly, there will be speed bumps along the way. One of them occurred in November 2005 when SBC Communications, Verizon's fiercest North American competitor, purchased AT&T and adopted the acquired company's name along with a renewed emphasis on broadband. Meanwhile, Mr. Seidenberg will keep his eyes on the horizon to see how the big picture is changing. He knows that the new moneymaking approach involves risks, but the risk of not making a change is greater than the risk of making one.

Learning to See

Working through these six questions helps executives assess the validity of the company's moneymaking approach. This is an iterative process that tests the leaders' mental abilities to qualitatively see how the world is changing — almost always including the perspectives of others. It requires transcending the old rules of thumb that are etched deep in the psyches of many executives, and it means giving up the habitual reliance on precedent that worked for many companies during times of more linear change.

But the ability to perceive trends quickly, or even to make sense of them, will not automatically guarantee success. Rather, success depends on the rigor and discipline applied to the entire process of envisioning the changes, deducing specific actions, and implementing the plan.

Some leaders do this by deliberately seeking out diverse perspectives and listening to a wide variety of sources. They meet regularly with other top CEOs to bounce ideas off one another; they regularly read not just magazines and newspapers, but also Weblogs; they attend confabs like the annual World Economic Forum at Davos. Their social networks are filled with sharp observers who share their intense curiosity but come from diverse backgrounds. Leaders with business acumen are accustomed to informal chats with others, during which they feed their hunger for other viewpoints. They seek out younger leaders who understand how new technologies are being used or who are less bound by past ways of doing business.

Of course, there is a good deal of noise out there, too. Not every conversation will add clarity to the big picture. Davos, for example, has hundreds of formal sessions, sometimes hosting speakers with oppositional perspectives; not all of these voices will reveal the external landscape.

But great leaders can stay on point. They build their big-picture view, listen to and sift out extraneous threads, bounce their opinions off others, retest their qualitative hypotheses, and reformulate their big-picture view. This unseen iterative process provides the vital foundation for developing business acumen. Such leaders know that they are responsible for the organization's ability not just to adapt, but to choose its course; the long-term survival of the enterprise depends on their ability to learn to see more effectively. +

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