An Interview with Ram Charan by HBR's Melinda Merino

Points of Interest

- *The importance of perceptual acuity*
- *Getting the right input when faced with challenges of geography*
- *Separating the brilliant decision makers from the average ones*
- *Insight into real-world executive challenges*

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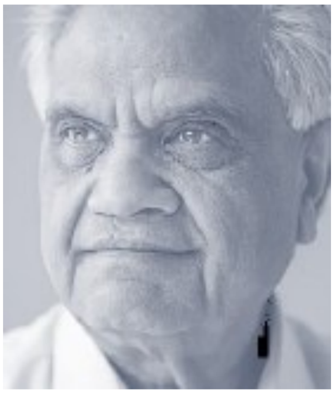
THE STORY BEHIND RAM CHARAN

As one of the world's preeminent advisers to CEOs and boards, Ram Charan has spent the past 35 years on the road, watching hundreds of executives deal with their toughest challenges. He regularly shares the in-sights from his experienc-es in speeches and the class-room and is the author of several best-selling books. (His latest books are Boards That Lead, which he cowrote with Dennis Carey and Michael Useem, and Global Tilt.) He has also published many popular articles, including the HBR classic "Conquering a Culture of Indecision" (April 2001), in which he addresses the problem of organizational paralysis. In this edited interview with HBR senior editor Melinda Merino, he re-turns to the topic of deci-sions and talks about what he's learned in three decades of helping execu-tives make them.



Ram Charan

WHAT HAS CHANGED THE MOST OVER THE YEARS ABOUT HOW EXECUTIVES MAKE DECISIONS?

Getting to the right an-swer is tougher these days. It's not just the greater number of varia-bles to consider; execu-tives also need to make subjective judgments about highly ambiguous factors that are moving targets. The usual com-petitive analysis doesn't work well when technolo-gy keeps erasing industry boundaries and the pace of change is so fast that you can't wait for things to stabilize.

So you're wrestling with more qualitative factors, with no conventional methodology, under the real threat that part of your business has peaked or could be-come irrele-vant. Meanwhile, enor-mous opportunities that require big bets arise and vanish quickly. And any decision you make will be judged in the court of pub-lic opinion. You have to take into ac-count poten-tial consequences for a range of constituencies who may have no direct long-term economic inter-est in the business—regulators, shareholder activists, societal watch-dogs, the media. These conditions were beginning to emerge 10 years ago, but now they're dominant.

> *"Any decision you make will be judged in the court of public opinion."*

HOW ARE CEOS ADAPTING?

The good ones know it takes more than analytics. They take in a lot of information from many sources and then crystallize a point of view. They sort and sift the information and select the handful of factors that matter most—usually no more than six—from the myriad possibilities. That's what they'll base their decision on. They cut through the complexity to get to the heart of the matter, without getting superficial. And they do it with-out losing sight of the customer.

In the boardroom of a company whose most profitable division was directly affected by Napster, the online music service, the CEO and directors debated for roughly an hour about how to kill Napster. After all the brouhaha, one quiet director made a simple but incisive comment: "No law is going to prevent social change." He recognized that the consumer was being liberated and the industry was about to go through a radical shift.

WHAT TO DO IF YOU'LL NEVER HAVE ALL THE RIGHT INFORMATION...

AND WHAT HAPPENS ONCE DECISION MAKERS NARROW DOWN THE CRITICAL FACTORS?

"Today most CEOs factor how investors will react into their decisions, especially in transformative moves"

The most successful CEOs actually develop and shape options in their minds. They re-frame the issue as part of a broader phenomenon, maybe looking at it from the outside in and with a longer time frame. Imagination and the ability to connect diverse insights come into play. They're also very good at making sure each option is specific and concrete, taking their thinking from an altitude of 50,000 feet down to 50 feet. With each option, they ask, "If we were to go this way, what would our success depend on?" Those are the assumptions their decisions hinge on—the things that will make the decision succeed or go bust. As their thinking gels, they pose incisive questions, ask for quantitative analyses, solicit more information from inside and outside the company, and bounce ideas off a small network of trusted people for a dose of reality. From that they draw inferences and thread ideas together to reach what they consider the right solution.

HOW DO YOU TEST A DECISION?

The most successful CEOs actually develop and shape options in their minds. They re-frame the issue as part of a broader phenomenon, maybe looking at it from the outside in and with a longer time frame. Imagination and the ability to connect diverse insights come into play. They're also very good at making sure each option is specific and concrete, taking their thinking from an altitude of 50,000 feet down to 50 feet. With each option, they ask, "If we were to go this way, what would our success depend on?" Those are the assumptions their decisions hinge on—the things that will make the decision succeed or go bust. As their thinking gels, they pose incisive questions, ask for quantitative analyses, solicit more information from inside and outside the company, and bounce ideas off a small network of trusted people for a dose of reality. From that they draw inferences and thread ideas together to reach what they consider the right solution.

HOW DO YOU TEST A DECISION CONT...

Good executives don't let concerns about the consequences make them indecisive, however. One midwestern CEO was outperforming by a mile in the late 1990s, when the top brass at Home Depot said they wanted his company to supply theirs. Volume would obviously go up, but selling to the retail power-house would have sever-al negative consequences for the brand in the long run. The CEO didn't think it was the right thing for his company and said so. He had to wrestle with how the board and in-vestors would see it if the story went public—which it did, with a negative spin—but that didn't stop him from turning Home Depot down. His com-pany did suffer for a while from lower growth and a stock price in the dol-drums, but the CEO won the board's support, and his strategy and long-term/short-term trade-off were eventually proved right.

But regardless of how much you test decisions, uncertainty is a fact of life. So in addition to having the courage to make a big decision, you need the fortitude to deal with un-pleasant surprises. In mid-2008, Dow Chemical CEO Andrew Liveris made an all-cash deal to acquire Rohm & Haas. He planned to fi-nance it with proceeds from a joint venture with Kuwait's state-run Petro-chemical Industries Compa-ny. No one was expecting the global financial crisis, and when it hit, the Kuwaitis wavered. In late Decem-ber—just two days be-fore the deal was to go through—they backed out, leaving Dow $6 billion short of the cash it needed for the Rohm & Haas transaction. The contract was ironclad, so Dow was painted into a corner. Liveris had the expe-rience and resilience to find other sources of funding and save the company.

SO YOU HAVE TO DEAL WITH THE UNEXPECTED. BUT DON'T YOU ALSO HAVE TO ANTICIPATE THE FUTURE?

Yes. You need what I call perceptual acuity—the ability to sense what is coming before the fog clears. Ted Turner saw the possibility of 24-hour news before anyone else did. All the ingredients were there, but no others had connected them until he created CNN. Like Turner, the best CEOs are compulsively attuned to the external environment and have a sixth sense that picks up anomalies and detects early warning signals and opportuni-ties. A great example of this is Ivan Seidenberg's investment in fiber op-tics as CEO of Verizon. It was a huge and unpopular move at the time, but it was in-formed by a deep under-standing of the external landscape and technology. Seidenberg had a realistic view of where the market and competitors were going and saw that Verizon could not put video on its net-work and run fast enough against the competition. So he made a big bet.

Perceptual acuity, by the way, is in short supply. I can think of five major companies that went under in the past five years because the CEO couldn't see how, or how fast, the game was changing.

"Regardless of how much you test decisions, un-certainty is a fact of life. So in addition to hav-ing the courage to make a big decision, you need the fortitude to deal with unpleasant surprises. "

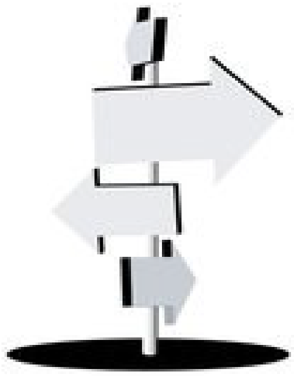
HOW CAN PERCEPTUAL ACUITY BE IMPROVED?

You can't do it by sitting in your office and meditating. Many complain that the top job is a lonely one, but good CEOs are always meeting with people, searching out information.

One CEO I know gets together with his critical people for half a day every eight weeks to discuss what's new and what's going on in the world. They don't look only through the lens of their industry. They look through a much wider lens, because some trends that affect one industry impact others later. The setting is informal, and outsiders often attend. It gives everyone a chance to talk about signs of change and decide which ones matter. Is our strategy adequate for what's coming? Is this going to be fantastic for us, or are we on the verge of becoming obsolete? The meeting doesn't involve 200 PowerPoint slides or quantitative analysis. It's about big ideas.

Another CEO meets four times a year with about four other CEOs of large but noncompeting diverse global companies. They examine the world from multiple angles, looking for unstoppable trends, and share their best thinking about how each could play out. Then this CEO goes back to his own weekly management meetings and throws out a bunch of hand grenades to shake up people's thinking.

Two companies I know of ask outsiders to critique strategy in their boards' strategy sessions. These are spirited discussions that shed more light on the hinge assumptions and the options being considered. In one session the focus was on pinpointing the risk in a certain strategy, but it came out that the company was missing an important opportunity. CEOs can lose credibility if risks come to haunt them, but few get penalized for missing an important opportunity.



HOW CAN PERCEPTUAL ACUITY BE IMPROVED?

Yes, that's why you have to find people early in their careers—as young as their late twenties and early thirties—who look for contra-dictions, oddities, coincidences, and bends in the road. You want people who can both think qualitatively and shape ideas based on conflicting and limited Information. You can help executives develop those skills by sending them to China, India, or somewhere else where they have to learn how to deal with foreign governments. Deb Henretta had spent her career at P&G's Cincinnati headquarters when A.G. Lafley sent her to Singapore for two years, and she ended up staying for eight. Over those years she developed the mental capacity to deal with 18 countries, to make decisions based on unreliable and incomplete information, and to sift out the sources and variables that mattered. Ultimately, she was asked to sit on a committee to develop Singapore's 10-year plan. She now reports directly to Lafley.

"It is about big ideas…"

HOW DO YOU KNOW YOU'RE GETTING THE RIGHT INPUT, ESPECIALLY WHEN YOU'RE FAR REMOVED FROM THE SOURCES BECAUSE OF ORGANIZATIONAL LAYERS OR GEOGRAPHY?

You have to develop a nose for finding the right sources and detecting distortion. You might know, for example, that one of your direct reports is always pessimistic, so you adjust for that. And you cross-check information by consulting multiple sources and people who are inclined to take different viewpoints.

Many CEOs do not hesitate to go directly to sources at the scene of the action or to tap informal social networks. In India the government has been loosening its hand on the economy over the past 18 years, but it's still pretty heavy and, in some cases, very unpredictable. Decisions can be delayed for years or even reversed. Executives in India do a lot of sensing at casual week-end get-togethers. They invest a significant amount of energy in being in the bridge of information.

WHAT ABOUT MAKING DECISIONS WITH YOUR TEAM?

If you're wise and not a know-it-all, you have a spirited, candid dialogue with your team, and you listen. Listening isn't just hearing; it requires the willingness to entertain other viewpoints— especially opposing ones. You extract the inner feelings of your people, get them to explore the depth and breadth of their thinking. But it's not a democracy. I've seen some executives become prisoners of their direct reports. They succumb to endless debate, or they may just want to be liked. They lose time and respect. If you're the CEO, you decide.

"Listening isn't just hearing; it requires the willingness to entertain other viewpoints"

WHY CEOS NEED COURAGE...

WILL PEOPLE ACCEPT A DECISION THEY DISAGREE WITH?

Of course you need to bring people along with you to carry out the decision. You can begin by explaining your reasoning. Strong leaders ask people to get on board or depart honorably. The other side of the equation is where the CEO makes little effort to socialize the decision and loses the support of his or her direct reports. I know three high-profile CEOs who were asked to leave after the board was approached by their subordinates.

Many CEOs talk with people informally one-on - one to get their buy-in. With the board, they explain what they see coming down the road and what actions they might take six to 12 months ahead—for ex-ample, the areas where they might be looking at acquisitions and the potential targets they're tracking.

WHAT ELSE SEPARATES BRILLIANT DECISION MAKERS FROM

CEOs face countless decisions. The best executives understand which ones they need to focus on and which ones they can delegate. They also know when to make a decision. And they've debated the risk of not doing it. Any change in the landscape creates opportunities for somebody. The decision to grab a big opportunity can be destiny-changing. If you don't do it, some-one else will. Look at how Amazon, Apple, and Google move ahead of everyone else.

EMC's CEO, Joe Tucci, grasped the opportunity in virtualization when he visited a global customer. The customer had asked EMC to support a new type of software it planned to use: virtualization software, which was made by a West Coast start-up named VMware. On returning from his visit, Tucci walked into EMC's engineering labs to chat with his team, and to his surprise they too were using VMware's virtualization software, fairly pervasively, and they loved it. Without missing a beat, he called VMware's CEO and a couple of its board members, then quickly dispatched a team to California, saying, "Don't come back until you seal the deal." A few big players were already wooing this company, but EMC jumped on the deal, snatching VMware, an industry disrupter, out from under them. Surprisingly, many of the biggest technology companies had completely missed it.

WHAT ARE THE CAREER-MAKING DECISIONS THAT CEOS NEED TO GET RIGHT?

"When resources are allocated from the bottom up instead of from the top down, they get out of sync with what the senior team is trying to accomplish."

The obvious one involves strategy and competitive advantage, and keeping them relevant when their shelf life can be very short. Annual strategic planning is an antiquated idea. You can't wait for your normal planning cycle to change your strategy. Shifts in the global financial system, marketplace, and geopolitical and digital arenas don't wait. When an early warning signal appears, get your team on it right away. And you have to seize opportunities as soon as they emerge, as Tucci did.

WHAT OTHER DECISIONS DOES THE CEO NEED TO OWN?

Decisions about the mix of goals, resource allocation, and people and the organi-zation. As a rule CEOs don't give enough attention to setting goals. The greatest mistake they make is to look in the rearview mirror at what they did last year or at what their competition did. The brilliant decision makers look at the runway

AND WHAT ABOUT RESOURCE ALLOCATION?

These decisions are big because some competitive moves need disproportion-ate resources. When resources are allocated from the bottom up instead of from the top down, they get out of sync with what the senior team is trying to accomplish. At many companies the total cash in-vestment in acquisitions, R&D, and fixed assets has not earned back its cost of capital after adjusting for the time lag in realizing incremental benefits. That outcome reflects the wrong allocation and/or ineffective execution. Some activist shareholders are finding gaps in CEO performance by doing this calculation.

WHY ARE PEOPLE DECISIONS SO HARD TO GET RIGHT?

"The most common reason for failure was putting the wrong person in a job and then not dealing with the mismatch."

When I studied 82 CEOs who failed, I saw that the most common reason for failure was putting the wrong person in a job and then not dealing with the mismatch. I've seen CEOs take staff people who are in the succession pool because of their brilliance, energy, and business acumen, and give them big line jobs to test them. Then the CEOs get busy and lose sight that these in-experienced people are killing the company. In one situation the person put in charge of the largest division took the company into a negative position in less than two years.

It's usually obvious who needs to go, and most of the time CEOs know it in their gut but don't do anything. It's hard to admit the error, or they have a psychological bond with the person or think they can coach him or her. Sometimes it's a matter of misjudging performance, because they don't dig into the causes. Today most if not all industries are impacted by digitization—mobile technology, big data, and the like. It has a tremendous effect on which people are more critical than others. One CEO of a large Indian company has been bringing a lot of younger people into senior jobs because of their digital experience. It's been hard for him to bypass some long-serving executives, but he had the spine to make those decisions.

WHAT'S THE CHALLENGE WHEN IT COMES TO DECISIONS ABOUT THE ORGANIZATION?

In late 2010, GE CEO Jeff Immelt decided to give country managers P&L responsibility for all of GE in their countries and have them report to vice chairman John Rice, who would be stationed in Hong Kong. It was the first time a vice chair would be based in an emerging market. It reflected the reality that a lot of GE's growth will be coming from the developing world, and the leaders have to be there. As Keith Sherin, then GE's CFO, put it, "This is where the growth is. We are shifting our center of gravity." Such decisions might be unpopular and break a lot of traditions, yet they set the future course of the company.

WHAT IS THE BIGGEST MISPERCEPTION CEOS HAVE ABOUT EXECUTIVE DECISION MAKING?

One is that they know it all. That they can figure it out on their own.

A second is that if your decision doesn't work out, your career is done. That's not true if you have established credibility. Credibility of the CEO is the number one thing. If you lose it—with your direct reports, the board, key investors, the rest of the company—then you are done.

THE IMPORTANCE OF BEING CREDIBLE WITH YOUR BOARD AND INVESTORS

SO YOU CAN'T BE A GREAT DECISION MAKER WITHOUT CREDIBILITY?

None of your decisions will be executed. Credibility also helps you gain access to the right people, the right information, investments, and support. In some cases, it's what allows you to make the right decision in the first place.

Verizon's directors concurred with Ivan Seidenberg's decision to invest $23 billion over 10 years in fiber optic cable because he had built credibility with the board over many years. It was a highly controversial in-vestment at the time, and some investors were skeptical. The media and competitors were especially harsh. But the senior team had developed a deep understanding of what was required and, led by Seidenberg, se-cured board sup-port.

Later, Seidenberg created a new entity combining Verizon with Vodafone's U.S. wireless as-sets. Verizon's 55% stake gave it man-agerial and financial control. Again, many people thought the joint venture wouldn't work, especially when the dividend was sus-pended and the cash re-invested in the business, but these decisions turned out to be brilliant. Verizon has been able to expand its national foot-print and outperform against some very tough competitors. Seidenberg's decisions built a strong foundation that allowed the company to achieve full own-ership of the U.S. wireless ven-ture in September, giving Verizon great strategic flexibility in the fast-moving global game.

WHY DID THE BOARD BACK THOSE RISKY DECISIONS?

"You need the courage to go on the offensive based on your subjective judg-ments"

Seidenberg had a very good record of delivering the numbers and building the organizational muscle for the new game. He developed a broad and strong management team. But he also had demon-strated that his ego was subordinated to his ambi-tions for the company. The first time was when Verizon merged with Bell Atlantic, and he proposed that he take the number two position and that Bell Atlantic CEO Ray Smith be named number one. When Smith retired, Sei-denberg became CEO, but he gave up control again to Chuck Lee in the subse-quent merger with GTE. Neither of those mergers was likely to get consum-mated without such ar-rangements. He had in-tegrity—and a great habit of educating the board about the external envi-ronment at every meeting. The board al-ways knew where he was going and that he had an out-standing senior management team to deliver on the plan.

WHAT CAN'T BE TAUGHT?

You need the mental capa-bility and tenacity to knit your inferences into some-thing meaningful, and the imagination to think of new options. And you need the courage to go on the offensive based on your subjective judg-ments. You can't be a wimp—make the tough calls

MLX ADVANCE: SUMMARY AND REFLECTION

MAIN POINTS OF CONSIDERATION

- The right answer or solution is not so easy to come by
- Executives are increasing-ly having to rely on intuition and their own judgment as objective data is not always available
- There really is nowhere to hide when it comes to making decisions, be they the right course of action or not, everything is open to public opinion eventually
- The best CEO's are able to take in information from multiple sources and consider diverse factors in making their decisions, whilst maintaining an unwavering focus on their customers. They maintain a systemic approach towards the challenge at hand
- As a top executive you need to use your imagination yet focus on the specifics and making things concrete and practical. Real forward thinking and anticipation of the future is hard to come by and is an absolute criticality for remaining competitive, seizing opportunities and keeping up with and ahead of the change curve
- Knowing when to delegate is another hallmark of good decision makers and executives
- Never assume that you know it all

QUESTIONS FOR PERSONAL REFLECTION

- How do you take in and consider information when making your decisions?
- What type of questions do you ask when you go about gathering information?
- How resilient would you say you were when faced with uncertainty or when things do not go according to plan?
- How forward thinking are you?
- When faced with a decision that you have an intuitive sense about, how do you access that intuition of "6th sense"? And what do you do with this less tangible information or gut instinct?
- Do you have the opportunity to engage your intuition with credibility? What could you do differently?
- What do you do to remain up to date with what is happening in the world? Do you focus on just your industry or look at broader issues and trends?
- How do you engage with your team in the decision making process?
- How do you approach a situation where people do not agree with your decision?
- Are you able to delegate decision making? What is the process you go through?
- What TYPE of decisions are you making ?

Spend some time reflecting on this articles relevance and application in your career, explore the implications with your coach

ACTIONS GOING FORWARD

What would you like to do differently based on the insights gained in this article...

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