PICTURE LIBRARY

“A morally mature society is one in which individuals are not just happy to take responsibility for their actions but also recognise enthusiastically their obligation to be accountable to others for what they do”
Jules Goddard and Tony Eccles

REBELLION MEETS REGULATION IN THE CITY OF LONDON.

STRATEGY

UNETHICAL BEHAVIOUR

THE RIGHT SIDE OF THE ROAD

Recently appointed as a Fellow of the Edmond J. Safra Center for Ethics at Harvard University, ***Celia Moore*** *is an Assistant Professor of Organisational Behaviour at London Business School. Her research focuses on the unexpected causes and consequences of corruption and unethical behaviour among individuals, groups, and organisations.*

During your fellowship at Harvard, you will be focused on two projects with slightly unusual samples.

Yes, one uses a nine-year sample of State Patrol records in Washington State to investigate triggers of police leniency in drunk driving arrests. The second uses a proprietary sample from the U.S. Sentencing Commission of several hundred firms criminally convicted in federal courts over an 11-year period. This project will examine how firms endeavour to re-establish their legitimacy after episodes of corruption, and whether those steps are effective.

One of the things that firms do to re-establish legitimacy is to change their name or be acquired. What will be interesting to determine is whether they are actually changing their ways. When they are called A they get convicted criminally, and then change their name to B, does that mitigate the consequences, and do they continue the bad behaviour?

Your research has also looked at people pulled in for speeding and drink driving. What did you find?

One thing we have found is that when there is a social norm to treat people nicely — such as if it is a driver’s birthday, or for women on Mother’s Day — people tend to be treated more severely. People seem to recognise that they are likely to be biased if it is someone’s birthday, so they overcompensate.

I am also looking at the effect of leadership change when and to whom leniency is shown.

So you are looking to see if leadership had an effect on arrests and penalties?

Yes, if leaders do matter then we’ll be happy. If leaders don’t matter then that’s also interesting.

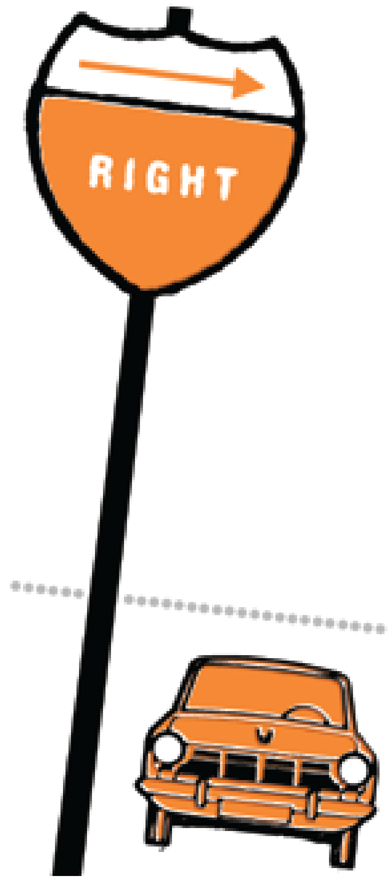
What led you to use data from police forces?

It’s very hard to empirically study what I’m interested in, which is corruption, because most of it is hidden. People don’t like to admit it, and so you if you actually do manage to get data, you never know how much you’re missing.

This data allows us to “back out” rates of corruption without having to depend on it being caught. It is also very applicable to organisations. All of these small police departments are organisations with leaders who change

“This project will examine how firms endeavour to re-establish their legitimacy after episodes of corruption, and whether those steps are effective.”

THE AUTHOR
CELIA MOORE
CMOORE@LONDON.EDU
Moore is an Assistant Professor of Organisational Behaviour at London Business School and a Fellow of the Edmond J. Safra Center for Ethics at Harvard University.



STRATEGY ILLUSTRATIONS: JOE MCLAREN

> "Organisations often make deals with the prosecutors, so either they agree to defer prosecution or the company is charged but then the charges are dropped when they agree to pay a fine or something similar."

and influence subordinates, who create direction and standard operating procedures. The extent to which you let regulations slide is very interesting to me. With such rich data, you can actually empirically identify how corruption is working, which is rare.

And what about the second strand of your Harvard research, about how firms re-establish legitimacy?

This is data from the US Sentencing Commission, of all firms that were federally sentenced after being convicted criminally. Most of these are well-known cases.

Organisations often make deals with the prosecutors, so either they agree to defer prosecution or the company is charged but then the charges are dropped when they agree to pay a fine or something similar. I will be looking at which firms did take these kinds of deals, and ones which didn't or weren't able to make these deals, and what strategies they take in the aftermath of these outcomes.

If it turns out that the consequences for firms are exactly the same whether they are criminally convicted or avoid prosecution — then that says something really positive about the criminal justice system.

What kind of offences are you talking about here?

Fixing prices, environmental offences, fraud and anti-trust offences. These are the big-time crimes, with fines up to $500 million.

How did you get interested in corporate corruption in the first place?

Because it's everywhere! We keep going through cycle after cycle of things going very wrong — from Enron to Lehman Brothers — with massive consequences for a lot of people, because people in organisations are not living up to the standards that societies set for them, or that we set for each other.

Perhaps these are lessons we don't want to learn?

I think that's probably true.

Isn't corruption in organisations inevitable, given human nature?

I hope not.

What other strands do you have to your research?

The Harvard projects are more macro oriented, in terms of analysis. I also do research at the individual level, so I have a series of projects on cheating — what makes us cheat, and what are the consequences when we cheat?

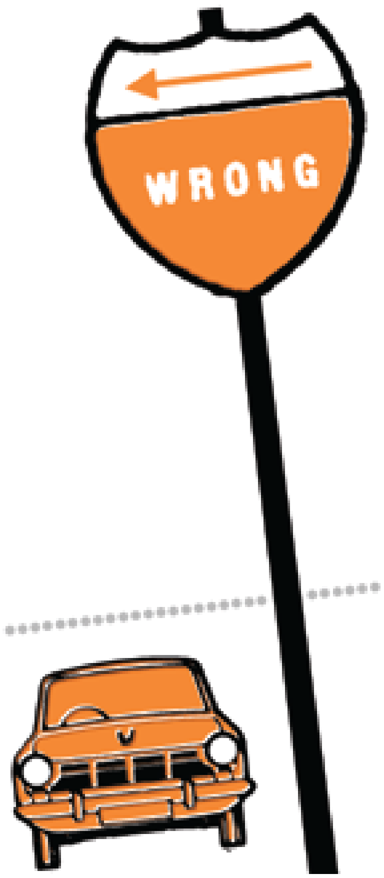
One recent study I'm involved in has found that cheating can put us in a positive mood. Most theories of moral behaviour assume that when we engage in unethical behaviour it puts us in a bad mood, and that's why we don't continue with it. We attempt it, and then we think, oh, but if I do that I will feel bad, so then I don't. In certain contexts — where the harm that you cause is not immediately obvious — this is not necessarily the case. The thing is that this type of unethical behaviour covers a great deal of crime — cheating in an exam, being truthful on your tax return, and that sort of thing.

I've also looked at what causes us to make worse ethical decisions. Usually this is an indication that we're trying to rationalise something. In decisions where you can either do the "right thing" or the selfish thing, people made the worst ethical decisions when they didn't think about it at all, or when they thought about it a lot.

You need to think about it just enough to come to the conclusion that you should resist temptation, but not so much that you can justify it.

Has the financial crisis had an impact on the level of cheating and corruption? Presumably, when the going gets tough more people make unethical decisions?

There is data to suggest that. It puts you in a context where it's easier to rationalise, so it becomes a real opportunity.



TICKETING THE GAMES

THE PRICE OF OLYMPIC SUCCESS

*Pricing the almost eight million tickets for the 2012 London Olympic Games was a hugely complex challenge. How could those in charge of the Olympics, billed as 'Everybody's Games,' juggle the clashing objectives of the Games' many stakeholders? **Marco Bertini** spoke with **Stuart Crainer** about the challenge of Olympic ticketing and what it reveals about setting the price of all goods in the future, especially given today's savvy consumers and the new technologies that are changing the way business is done.*

You have been examining the 2012 London Summer Olympics almost from the awarding of the bid. What made you so interested?

My interest stemmed from the extreme context. Obviously the Olympic Games is a great event because of the athletes and their stories. But people seldom think about all the problems posed by holding such a complex event in such a short period of time. What intrigues me is the conflict faced by the London Organising Committee for the Olympic and Paralympic Games (LOCOG) between selling enough tickets to fill the stadia and making sure the revenue target is met. It's a classic example of volume or revenue, where it seems that going for one objective will hurt your chances to achieve the other, and vice versa. Sometimes the two don't move in the same direction. If LOCOG had been able to ignore revenues, maximising attendance would pose little challenge. Similarly, if they didn't care to see full stadia, reaching revenue targets would have been greatly simplified. In addition and perhaps the most important goal of them all, LOCOG has to make sure the British public is happy with the process and outcome. Their pricing decisions have to be made to meet the attendance and revenue goals while remaining inclusive—it was sold as *everybody's* Games for a reason.

And it must have been hard to price such a wide array of events.

Very. Keep in mind that the Olympics involve 26 world championships that take place in the course of only two weeks. Moreover, these world championships are in sports that are completely different from each other in terms of their demand profile. Tai kwon do is completely different from football and both are different from, say, swimming. Each poses different problems. For example, few would guess that football is the hardest sport to sell at these Games. England is certainly a football-loving nation, but this sport accounts for a large portion of all available tickets, the stadia where the matches will be held have very large capacities, and the athletes competing are not the household names we see every week playing in the Premier League, in Serie A, and so on. Then there is the fact that you have hardly any available data upon which to base your decision-making. Whereas a company like Procter & Gamble can take scores of historical sales data to decide how to set prices, in this situation there is nothing to rely upon.

Finally, there really isn't a chance to do things over. If you go wrong, you can't say: "Let me tinker with the prices a little." Most companies that make a pricing mistake can correct it during the next quarter or at the first opportune moment. With the Olympic Games, you have to post a pretty good indication of your prices as early as when you submit the initial bid, which makes it difficult to deviate too much from estimates made years before the event.

What about past Olympic events, don't they provide useful data?

The Beijing Olympics didn't provide numbers; and even if it did, they wouldn't have been relevant because Beijing had a completely different objective and cultural and geographic context when it hosted the Games than London does. Even if you go back to Sydney, which has a fairly similar profile to the UK, that Olympics took place before the Internet was available for ticket selling, a different time and a completely different world. So there's no data. And London's Games will be sold almost 100 per cent online.

We are talking about a huge number of seats to be filled, aren't we?

The numbers are staggering. Almost eight million tickets were up for sale, which meant, according to LOCOG, almost 500,000 spectators per day could be expected to attend the Games, with up to 800,000 on the busiest days. LOCOG estimated that roughly 30 per cent of all tickets would be purchased by Londoners, 25 per cent by United Kingdom residents who

> "The key lesson for me would be about moving away from more mechanical ways of thinking about pricing to a much more humanistic way."

lived outside of London, 20 per cent by people from the rest of Europe and 25 per cent by people from the rest of the world. Total ticket revenue was budgeted at close to £411 million.

Was the pricing process as complex as staging the events?

When it came to selling seats, the simplest and most transparent process was deemed necessary to help people understand how some buyers were successful in getting tickets while others weren't. The more complex and opaque the process, the more likely that applicants would infer some sort of 'fix' to ensure favoured parties, say, corporate sponsors and rich people, got tickets while others came up empty. To limit negative reactions, those in charge decided to sell the tickets over several rounds. They also decided to engage the buying public very early on, communicating often via email to explain the process, the key dates, and what the expectations should be.

In the end, some two million applications were filed for round one in mid 2011, and the average applicant asked for 11 tickets. Thus, the early demand was for over 22 million tickets. Although a complicated process, the goal was to try to ensure fairness.

Some of this must sound familiar to people who work in pricing in the commercial world.

Yes, firms face these decisions all the time. How should a company's pricing handle trade-offs among profit, volume, customer selection, and so on? How might the mix of customers influence the reputation of a brand both now and in the future? Should the firm care who buys its product so long as the product sells? After all, not only does LOCOG have to fill seats, but they also have to fill them with the right people—real fans of the sport, the nation competing, or the Games in general. There is nothing like competing in a stadium full of excitement and energy. The athletes feed off their surroundings, and LOCOG is keen on providing the right setting for each event.

What do you mean by 'the real fans'?

You have to attract those that are interested in and knowledgeable about the sport they are going to watch. For example, at the Beijing Games there were several incidents where unknowledgeable spectators clapped at inopportune times, creating embarrassing situations that were demotivating to athletes. So, you want the right sort of customer, experts in the sport, fans of the person or the nation, fans of the Olympic Games in general. It was fascinating to watch the process by which decisions were made; for example, 26 different business plans were constructed, one for each sport. Each one was treated as a separate business: football was a business, tai kwon do was a business, and the plans involved determining how to maximise attendance for that particular sport/business.

Under the microscope

How did the people in charge handle the problem of less popular events and less known sports?

Here is where marketing came in. How do you attract attention to a sport? Do you find a potential star with a good back story? Will that help build media interest enough to get them to cover that athlete and his or her sport, educating people about what the sport involves? These efforts can make a huge difference.

Is getting the media to focus on the Olympics long before they take place always a good idea?

Encouraging media involvement, of course, has a potential downside. You don't really want to make too much of a fuss in the press and get them to focus on every aspect of what is going on, especially early in the process when things are changing as problems emerge, because they have a tendency to look for drama. For example, you don't want the press to say that grandparents from East London who funded the building of the stadium cannot find a seat, because they've been priced out of the Olympic Games.

Is the price right?

What one aspect of all this did you find most fascinating?

I thought the Olympic Games offered a very interesting way to think about pricing, generally, as a concept. If it were an industrial goods company, it would have been less interesting. It was the brand that made it so interesting. Even though it's a strange situation in a strange setting, it allows you to highlight, in my opinion, one of the main aspects of what a good pricing strategy looks like: the need to connect your pricing decisions to those relating to your brand, making sure you're consistent, and using the pricing mechanism to underscore what a brand does and is. Branding and pricing cannot move ahead at separate speeds and on separate paths..The Olympic Games have a strong, well-defined brand, so you have to make sure pricing is consistent with that idea.

Which must raise unique questions...

As you think about pricing, you've got to think about how the policies you settle on affect the perception of the brand you charge customers: Do I bundle tickets for tai kwon do with athletics? Do I bundle public transportation with the prices of tickets, to motivate certain kinds of behaviours? Do I offer free tickets? Then there is the question of the actual price levels. How much should they be? How many levels should there be? Should they be flexible, so that I can discover demand as I go? In other words, how do I structure my menu of prices?

One useful approach is to divide events under three headings:

01

THE 'BIG FOUR'

Swimming, artistic gymnastics, athletics (track and field) and the opening and closing ceremonies These were considered events for which demand historically far exceeds supply and which would likely sell out at almost any price. About 40 per cent of ticket revenues were expected to come from these four events.

02

FOOTBALL

With almost two million tickets across 58 men's and women's matches, football is the most popular sport in Europe; but — unlike the FIFA World Cup — Olympic teams are largely limited to players under 23 years of age, eliminating some of the biggest names in the sport. About 10 per cent of ticket revenue was expected from football.

CONSUMER POWER

MUTINEERS OF THE WORLD

The advent of the Internet as a means of selling tickets is just one of the changes that has made a difference in the world of pricing. Today, everything about a product is open not only to scrutiny and comment, but also to campaigns that can be mounted quickly to change what people see as right or wrong about pricing decisions. Consumers no longer just walk away from a product because of its pricing; they make their dissatisfaction known, prompting others to see a problem. What once would have been a voice in the wilderness is now — through the use of Facebook, Twitter, YouTube and all sorts of smartphone apps — a voice that can bring about a mutiny, upsetting the corporate applecart when it comes to pricing decisions.

THE M&S PRICE BUST

The new power of individuals manifested itself in the case of Marks & Spencer. The store had a policy of charging more for bras that had a cup size above DD. That is, it did so until 'The Busts 4 Justice' group was set up by Beckie Williams, a 26-year-old writer from Brighton who said, according to the Guardian, that she "was fed up of paying extra for her *30G* bras. Williams called the policy 'ridiculous' and bought a £3.40 share in M&S so she could put her case in person." Her Facebook group quickly attracted more than 14,000 members. Although the company defended its position, saying the charge reflected the extra cost of producing a bra for larger sizes, it ended up backing down and taking out advertisements in the press to tell consumers that all bras would in the future be operating a one-price-fits-all policy across their ranges.

A FEE TOO FAR

Another similar case was the planned imposition of a $5 per month fee on debit cards by *Bank of America*. The company announced that it would be imposing the fee in November 2011. According to *BusinessWeek*, Molly Katchpole, a 22-year-old nanny, started an online petition in response, urging Bank of America to drop the debit fee, explaining that she was "living pay cheque to pay cheque and one more fee was just too much." The petition was signed by hundreds of thousands of customers who were "mobilised to close their accounts and take their business elsewhere". The result: Bank of America's Co-Chief Operating Officer David Darnell announced that "Our customers' voices are most important to us. As a result, we are not currently charging the fee and will not be moving forward with any additional plans to do so."

GEORGINA PETERS

03

ALL OTHER SPORTS

Here, supply historically exceeds demand; thus, great effort and brilliant marketing would be required to maximise sales.

Does this tiered structure mean that prices can be astronomical for the tier one events?

LOCOG has a financial obligation to meet the revenue target that will allow it to stage the type of Games the British public will be proud of. To do that, popular sports will have to be, on average, more expensive. But it doesn't necessarily mean that outcry over ticket prices will follow. LOCOG is still being true to its brand positioning of inclusion and participation. It does that by making sure every sport, no matter how popular (even the Opening Ceremony!) has some tickets at £20. There might be less entry-level tickets available for these high-profile events, but nonetheless LOCOG is making sure that anyone with £20 to spare has the (equal) chance to attend any sport. This is a powerful statement in my mind. That said, you are never going to satisfy everyone. So of course there is going to be some animosity. In great part, it then becomes a matter of how you manage people's expectations.

Unfortunately, if you ask somebody in the street, "What do you think about the Olympic Games and would you like to go?", in reality they would probably say, "I want to go and see Usain Bolt in the 100m final, but I only want to pay 20 pounds." That is people's expectation: I want to pay little to see something very good, that is, tier one events. As a result, there are going to be people who are disappointed, which is what happened, because everybody is going to want a ticket for that. No matter what the price points had been, that would have sold out.

Even though the average ticket price for these more popular events is undoubtedly higher, it is still critical to have a range of price points available. There have to be some people going to the stadium at the very affordable prices. But perhaps the proportion of those prices is relatively less.

It is interesting to note that the London Games is the first Summer Games with five price points, instead of three, for most events. This captures what I meant about having the ability to provide different price points to people for all sports.

> "Almost eight million tickets were up for sale, which meant, according to the London Organising Committee for the Olympic Games, almost 500,000 spectators per day could be expected to attend the Games, with up to 800,000 on the busiest days."

I presume that disappointment is something they build into the strategy.

Indeed, LOCOG had clear messages about certain amounts of tickets being available at £20, a certain amount of tickets at £30, and so on. These key statistics were thought to help shape the conversation and guide it away from, say the average ticket price, or the number of people that did not get a ticket. Pricing the opening ceremony with ticket prices ranging from £20.12 to £2012 was also a media savvy move.

Getting it all right is a pretty impossible task, isn't it?

It certainly is. And there were two key questions that those pricing the Olympics had to ask, namely: Where would you like to be wrong? Would you prefer to be wrong on the revenue side, which would leave you under your revenue budget, or do you want to be wrong on the attendance side? Pricing strategies always involve trade-offs.

Perhaps most important is to keep in mind that the perception of unfairness in today's world of social media can have devastating effects. Technology changed the way Olympic tickets were sold, and it was a change that happened extremely fast. Violating the perception of fairness already has had devastating results for some companies. Who knows what new technologies will appear that could force us to rethink pricing yet again when the next Olympics are staged?

THE AUTHOR

MARCO BERTINI
MBERTINI@LONDON.EDU

Bertini is an Assistant Professor of Marketing at London Business School. A Harvard case study was created on the London 2012 Olympics by Professor Bertini and Harvard Business School Professor John T. Gourville. For more information, see http://cb.hbsp.harvard.edu/cb/product/510039-PDF-ENG

REGULATING FINANCE

TOXIC TAPE

There is a clamour for more and more regulation of the financial services industry so as to avoid another economic meltdown. The goal is admirable, perhaps, but ***Tony Eccles*** *and* ***Jules Goddard*** *says that too much regulating can create problems of its own — worse problems*

During the Vietnam War, J.K. Galbraith notoriously claimed, "This is a war that we are not winning, cannot win and should not wish to win." In the same spirit, I argue that the regulation of financial services does not work, cannot work and should not work.

As night follows day, bigger and more damaging crashes follow tighter and more numerous regulations. Every new regulation raises the severity of the next crisis. Indeed, regulation serves mainly to create the conditions for the next crime of exuberance. It sets the bar ever higher; and, in so doing, challenges entrepreneurs to find and exploit ever more arcane loopholes. In short, regulation encourages the very thing it was designed to outlaw. Adding more bars to the cage does not calm Keynes's 'animal spirits'. The result of more onerous and pernickety regulation is that bankers find themselves competing more with the regulator than with each other. Some banks now employ more people to research the Financial Services Authority than they do the market, the assumption presumably being that an understanding of the motives and assumptions of the regulator provides more valuable information than an understanding of the needs, preferences and choice processes of customers.

We can draw an analogy with the new theory of traffic management in cities. The late Hans Monderman, the inventor of 'naked streets', has shown in his native country, Holland, that as the health and safety clutter is removed from the centre of cities (traffic lights, warning signs, pedestrian crossings, markings and so on), they become safer: there are demonstrably fewer accidents, and traffic moves faster. In an ambiguous space where the rules are not clear, drivers, cyclists and pedestrians have no choice but to take personal responsibility for their own behaviour. Instead of relying on statutory instructions and warnings, they use their own perceptions and judgement to negotiate the shared spaces in the centre of cities. Monderman's pioneering experiments are being replicated across the world, always with the same unexpected results.

Regulation of financial services has the same effect on lenders as traffic lights and speed bumps have on drivers: it blunts responsibility. Worse, when things go wrong, it provides an excuse for the wrongdoer. When a driver in an accident blurts, "But the lights were green," it's so much like the banker testifying before Parliament that "we were compliant with Basel II." In effect, regulation 'socialises' the crimes and misdemeanours that it was designed to eradicate but which it only served to exacerbate. After the credit crunch, everyone found themselves being blamed — lenders lending too much, borrowers borrowing too much, bankers taking reckless risks, businessmen overextending their businesses, accountants and auditors failing in their fiduciary duty, regulatory authorities falling asleep at the wheel, politicians urging 'inclusive lending', professors of finance failing to predict the crisis, business schools teaching the wrong things to the wrong people, journalists failing in their investigative duty and so on. Of course, if everyone is culpable, then no one feels guilty. Everyone can justifiably point to everyone else. When no one bears the onus of responsibility, no one learns from the experience and the lesson gained from the crisis is wasted.

Despite all the regulatory restrictions in place before the credit crunch, the financial crisis has had to be treated as a culprit-less crime. If we define a fair society as one in which the culprit bears the consequences of his own actions, then regulation has failed in its principal goals of justice, fairness and the protection of the innocent.

The remedy for these ills has to be to restore bankruptcy to its prime role of allocating the right degree of pain and shame to the guilty party. Taking a cue from the US, something like the Glass-Steagall Act of 1933 (as a minimal form of regulation) has to be restored to ensure that never again can banks externalise the risks that they choose to take; and, as recommended by many economists, no single bank should be too big to fail. It should be possible to witness the sporadic bankruptcy of individual banks with equanimity and without recourse to public assistance or taxpayer largesse.

> Despite all the regulatory restrictions in place before the credit crunch, the financial crisis has had to be treated as a culprit-less crime.

Logically, regulation cannot work

Since 2008, the loudest noise in the City of London has been the sound of barn doors slamming shut. The horse that bolted was irresponsible banking. The slamming doors were the slew of new regulations, or at least the threat of a much stricter regime, being proposed from various quarters. The advocates of these instruments believe that if these measures had been in place before, say, 2005, there would have been no crisis.

The problem for proponents of regulation is that it is only after a crisis (after the horse has bolted, so to speak) that the preventative measures are self-evident and clear for all to see. However, to know what to do before a crisis presupposes the ability to predict the crisis. With very few exceptions indeed, the last crisis was not predicted; just as the next crisis, which, by definition, will have a logic all of its own, will not be predicted. Every crisis is unique. We should not, as a society, expect regulators to be so astute as to identify the next financial misdemeanour even before the perpetrators themselves have hatched it, applied it or understood it. An entrepreneurial society takes risks of which the consequences, by definition, cannot be foreseen.

Regulators are human. They are fallible. And, for the most part, they are not as clever, imaginative or motivated as those whom they are trying to regulate. It is a peculiar person who, despite having the ability to be a highly successful investment banker (with all its kudos, excitement and wealth), prefers instead to invest his skills in the fruitless task of ➤➤

predicting the unpredictable and pre-empting what simply cannot be pre-empted. The very attempt to do so suggests a level of intelligence several notches below that necessary to even begin to understand the genesis of the next financial crisis.

Arguments for regulating banks can be no stronger than arguments for regulating regulators or, indeed, arguments for regulating the regulators appointed to regulate the banks, ad infinitum. Therefore, why start the process of regulation at all? Why not place responsibility squarely with the originator of the actions you are seeking to regulate? Then, if that responsibility is abused, ensure that the punishment is proportional to the offence.

The logical result of the desire to regulate risk out of existence is a society in which everyone is a regulator, but there are no activities left to be regulated. This, broadly, was the state of affairs in East Germany before reunification. Here was a nation so replete with Stasi spies that the only people left to spy on were other spies spying on them.

If regulation is an error of logic, deriving from the fallacy that something that is impossible to foresee can nevertheless be prevented from happening, then the remedy will need to be based on an entirely different principle. Perhaps markets are best kept honest by trying to make them transparent instead of trying to make them compliant. The more transparent the operations and transactions of a bank, the greater the role of everyone (not just experts) in exercising oversight. The contribution of government would be to legislate for much greater transparency; once this is achieved, predictive markets could be created to replace regulatory authorities. The suggestion is that the best regulator is itself a market in which very large numbers of people compete to predict the future performance of each of the players in the market being regulated. Imagine, for example, a spread-betting market in which the odds of any particular bank going bust within the next year become public information. Such information would be more powerful in preserving the integrity of the financial services industry than any number of rules and regulations.

Morally, regulation should not work

There are many activities that can be outsourced successfully by individuals, companies and governments. For example, individuals may choose to outsource the preparation of their tax returns to an accountant; many companies benefit from outsourcing the design and administration of their IT systems to a consultant; and governments are increasingly finding it more efficient to outsource the delivery of public services to voluntary organisations. Equally, there are some activities that cannot legitimately be outsourced. By definition, ethical responsibility for one's own actions cannot be delegated, shared or outsourced. Moral accountability must attach to the author of the action.

Regulation has the perverse effect of encouraging banks to outsource their conscience to the regulator. Bankers have good reason to do so: if something is not explicitly forbidden by the regulator, then it cannot be deemed irresponsible if they choose to adopt it or to practise it. By 'socialising' moral responsibility and breaking the link between action and outcome, regulation reduces virtue to a tradable commodity.

A morally mature society is one in which individuals are not just happy to take responsibility for their actions but also recognise enthusiastically their obligation to be accountable to others for what they do. They want to be members of a society in which personal and corporate transgressions have personal and corporate consequences.

Taking responsibility for one's actions includes learning conscientiously from one's mistakes. One of the tragedies of the global economic downturn has been that the lessons of the debacle have not been learned. If no individual sees himself as even partially responsible for the crisis, then no one has any reason to interrogate his own beliefs and values or make strenuous efforts to change his behaviour. Indeed, recent empirical studies of bankers in the City over the last couple of years have shown that individual behaviour does not seem to have been affected by the crisis. It is business as usual. Because regulation gives everyone an excuse to externalise personal responsibility (akin to the excuse that "I was just following orders"), no one is obliged to reflect on his own culpability or draw ethical conclusions from the consequences of her actions.

Recently, the European Working Time Directive (EWTD) has been widely blamed for encouraging junior doctors to desert the NHS, for having a malign influence on medical training and for putting patients at danger. David Nunn, a consultant surgeon at London's Guy's Hospital had this to say in a letter to *The Times*:

"Who is to blame for the nonsense that is now surgical training? Who agreed to allow nurses to take over the role of junior doctors to the detriment of both doctor and patient? Who acquiesced to the farrago of the Modernising Medical Careers programme? Who was persuaded to accept the 'challenge' of redesigning training to meet the requirements of the EWTD?

"I am afraid it was me and all of my senior surgical colleagues, who should have resisted all of the above. Not only have we failed the generation below us, but we have allowed politicians and managers to undermine our profession and our own status."

In the aftermath of the global economic downturn, who has had Nunn's disarming humility to take any responsibility for what happened?

The economic costs of the banking crisis, however great, will always be trivial by comparison with the social costs of the regulatory methods designed to forestall them. It is better for a society to bear the costs of financial exuberance every 50 years or so, however painful, than suffer the decline in ethical standards, the abdication of personal responsibility and the depletion of social capital brought about by ever more intrusive government-inspired regulation, however gradual. Sometimes in life, the therapy is more toxic than the disease it purports to cure. ◘

THE AUTHOR

JULES GODDARD
JGODDARD@DIAL.PIPEX.COM
Formerly Gresham Professor of Commerce at City University, Goddard is currently an Associate of the Management Lab at London Business School.

TONY ECCLES
TONYJECCLES@GMAIL.COM
Tony Eccles is Visiting Professor of Strategic Management at Cass Business School, City University, having previously been Professor of Strategic Management at London Business School, as well as working in operations management with Unilever. Eccles and Goddard's latest book is Uncommon Sense, Common Nonsense (Profile, 2012).

PUSHING FURTHER

BRITISH ENTREPRENEURS, GLOBAL VISIONS

*Start-ups used to start local and then expand globally. Now, say **Klaus Meyer** and **Helen Xia,** a growing number start local and global.*

Many entrepreneurs think of their businesses as global because, from the outset, they pursued markets outside their home country. However, the pursuit of global markets is only one way to exploit the opportunities of globalisation. Some ambitious entrepreneurs, especially in high-tech ventures, push further and create business models that explore and exploit resources in multiple countries. Their businesses do not aim for, but start with, international operations. The essence of their business idea involves identifying, attracting, transforming and applying resources in different countries, and implementing their idea from day one.

A famous example is Genmab, a biotechnology firm established by US entrepreneur Lisa Drakeman in 1999. Genmab was formally registered in Denmark (and listed on the Copenhagen stock exchange in 2000) because Danish venture capitalists initially backed her project. At the same time, the firm's main research laboratory was in the Netherlands, where the lead scientist was based and where researchers with the required specialisation were available. Thus, Genmab from the outset drew on resources from multiple countries: the United States for entrepreneurial skills, Denmark for venture capital and the Netherlands for technology and research capabilities.

We have investigated British high-tech start-ups that, like Genmab, began by combining resources from multiple countries. To protect their confidentiality, they shall remain anonymous. They include:

- A London-based clean energy start-up combining technology developed in the UK with a Hong Kong-based venture capital fund, manufacturing in China and selling to literally the entire world, with major orders from places such as South Africa, Chile and Haiti — and all with just nine employees
- A semiconductor design start-up in the 'Silicon Southwest' cluster bringing together engineering teams in the UK and Belgium, while building customer relationships in Japan and the US
- A pharmaceutical entrepreneur in Oxfordshire buying, in quick succession, small companies in France, the UK and the US, and who is now developing commercial infrastructure to be shared across multiple countries and approval authorities.

Operating in a variety of technology-oriented industries, these UK entrepreneurs share one thing: their start-up wouldn't exist if they could not tap into resources around the world to build their business model.

New opportunities

Globalisation is creating many new opportunities for businesses. Large multinationals with established international operations have often been first to pursue these opportunities, yet entrepreneurs with the right sorts of capabilities and networks are also able to pursue them. Three globalisation trends stand out in creating opportunities for global entrepreneurs:

01

GLOBAL VALUE CHAIN FINE-SLICING

Multinationals are fine-slicing their global value chains by locating different tasks in different countries and selectively outsourcing some of these tasks. Beyond manufacturing and back-office services, these include research collaboration in systems of open innovation or buying in of innovations from independent technology firms either through licensing or other contractual arrangements. This creates opportunities for entrepreneurs to tap into a value chain by developing a specialised component or service targeted at major players in an industry.

Entrepreneurs we studied, for example, design semiconductors that enable faster data transmission in certain types of mobile devices or generate biochemical ingredients that reduce energy use in a particular

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manufacturing process. Their target customers may be as few as half a dozen manufacturers worldwide (based in places such as Japan, Korea or the United States — but rarely in the UK). As one founder/ CEO stated, "Our company is what we call a fab[rication]-less semiconductor company. That is, we design technology, silicon chips and the software that is used to drive those. We will subcontract the manufacture of silicon chips to Taiwan. And from that point, we will then sell the technology to a manufacturer of mobile phones. It is a bit more complicated than that, because there are some modifications to that model; but that is the classical fab-less semiconductor company's business model."

02

GLOBAL COMMUNITIES OF PRACTICE

In many fields of specialisation — be they technical, scholarly or even artistic — close communities have evolved between people who, despite geographic distances, frequently meet, exchange ideas and best practices and establish (informal) rules of conduct in the community. We regularly participate in scholarly conferences that take place in a different country every year, yet we continue to meet many of the same colleagues. Such repeated meetings allow members of the community to form close professional and personal bonds.

Industry-based researchers similarly participate in conferences in which they not only exchange ideas on new technologies but also establish networks that are virtually global. The more specialised the area, the more likely a handful of specialists are known in their community. These conferences allow researchers to create personal relationships with the experts, no matter the country in which they are based. Entrepreneurs can build on these ties when creating their own ventures, hiring or contracting the best — independent of their geographic locations.

Some of these communities have a geographic hub. For example, in semiconductor design, software engineering and biotechnology, Silicon Valley is not only a breeding ground for start-ups but also a point of reference for start-ups operating in other parts of the world. Many of the key people in our semiconductor cases have spent substantial amounts of time in California before returning to the UK. A company founder and chief technology officer described how this worked: "In semiconductors, I suppose the common reference point is to Silicon Valley because most people have been to Silicon Valley at some stage." He added that his own background was much like that of others he meets in Silicon Valley. He had worked for one company based in the US and another based in Japan; however, his present company had clients in "Japan, Germany and Spain and all over the place. So, you end up knowing lots of people in different countries".

03

GLOBAL COMMUNICATION TECHNOLOGIES

The revolution in communication technologies not only makes interpersonal exchanges across large distances feasible, it has also vastly reduced the set-up costs of such systems and thus enables small businesses to use them. Videoconferencing facilities are widely available, though not as flexible as web-based technologies for communication (for example, Skype), data-sharing (for example, Dropbox, Google Docs) and networking (for example, Linkedin, Twitter, Facebook, Xing).

Similarly, the falling costs of long-distance travel facilitate face-to-face meetings. Many entrepreneurs prefer to combine occasional intensive face-to-face meetings with frequent, but shorter, virtual meetings. Hence, coordination between members of a geographically dispersed team has become an everyday routine for some. One CEO and investor in a green energy start-up mentioned how frequently he travels. But he is not alone; so do the chiefs of technology and finance. Yet, he adds that the key players hold weekly management or other important meetings wherever each may be located. "We easily spend two or three hours one morning every week using Skype. Why bother with video; we know what each other looks like. We do that and have a very structured agenda. Once a month, we also have a board meeting; that is all done virtually, and it works very, very effectively."

Worldwide resource

Entrepreneurs can take advantage of these opportunities by designing their business models to combine and exploit talent from around the world, in any field. The challenge, of course, is integrating people with diverse backgrounds who live in different countries.

01

INTEGRATING TECHNOLOGY GLOBALLY

In high-tech ventures, the technologies and specialist skills employed are often highly specific. Developing new, leading-edge technologies requires working with the best available existing technologies. The entrepreneurs we talked with collaborated extensively with individuals, firms and research institutes both within the UK and beyond. They found their partners mostly in their specialist communities or through their investor network. However, somewhat counter-intuitively, some of the key relationships started with a Google search: the need for specific complementary competencies made such an approach both necessary and feasible.

One entrepreneurial CEO in Bristol used Google to search for a partner. The search, he said, "came up with an organisation in Belgium. So I jumped, sending them a couple of emails. We kind of guessed what they might want to do. It was clear that they have radio technology, but it wasn't absolutely clear in what direction they are moving. So I sent them an email saying we were interested in integrating the technology into silicon discs — it was quiet for about a week, suddenly there was a flush of emails from them, so obviously it splashed in to the right place."

02

RECRUITING MANAGERIAL TALENT GLOBALLY

Coordinating people and resources from different places around the world is a key challenge for global entrepreneurs. The development of complex business models across borders and time zones requires extensive coordination of people and activities. Start-up ventures thus need leaders who can coordinate resources (whether individuals or teams), work with distributors — and update, reassure or seek additional support from investors. At the same time, such leaders must not lose sight of the big picture; they must ensure that all the pieces of the entrepreneurial jigsaw actually work together.

The founders of global-from-the-start firms thus have to find people with leadership experience on the international stage who share their vision and their global outlook to build a multinational management team. The founders may even need to hire a CEO to run the company for them. Recruiting people with that combination of skills can be especially challenging, because people tend to be attached to their current locations.

With international experience and networks so important, 'returnee expatriates' are often a more obvious choice than recruiting someone based in another country. The founder and chairman of a biochemical start-up (someone who was a serial entrepreneur) shared with us why he sought to hire a leader who had roots in the UK for his new British-based business. "The issue is: will a guy in Silicon Valley who's 45-years old, who's at the peak of his career earnings, uproot himself with his wife and his family for a start-up in the UK? Is he going to do that? I don't think so. He'll say he will, but…. So, you have to look for people who've been in the US but have come back." He added that the reasons for someone to return may be tied to an unhappy spouse tired of living abroad or for some other personal reasons. Yet, there are many business advantages for trying to identify and hire a returning ex-pat. To begin with, such returnees could be easier to engage than someone who has to be pried out of his home country and who has to give up share options or other compensation hurdles as well as a family that's reluctant to give up their family roots.

03

RAISING CAPITAL GLOBALLY

Raising capital is a pivotal concern for many entrepreneurs. Why not raise it from angels or venture capital firms (VCs) overseas? Our set of entrepreneurs urged us to advise others that it is important in a start-up to be as thrifty as possible and to avoid bringing investors — angels or VCs — on board before such outside funds are critically needed. They noted that the constraints that accompany such outside investors reduce the flexibility of entrepreneurs to move at will later on. Our entrepreneurs cautioned that outside investors too often look for a quick return on their investments and thus too rapid an exit.

Most of the capital raised by our interviewees, despite their generally high international orientation, came from UK sources. Exceptions were business angels that had a long-standing prior relationship with the entrepreneur and US-based VCs that were operating out of a UK-based office, raising money in Europe to be invested in Europe. Although capital flows freely, VCs actually face difficulties investing in other countries because the due diligence of start-ups involves local activities that rely heavily on local networks and on understanding the local business community.

Several of the most ambitious entrepreneurs we interviewed

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addressed the issue upfront by setting up their legal registrations outside their own countries to facilitate access to capital. Some registered their business in the US because, first, it facilitates attracting VCs and, second, allows for a higher market valuation should the entrepreneur decide to sell the company. Also, the availability of government grants for research and corporate taxes sometimes influenced this location decision, but only as a secondary consideration.

For example, a pharmaceutical company operating from Oxfordshire is actually registered in the US state of Delaware. The CEO revealed why: "The US pharmaceutical market is the biggest in the world, and companies get a much better valuation in the US than almost anywhere else. Second, if you were to go public with an IPO, the US is usually a better market — not always, but mostly. And the third thing is if we were to sell to a strategic player, selling to a US company is often easier than selling to a European company."

04

BUILDING DISTRIBUTION GLOBALLY

Most of our interviewees operate in specific business-to-business industries, developing technologies targeted at specific corporate customers. Their main marketing-related activity was thus based on networking and building a reputation within the specific community, for example, by liaising with potential customers and potential users further down the value chain. They also marketed by building a community around a website or Twitter account or by participating in industry conventions. The focus on key customers reduces the need for local knowledge that, for many, is an obstacle to reaching customers overseas.

However, others sell to customers in a wide range of locations; for them, establishment of product approvals and distribution channels is often the most critical element of their business model. A good example we found is a late-stage pharmaceuticals company aimed at selling its products across Europe and North America. The core of its business model is an organisational infrastructure to take medicines through the market introduction process, closely working with regulatory authorities, medical associations and pharmacies in each location.

In another example, a provider of a clean energy device is building a distribution network of independent agents, often identified via its web-based community. To illustrate the point, the CEO noted how his company built a common database of likely customer queries; the database was started by the company's London team, then reformatted so all partners could access it. "So," he added, "if a customer, say, in Malaysia, has bought a unit from a Malaysian distributor and needs help, he should call the distributor first and generally people do. The distributor will run through his knowledge base and generally find an answer. If they can't find the answer, the distributor will ask us."

Global entrepreneurs

Who are the people who engage in this sort of entrepreneurship? Most of the entrepreneurs we have met are mature individuals who have achieved professional success before — mostly in business, but occasionally in academia. Two of them have a PhD and a string of oft-cited publications to their names. Yet, at some stage, they strike out to pursue their own ideas, ones they could not implement in their previous jobs.

Developing a business model that integrates resources at different locations requires a combination of experiences often developed in an industry with an international scope of activity and responsibility. This experience provided our entrepreneurs' competencies and networks with global breadth and industry depth. Such entrepreneurs have four crucial capabilities.

01

GLOBAL MINDSET

The entrepreneurs we interviewed were comfortable acting on an international stage, dealing on a daily basis with people around the world, crossing political borders and accommodating diverse national idiosyncrasies. In other words, they had a cosmopolitan view of the world and were at ease with cultural differences. Their cross-cultural competence and their ability to deal with the complexity and uncertainty of the global economy provide a foundation for developing a global vision for their business. This global mindset enables entrepreneurs to operate where 'mono-cultural' people fear to go. These entrepreneurs can adapt smoothly to new customs and traditions while simultaneously keeping a firm focus on their own objectives and values.

One VP of marketing in Bath confided that such skills can become second nature. "You know," he offered, "I am so used to this. I actually had more problems cross-culturally when I worked with a Scottish management than when I go to China. When I am dealing with Chinese customers or Korean customers, I am expecting and prepared that there's going to be some give and take. I am dealing with people who are very experienced international businessmen who also are expecting some give and take. I am sure it would be different if I were dealing with someone who has never met a foreigner before."

02

DEEP INDUSTRY EXPERTISE

Aiming for global leadership in their particular niche, the entrepreneurs in our study combine leading-edge technologies with business acumen to stand up to the best globally. Their potential customers and competitors are worldwide; so, they have to understand the industry on that scale. Developing a global vision requires a combination of knowledge of the technology and the specific markets — and hence downstream industries. Personal experience in the industry and the ability to envisage the future competitive landscape of the industry help global entrepreneurs to identify the gap they aim to fill, their 'billion dollar market opportunity'.

As a result, successful technology entrepreneurs understand not only the technology but also the marketplace. Explains the CEO of a pharmaceutical start-up: "Technology is just the first step in building a company, in building products…. The second generation of my leadership team is all about building products but not the technology; that's a big difference. Many start-up companies fail because they're so hung up on their technology and they are so much dominated by the technologists which tend to be part of the start-up field that they never go beyond that. Because their focus is the technology, they keep on saying, 'Well, we have to make the technology better and refine it.' At some point, you have to make that transition to focus on the outcome of the technology but not the technology itself. That transition is key in developing a business; and, if you can't make that, you will fail."

03

UTILISE GLOBAL NETWORKS

The entrepreneurs we met have built networks to connect with the best in their industry and technological fields around the world. They use their networks to identify and attract the most appropriate people and resources while also establishing relationships with new customers. Some of these networks cluster around geographies, such as California for software, semiconductors, biotechnology or green energy. Others meet in professional associations and conventions.

Entrepreneurs at the core of professional networks can spot new trends in markets and technologies early and join initiatives such as the creation of new international standards. Moreover, the networks help entrepreneurs identify and recruit key individuals, as the chairman of a biotech start-up explained: "How do you know that the people you're talking to and investing in are genuine? They will tell you all sorts of stuff. How do you find out what the back story is? You find that out through local networks. You find out who the charlatans are, who the crooks are — all the things that people won't tell you. But, you have to use special techniques when networking. If you ask somebody 'Is this guy a crook?', he won't tell you, not formally, because they dare not. He won't write it too. He won't write a bad reference. People don't. The secret is in the things they don't say. How do you find out? The way you find out is to talk to people and listen, when they go, you know, 'I wouldn't do that if I were you.' That's what they do. Or they go, 'Well, I'm not sure about this.' Lots of that is around; but, unless you're in a network, you don't know — and then you make big mistakes."

04

JUMP ON GLOBAL OPPORTUNITIES

Entrepreneurs who see the global economy as a stage on which they are free to act can do things that few others imagine to be possible. The opportunities of globalisation appear (almost) limitless. However, to succeed with a global business model, entrepreneurs readily deploy their cross-cultural and industry-specific competencies. Moreover, they reinforce all this with a lot of persistence. Often, it is not the first entrepreneurial venture that succeeds; but every entrepreneurial venture is an experience that helps with the next. Having an MBA helps, but it is not enough. All our entrepreneurs had hands-on experience in their industry in multiple locations around the world. Those aiming to join the elite of entrepreneurs should thus systematically build an adequate capability portfolio and augment that with a set of relationships to prepare for taking the big step. Then, when the right opportunity presents itself, jump on it. ◻

THE AUTHORS

KLAUS MEYER
K.MEYER@BATH.AC.UK
A graduate of London Business School's PhD programme, Meyer is currently Professor of Strategy and International Business at the China Europe International Business School, on leave from the University of Bath.

HELEN XIA
T.XIA@BATH.AC.UK
Xia obtained her PhD at Aston University and currently is a lecturer at the University of Bath.

FINANCING INNOVATION

THE VENTURE LAB

The pharmaceutical industry is the testing ground for a major shift in how entrepreneurial companies understand and utilise different sources of venture capital. ***Gary Dushnitsky*** *ventures inside the lab.*

The escape route from our challenging times is innovation. We need to be more innovative, create new industries, develop new products and services, and increase productivity. Innovation will create that much needed employment and growth.

Innovation requires the investment of talent, time and money. Over the last decade, my research has looked at the financing of innovation. When I started working in this space, the common answer was that independent venture capitalists stimulate technological innovation. Nowadays, we see an influx of new investor types entering the venture capital market, including corporate investors, venture philanthropists, and others. Documenting the implications for innovation is the subject of my recent work.

Pharma chameleon

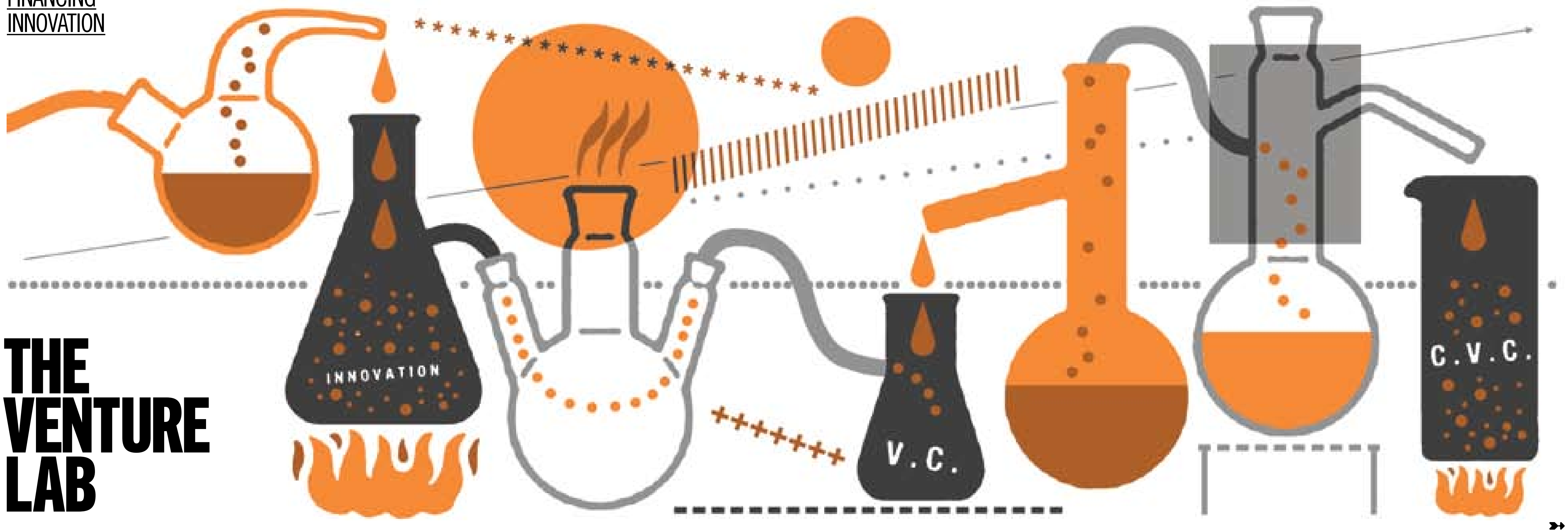
Real alternatives and complements to independent venture capital are now emerging. Consider the pharmaceutical industry. A 2012 survey of CEOs of biotechnology ventures in the US found that three times as many pointed to corporate investors as a likely source for funding in the year to come. The figure was previously only 10 per cent.

The shift has to do with fundamental changes to R&D in the industry. In pharmaceuticals the time and money necessary to develop a new drug has increased substantially, as costs of sophisticated infrastructure and talent rise, as do regulatory demands. Independent VC funds have traditionally invested in a biotechnology company and known that, with a fair commercial wind, they would be able to liquidate that investment successfully a few years down the road. In pharmaceuticals, that time period will now be ten years and require substantial investment along the way, thus eroding returns significantly.

This explains why, broadly speaking, VCs perceive fewer opportunities in pharmaceuticals, leading to a dearth of VC in that industry. Of course, it creates opportunities for other forms of entrepreneurial finance to step in. Indeed, over the recent years, the pharmaceutical industry has witnessed corporate venture capital and venture philanthropy growing in significance.

Venturing corporately

The rise of corporate venture capital (CVC) — investment by large corporations in entrepreneurial ventures — has been especially driven by the relative stagnation in VC fundings, but also by several other factors.



The reality is that nowadays many corporations — especially in pharma — have more capital in their treasuries. They have cash to put into play. In addition, incumbent pharmaceuticals have a great many resources — state-of-the-art laboratories; deep knowledge of regulatory systems; global distribution channels; insights and experience in how to position and sell a drug; and others. By leveraging these corporate resources, corporations can catapult the growth of young biotechnology companies.

In some of my past research, I have found that, in the pharma industry, CVC-investing corporations outperform their industry peers both in term of overall financial indicators (namely, market-to-book values) as well as in terms of innovation outputs (namely, generating patents).

It is therefore not a surprise that corporate venture capital is well established in the pharmaceutical industry. Johnson and Johnson's venture arm JJDC was set up in 1973; Roche has its Roche Venture Fund which goes back to the early 1990s and has a 500 million Swiss franc ($500 million) fund; and SR One, the venture arm of GlaxoSmithKline (and originally of SmithKline) was established in 1985. Eli Lilly span out its venture capital arm Lilly Ventures in 2009 with a $200 million investment fund. It invests in biotechnology, medical technology and healthcare IT.

A growing number of other pharma companies are setting up their own venture units. For example, Teva Pharmaceuticals, the world's largest generic drug company, has recently officially launched a venture fund.

The way forward

In the face of these shift in biotechnology financing, there is one thing we don't know: Are alternative forms of funding more or less conducive to driving innovation? Specifically, do corporate-backed biotech companies produce the same type and quantity of innovation as VC-backed ones?

Indeed, over the recent years, the pharmaceutical industry has witnessed corporate venture capital and venture philanthropy growing in significance.

In recent research, with Dr. Alvarez-Garrido, we put together a database of almost 600 US-based biotechnology companies founded between 1990 and 2003. Around a third of which received funding from corporate venture capitalists. We looked at the innovation outputs of these biotechnology companies. In particular, we investigated the scientific publications generated, as well as the patenting activity of those biotech start-ups.

We found that CVC-backed start-ups do no worse than venture capital backed start-ups. Indeed, their innovation track-record is at least as good as venture backed start-ups, or better. Interestingly, we found that in the area of fundamental scientific research — the kind done by eminent scientists who found or lead many current biotech start-ups — CVC-backed start-ups deliver superior innovation. They publish more academic work, and they do that irrespectively of whether or not the corporation targets the same broad market, niche, or therapeutic area.

When it comes to applied research — patentable research that has more immediate commercial use — we observe an interesting pattern. Compared to VC-backed start-ups, biotechnology companies exhibit superior patenting output when they target an area not currently served by their corporate investor. This superior performance is eroded when the biotech company operates in the same industry niche as the corporation: in those cases CVC and VC backed start-ups exhibit similar levels of applied research.

The evidence suggests that alternative forms of funding are associated with unique innovation trajectories. Specifically, the findings allude to a novel pattern of division of labour in the world of pharmaceuticals. Start-ups which operate in areas where their corporate investor already operates may be more focused on basic research, and likely work with and through the sponsoring corporation to monetise their work.

The shifting landscape

Make no mistake, the market for venture capital continues to be an important means of driving innovation. In the United States venture capitalists invested $28.4 billion in 3,673 deals in 2011, an increase of 22 per cent in dollars and a 4 per cent rise in deals over the prior year, according to the MoneyTree Report by PricewaterhouseCoopers and the National Venture Capital Association.

The aforementioned findings, however, uncover a changing awareness of the process of drug development and commercialisation. In the past, this was interpreted as a sprint: as VC-backed companies developed an innovative drug, commercialised it, and experienced lucrative exits. It was a world where the first to cross the line won, and won big.

> The escape route from our challenging times is innovation. We need to be more innovative, create new industries, develop new products and services, and increase productivity.

Now, what we have is more akin to a relay, where the baton is passed from one runner to the next. Different players and investors can and do work together along the drug discovery process. Accordingly, it is important to understand that the biggest bang for the investment buck may no longer be in taking something from A to Z, but rather to identify where there is a particular market failure in terms of the availability of funding for innovative biotech companies. In some cases, university research takes that development from point A to point D, with corporate venture capitalists — and other investors — support biotech companies at later stages.

Seen this way, it is clear that we can no longer have one solution for funding entrepreneurial innovation. Because the development of pharmaceuticals is a highly complex ecosystem, there is a need for different forms of entrepreneurial finance, and those investors should be encouraged to work in concert.

Of course, the pharmaceutical industry is not unique in having start-ups driving both basic and applied research. The energy sector, as well as the food industry, are critical for our economy and for our lives, and have many of the same characteristics. Interestingly, the number of corporate venture capitalists in the energy sector has ballooned over the last decade, and they are also now important players in the food industry. One way or another, in all of these industries the future of venture funding is unlikely to ever be the same again. ◘

THE AUTHOR
GARY DUSHNITSKY
GDUSHNITSKY@LONDON.EDU
Dushnitsky is an Associate Professor of Strategy and Entrepreneurship, and Academic Director of the Deloitte Institute of Innovation and Entrepreneurship at London Business School.

ORGANISATIONAL AGILITY

AGILITY IS KING

*We used to say that "cash is king". Not anymore, argues **Mike Richardson**. Agility is king and cash is just a way of keeping score.*

Organisational agility — the ability to deal with rapidly changing circumstances while out-executing the competition and stakeholder expectations — is the core differentiator of businesses these days, whether they are competitors or not. It differentiates the winners from the losers, the victors from the victims and the first from the worst. It determines which organisations survive and thrive, and which don't. It sorts the best from the rest, separating those businesses which are accelerating their growth, leveraging their value and beating their competition, from those which aren't.

Agility has always been a determining factor of sustained business success, among many others, but now it is becoming the bottom-line differentiator, between the rubber and the road. For executives, agility is the core differentiator of managers, executives and CEOs from their peers. Team agility is the core differentiator of functions, departments, or business units from their peers, as those that seem to execute more proficiently, adaptively, and dependably in a team context. Organisational agility is the core differentiator of businesses from their peers. The trouble is that, outside of the domains of IT and software, organisational agility isn't well understood.

Dynamically complex

So, what separates the agile from the fragile? The answer lies in dynamic complexity. In his book, *The Fifth Discipline: The Art and Practice of the Learning Organisation*, Peter Senge said: "The reason that sophisticated tools of forecasting and business analysis, as well as elegant strategic plans, usually fail to produce dramatic breakthroughs in managing a business — they are all designed to handle the sort of complexity in which there are many variables: detail complexity. But there are two types of complexity. The second type is dynamic complexity, situations where cause and effect are subtle and where the effects over time of interventions are not obvious. Conventional forecasting, planning and analysis methods are not equipped to deal with dynamic complexity. The real leverage in most management situations lies in understanding dynamic complexity not detail complexity."

The devil really is in the detail and, with wave after wave of dynamic complexity washing over us, the devil is also in the dynamics. We live in a constant state of flux, in which everything has become real time, online all the time. It's a world of hypercompetition, with the rules, the game and the field-of-play being continuously and disruptively

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Getting organised for agility is a higher order challenge, for which we need to develop higher order executive strengths reflecting an understanding of the anatomy of dynamic complexity.

reconfigured. Everyone is wearing multiple hats, serving a multiplicity of projects, clients, opportunities, change initiatives, sites and roles. We are constantly managing a portfolio of plans and re-planning on the fly in response to moving objectives and reshuffling priorities.

In these circumstances, traditional approaches to focus, time and priority management don't work very well anymore. The challenge has become much more like an ongoing, dynamic process of triage.

New order

Getting organised for agility is a higher order challenge, for which we need to develop higher order executive strengths reflecting an understanding of the anatomy of dynamic complexity. There are three levels:

01

PATH FINDING

This about understanding the anatomy of the road we are on, with the mental agility to reframe the landscape ahead and find paths of least-resistance/highest-reward for profitable growth.

02

EMOTIONAL INTELLIGENCE, INTUITION AND RESILIENCE

This trifecta of executive traits is essential to remaining composed in the face of overwhelming complexity. It's about leveraging our intellect (IQ) to avoid cognitive overload, deepening our emotional fortitude (EQ) to be resilient and trusting our informed intuition at the intersection of our IQ and EQ.

03

EXECUTION EXCELLENCE

In their 2002 book, Execution: *The Discipline of Getting Things Done*, Larry Bossidy and Ram Charan noted: "For all the talk about execution, hardly anybody knows what it is. They don't have the foggiest idea of what it means to execute. Execution is not just tactics—it is a discipline and a system. Execution hasn't yet been recognised or taught as a discipline, whereas other disciplines have no shortage of accumulated knowledge, tools and techniques. The leader who executes assembles an architecture of execution." We need a new architecture, system and framework of concepts, models and tools, uniquely integrated, aligned and attuned with the changing nature of our execution and agility challenge.

Learning to drive again

Think about it. In the driving seat of our cars we have mastered all of this. We have developed the higher order strengths required for driving, able to triage our focus, time and priority management, in the face of dynamic complexity and the agility required. We are able to be strategic and operational, leaders and managers, long-term and short-term oriented, all at the same time, hardly giving it a second thought, at the same time as changing the channel on the radio, making a mobile phone call (hands-free, of course), talking to a passenger, and thinking about life, usually arriving at our desired destination, safely, on time, and ready for what's next.

Yet, do you remember when you first started learning to drive a car? We faced an unfamiliar, overwhelming and scary amount of complexity. But look at us now. We have mastered the complexity of driving.

It's increasingly the same in business. As managers, executives, and CEOs, of any kind of organisation, our responsibility is to be in the driving seat, individually and collectively. Any shortfalls are increasingly likely to become very evident, very quickly, very fully, and very finally, with few second chances. Just look at the carnage we have seen in business in recent years — banks, retailers, and automotive manufacturers among many others.

We need to learn to drive again, developing new advanced driving skills for the new normal of business. This requires thirteen disciplines:

01 **Bringing journey orientation into focus.** Agility requires a paradigm shift of focus, because change has changed, becoming much more like a dynamic journey on a shifting landscape. The longitudinal dimension of journey-orientation has emerged as a third and primary dimension around which we must reframe our focus and approach to translating agile strategy and agile execution into traction. If anything gets lost in translation, we experience wheel-spin, which can cost us a fortune in lost revenue growth, profitability and cash-flow.

02 **Reinforcing a mindset of operations management.** Paradoxically, agile strategy and execution depend first and foremost on high reliability operations management. In continuous process businesses, errors unfold rapidly and propagate quickly, creating chaos and crises management, which can become increasingly chronic, often with disastrous consequences. All businesses are continuous process businesses to some degree, and high reliability operations management prevents chaos and crises management.

03 **Enhancing strategic productivity.** We are used to thinking about productivity at an operational level but not so much at a strategic level. Our productivity at a strategic level depends upon using an integrated framework and set of tools, to avoid overwhelm and formulate a progressive strategy work product. The test of good strategic tools is how quickly we can pick up the conversation next time from where we left off last time. Our agility depends upon it.

04 **Accentuating short-range culture.** Accentuating means, to stress or emphasise; intensify; single out as important; mark with an accent. More than ever before, the culture of execution and agility which we need to cope with short-range pressures and performance expectations must be loud and clear to all, with leaders turning up the volume.

05 **Keeping our flight planning envelope expanded.** Agile executives spend the right time in the right place at the right time. Our flight envelope is prone to collapsing back to the short-range operational pressures, because of two conspiring forces: the tyranny of the urgent and our unconscious-resistance to the important but more ambiguous and abstract work of long range strategy. This leaves us flying blind; the kiss of death to agility.

06 **Tackling operational productivity.** Our productivity at an operational level is about handling day-to-day work-flow, among shifting priorities, problems and opportunities. It's about our time management, priority management, project management and many other related concepts, individually and collectively as a team, driving the fast-cycle communication, coordination and collaboration which are essential for agility.

07 **Holding a recurring, rigorous and rallying strategy process.** The essence of agile strategy is conversation; if you don't have much conversation, you probably don't have much strategy. Unless we hold ourselves fully accountable, a strategy process can easily become ill-disciplined, open ended and laborious.

08 **Re-engineering structures, processes and systems.** The efficacy (capability and capacity to produce a desired result) of our infrastructure of agile systems, processes and structures is a key, not just relating to our core business-processes, but also our infrastructure of other management-mechanisms, such as meetings. Meetings are a mess in many businesses, subtracting from our agility.

09 **Orchestrating a goal-setting cascade and review process.** Agile alignment throughout our business depends upon a well-orchestrated cascade and review process of goal-setting and performance-feedback, balancing the over-engineered rigidity of too much and the organic open-endedness of too little.

10 **Unlocking and challenging mental models.** The paradigms, mindsets, assumptions and beliefs held by you, your team and your organisation are the mental models through which you interpret the world. Old, used-up and out-of-date mental models imprison our thinking and ability to see new possibilities and pathways. That's cancerous to agility.

11 **Guiding leadership/communication skills and style.** Our style and skills of agile leadership and communication set the tone for our agile culture, creating resonance (or dissonance) with the team-work we desire. We are the role model that our team emulates, founded on our intellect, resilience, emotional intelligence and intuition.

12 **Handling accountability for long-range culture.** Our culture regarding the long-range thinking and commitment to advance strategic initiatives can often be very challenging and prone to excuses rather than results. Excuses are rife in many businesses, with everybody buying in at all levels, like a pyramid marketing Ponzi scheme. Dismantling this pyramid by how we handle excuses is crucial, to sustain the accountability we need for agility.

13 **Integrating enterprise execution capability and capacity.** The execution capability and capacity of our enterprise is more than the sum of the above parts — though often all of the parts are there but the whole hasn't emerged. Extraordinary integration is required, to combine the art and science of a unifying architecture of execution. This includes recognising and teaching execution as a system and a discipline, of accumulating knowledge, tools and techniques, broadly and deeply throughout the organisation. Our organisational agility depends upon it.

Achieving agility really is like learning to drive again. ◻

THE AUTHOR

MIKE RICHARDSON
MIKE@MYDRIVINGSEAT.COM

Richardson is a chair of peer groups with Vistage International (a worldwide CEO membership organisation), facilitator, speaker and author of *Wheel$pin: the Agile Executive's Manifesto — Accelerate Your Growth; Leverage Your Value; Beat Your Competition*, from which this article is adapted. He previously ran the Aerospace Division of Spirent and holds an MBA from London Business School.

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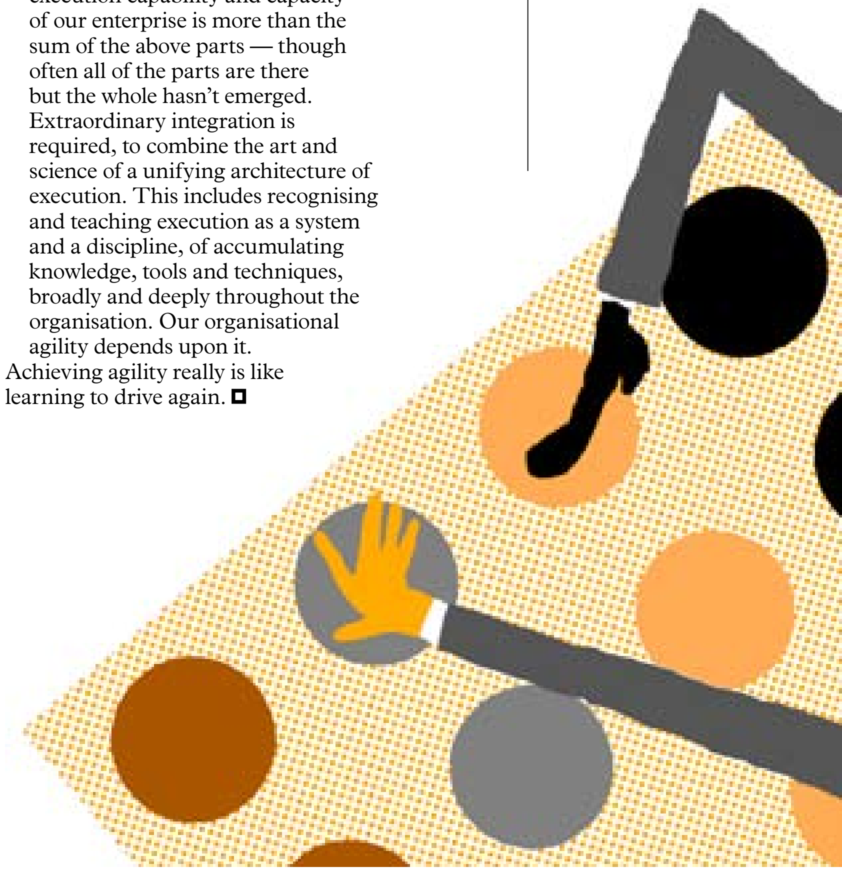


BEYOND
THE CRISIS

THE REAL PROBLEM WITH GREECE

What really lies behind the economic fall of Greece? ***Michael G Jacobides*** *provides administrative lessons from a fiscal tragedy.*

As the debt crisis in Europe unravels, we are starting to build a better understanding of what really caused the crisis and how it should be resolved. Only a short while ago, analysts were focusing on the similarities between Portugal, Ireland, Italy, Greece and Spain — lumped under the unflattering "PIIGS" acronym. Yet as events unfolded, it became clear that each country had a very different set of problems. Nowhere has this been more evident than Greece. As the crisis in Greece took a turn for the worse, European leaders of other struggling economies, as well as senior civil servants and Eurocrats took pains to explain how Greece was a "particular case".

Yet, while there is a growing consensus that the Greek problem may be idiosyncratic, it has, by and large, been treated as an "ordinary" case of macro-economic imbalance. Expenditures vastly exceeding fiscal receipts and an inefficient public administration are rightly seen as the kernel of the problem, and Greece has been pushed to restore fiscal balance.

But, there is much more to the Greek crisis than this. The true underlying issues are a crumbling public administration and a political system where a few beneficiaries distort economic flows in the country, stifling development and depleting state resources.

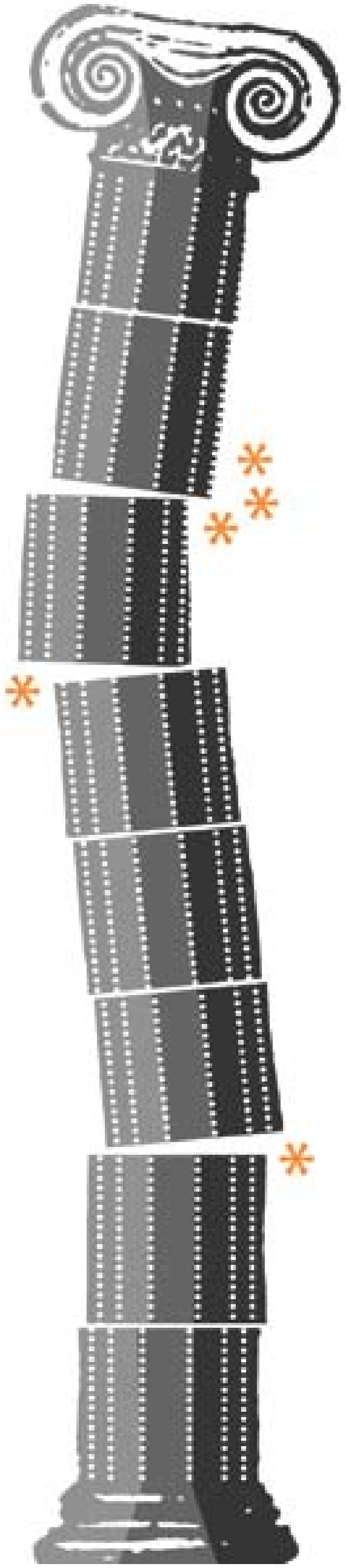
While such structural problems have been noted for a while, their magnitude seems to have been underestimated. The true Greek tragedy is that a country that could potentially be on a solid growth trajectory is instead facing chaos because of the way the public sector (and its associated political system) interferes with the use of public resources. The press has been part and parcel of this corrupt system, impeding the understanding that would help resolve the issue.

More consequentially, it has proved convenient for the stakeholders in the crisis — in particular the European Union — to avoid confronting the real nature of the problem. Doing so would require the sort of far-sighted action and pragmatic leadership that is — perhaps understandably — lacking from politicians concerned with re-election and administrative units vying for relative power.

As a result, kicking the can down the road has become the de facto solution, in the hope that things get better. The EU and the IMF have been treating a cancer with patches and aspirin. They have been busy addressing the symptoms of the sickness, without daring to address the underlying cause. But it's time we addressed the problem head-on, whatever we think about its appropriate resolution.

The state of the problem

The problem in Greece is three-fold. First, the public sector has proven to be a woeful manager of its own resources. The Greek public administration lacks accountability as well as a stable backbone of senior civil servants. It relies on formalistic rules to guide every step of the operation of public administration, as opposed to focusing on how it can substantively serve its purpose. These personnel issues, along with poor information and management systems (or data of any sort), mean that the public output related to expenditure is disappointing.



Serious problems exist at the top of the structure. The political system is highly influential and self-serving; its beneficiaries are able to carve out excessively compensated positions within the broad public sector, which means diverting funds from where the need exists. One such need, not surprisingly, is the growing number of Greeks living below the poverty line, as well as increasing criminality. Finally, an extremely important problem in Greece is tax avoidance — Greece has only 29 per cent of its GDP as tax receipts; the EU average is 37 per cent. The inability to tax fairly has hit not only public finances, but has also created a sense of unease and social discomfort with taxation, especially under conditions of duress.

Second, the interface between the private and the public sector has seriously skewed the productive tissue in Greece. The Greek state has been a purchaser of services for construction, armaments, technology, and more mundane goods and services. Side-payments are often inherent to such procurement. So, exposed to a corrupt system, many Greeks have shown initiative, adaptability and drive but, sadly, this has further increased the incidence of corruption. Entrepreneurial drive and corruption have created a vicious circle amplified by the political system, but one which is not desired by most Greeks.

Third, the state distorts the functioning of the private sector. "Closed" or regulated professions that have given birth to local monopolies; a loose competition policy that does not really promote competition; and most importantly, a bewildering set of regulations, all deter entrepreneurial activity and private investment. Capricious taxation and unpredictable authorities add to the problem of a malfunctioning justice system, with long delays and inefficient procedures. All of this means that reduced Greek labour costs have yet to translate into reduced prices and productive investment has all but stopped.

A Greek hangover

With these problems in the background, the genesis of the Greek debt crisis comes into sharper focus. After a period of fiscal and economic adjustment which led to Greece joining the euro, loosening happened from the beginning of the last decade. Ratings agencies were unsurprisingly short on due diligence and overly soft on Greece and thus Greece enjoyed a prolonged period of low interest rates. The availability of cheap credit in a time of plenty meant that the structural reforms that had helped Greece join the euro, politically difficult as they were, had no reason to continue. Political parties then focused their tactics on blaming their opponents, and damaging Greece along the way.

Of course, after every party, there's a hangover. Yet Greece's party was not one of a uniform wealth creation. It was a party of targeted, limited wealth creation and substantial redistribution, made alongside increased rigidities in the economy. Problematic structures became worse and the dependence on borrowing increased ever more. Then, in 2009, the party was over. Yet neither in Greece, nor in the EU, was the problem appropriately diagnosed. Greek officials initially ignored the problem, and then denied its magnitude. European officials wished it away. Decisions were taken with the horizon of a few months. Greece did have the option of facing the problems, addressing inefficiencies and restructuring its debt. Yet, weak leadership simply kicked the can down the road. Worse, rather than restructuring its debt, it substituted its private debt with official debt (coming from the EU and the IMF), tying its own hands in the medium term.

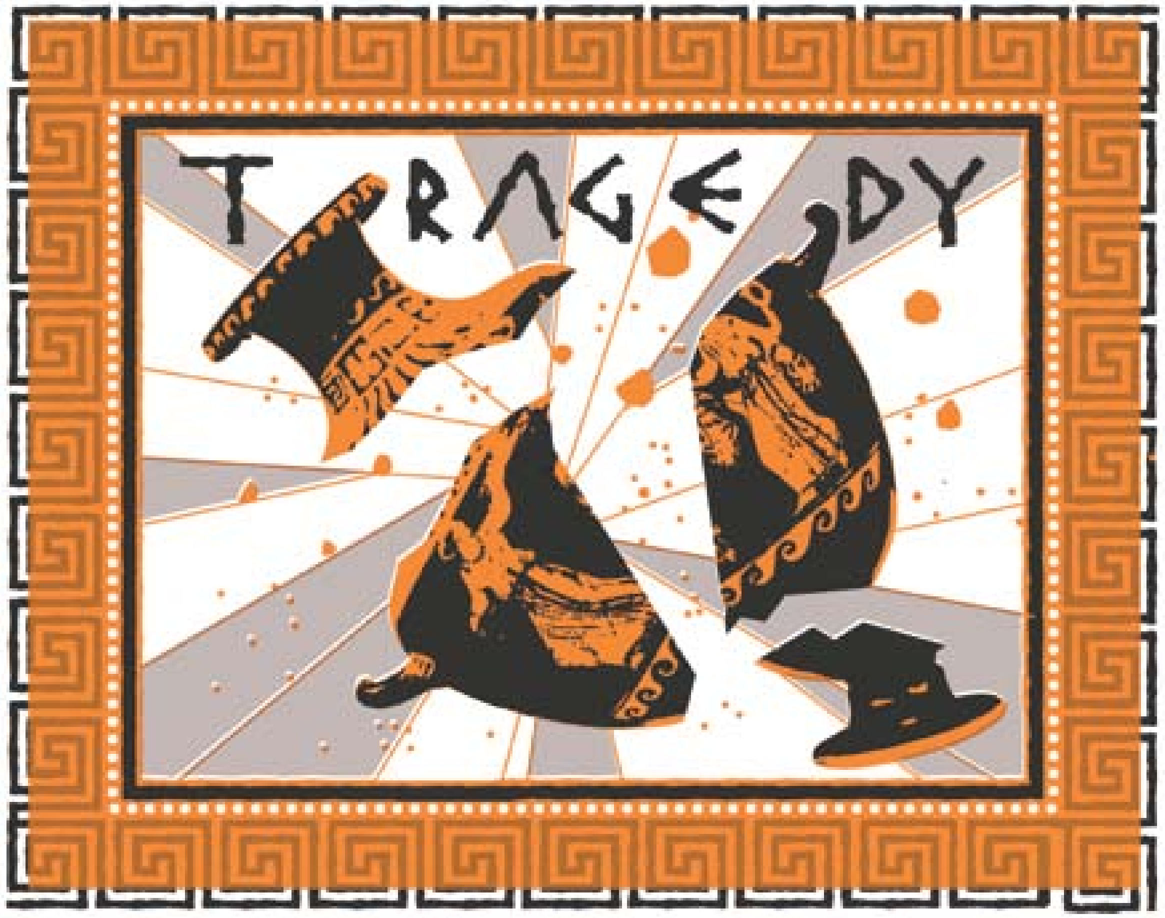
When in 2012 Greece eventually restructured its debt, its private debt was just over half of the total. So a 53.5 per cent haircut translated to a 30.5 per cent reduction of its total debt exposure, as the EU and IMF debt could not be restructured. In other words, Greece and the EU/IMF allowed the private creditors of Greece (primarily large French and German banks — as well as some Greek ones) to be fully paid at the expense of European and other

IN SEARCH OF CAUSES AND SOLUTIONS

In an effort to reform the Greek administration, in October 2011 London Business School's Richard Portes and Michael Jacobides, and Dimitris Vayanos of the London School of Economics convened a meeting in London where former Greek ministers, current MPs, senior bankers, industrialists, policy-makers, central bankers, academics and turnaround specialists from Greece and internationally, came together to discuss the way forward. The resulting White Paper proposed a transformation programme of the Greek public administration. This involves independent authorities with a clear responsibility and mandate, working toward focused key performance indicators — such as a Tax Assessment and Collection Authority, a Reforms Authority, a Healthcare Authority and a corruption initiative. The group considered how tax evasion should be tackled head on, and why the focus should be on the rationalisation of public authority design. It also considered why privatisation should be seen as a tool to improve resource allocation and management rather than a mere source of cash, and how debt financing could be combined with sales of assets and state-owned firms to help achieve the goal of restructuring Greece.

To tackle the Greek problem, the underlying causes, as opposed to the symptoms alone, need to be treated. And to do so, awareness and involvement is needed, in Greece and internationally. With this in mind, in January 2012, the Hellenic Alumni Club and the Hellenic Student Club of London Business School put together an invitation-only event on Greece: Options Ahead. This addressed the main aspects of the Greek crisis — the debt problem, the reform of public administration and the changes needed to support growth.

The website, www.redesigngreece.org aims to help not only educate, but also create a forum to help inform the debate and shape the change process in Greece.



taxpayers, while leaving the underlying causes of its malaise entirely intact.

More important, though, were the responses from Greece's creditors. Due to the fact the European Union, the IMF and the ECB were providing liquidity to Greece, the power has gradually shifted from Greece's decision makers and politicians to those controlling the purse. Creditors, of course, do understand that structural changes are needed. And they have promoted market-friendly changes, particularly the liberalisation of closed professions and the modernisation of the administration. Yet structural measures have not been their real focus. Worse still, many of the measures taken, and even more of the measures discussed, seem to be oblivious to these hard realities that cause the deficit.

Take, for instance, the behaviour of the EU and Greece's creditors to date. The focus has been on fiscal targets, with flexibility on "structural changes". Some of the most painful measures imposed by creditors, such as the lowering of the base-wage, have never featured high on the employers' agendas, while structural issues — such as cutting red tape or combating rampant corruption — have taken the back seat. And even where organisational structures were considered, little attention was paid to implementation. While there has been a decision to merge and cut the funding to many organisations in the broader public sector, little, if any, provision has been made on how these restructured problematic institutions will rationalise and restructure their operations. The basic administrative issue of the time, resources, skills and attention required when merging and redesigning organisations has not received any sustained attention.

Exit strategies

Alternatively, consider the ongoing debate on Greece's potential exit from the euro. Regardless of the ramifications this would have for Europe and the euro, such an exit would do nothing to address the underlying weaknesses. Sure enough, Greece would be able to devalue, and inflation would ensue. The root causes of the problem, however, would remain intact, if not worsen. Banks taken over by the state as a result of the exit from the euro, would likely cause the allocation of credit to suffer as politicians would use banks, and the allocation of credit, as their source of power and influence in a declining economy. Private firms with euro-denominated debt might need to be declared bankrupt. Given the structural inefficiencies, little could come in the way of new entrepreneurial entry that would help regenerate the economy. With the crisis introduced by a forced currency change, a solid public administration would be needed to helm Greece through the transition and, as previously detailed, there is hardly one functioning under current fairer weather conditions.

Structural issues are at the core of the problem and unless they are tackled, leaving the euro would be more of a hindrance than a solution.

Essentially, Greece's problem is administrative. It is a problem of the design of the government and its institutions, which prevents a highly skilled, well-trained, entrepreneurial workforce working more hours than the EU average (against the stereotypes enshrined in the press) from realising its potential. And the challenge is that even today, as Greece's creditors are starting to focus more on structural problems, (two years too late), the need is urgent and needs to be combined with a focus on implementation.

The up side

There is, of course, some good news. The EU has set up a taskforce to help Greece's transformation. Particular areas are being developed by national teams — for example, a French team is helping rethink the administration and a German team has come to improve taxation. Their value will lie not only in the transfer of knowledge, but more importantly in their independence and ability as separate bodies to consider existing and proposed changes. Announcements have been made that the reform process will be monitored, although the way this will be implemented remains unclear. Greece's challenge is an organisational one and this will determine its macro-economic survival. The magnitude of the task is great and public understanding — in Greece and abroad— is still limited. The proof will be in the reform pudding.

Rather than considering "how much" state is good, the real question is "how efficient" the state is. Rather than fretting about regulation, we need to consider the accountability and transparency of those who regulate instead. Rather than looking at macro-economic, aggregate indicators — which reflect real economic activity with a lag — we should consider progress on the treacherous path to structural and administrative reform. Rather than creating a EU Taskforce comprised of senior public servants from the EU, we urgently need experts in administrative reform and change management. Rather than focusing on austerity measures, we need to focus on restructuring the administration. Whatever happens with politics, elections, the EU, or adjustment of the current loan programme, the umbrella task should be a redesign effort, focused on solving the organisational and administrative problems. These are the root causes and these should — and must — be the focus of attention.

> Whatever happens with politics, elections, the EU, or adjustment of the current loan programme, the umbrella task should be a redesign effort, focused on solving the organisational and administrative problems.

Evidence through history shows that large-scale transformation is possible. Consider Denmark — often held as an exemplar of public administration and effective welfare state: Prior to the 1840s it was the paragon of corruption and state inefficiency, yet managed to change in little over a decade. Or consider all we know from organisational behaviour and change: changing the system, structures, and culture can transform organisations and institutions. From IBM to American Express to Saatchi & Saatchi, to the transformation of the former Soviet Bloc, there is evidence aplenty that changing structures, incentives, accountability and processes is what allows individuals to change their ways. Greece has a healthy private sector and a well-educated workforce, which is currently beholden to an inert and ineffective system. So the upside could be great, even though the threat of uncontrolled bankruptcy is ongoing.

While the road ahead for Greece may be uncertain, what is certain is that it can teach us the perils of confusing a symptom for a cause, of ignoring the administrative basis of macro-economic output. ◻

THE AUTHOR

MICHAEL G JACOBIDES
MJACOBIDES@LONDON.EDU
Jacobides holds the Sir Donald Gordon Chair of Entrepreneurship and Innovation at London Business School.

NEXT ISSUE

Uncommon sense from Julian Birkinshaw; Stefan Thau; David de Cremer; Freek Vermeulen; *thirty years on from In Search of Excellence.*