

Anchors Weigh Down Competitive Thinking

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Try this exercise. (For it to be effective, please do not read ahead until you have completed each step.)

- Pick a number, any number, between 1 and 99. Write it down.
- Next, answer this question: Is the percentage of African countries in the United Nations higher or lower than the number you wrote down?
- Finally, answer this question (without looking it up): What is the exact percentage of African countries in the United Nations?

What number between 1 and 99 did you pick, and what exact percentage did you write down? Believe it or not — and you should believe it since it's been proven in experiments — the higher the number you picked, the more likely it is that you chose a high percentage. The number you picked morphed silently from a random number of no particular significance, to an unconscious influence on a decision you made. It became what psychologists call an anchor. (This exercise was adapted from *The Psychology of Judgment and Decision Making*, Scott Plous (Wesleyan University), McGraw-Hill, 1993.)

EXALTED NUMBERS

In business, some numbers take on a special status: the cost of capital, the rate of inflation, the market average, last year's results, the industry benchmark, six sigma. These and other numbers are so exalted, we rarely notice, let alone question, their unintended consequences as anchors.

One set of numbers stands out even in this exalted company. We fear and venerate it. It is first fluid and then

becomes stone. It defines the limits of what is possible. This set of numbers is, of course, the budget.

Advanced Competitive Strategies (ACS) conducted a business war game for a major company. We divided the company's managers into teams to role-play their own business and their competitors. We told them to allocate their marketing budget among several messages that they could deliver through various media. Their market share and gross margin numbers would be based on how much they spent and how well they spent it, compared with their competitors.

We gave each team a budget, and we told them that they were free to spend more or less than those budgets. We told them there were no limits to how far their spending could diverge from their budgets. Every team, in every year of the business war game, spent within a few percentage points of their budgets.

In most companies, the budget is rather like Goldilocks' porridge. Spend less than your budget, and your bowl shrinks next year. Spend more than your budget, and you get burned. Spend very close to your budget, and you are just right.

CONSTRAINED OPTIONS TO COMPETITIVE CHALLENGES

Unfortunately, the meet-your-budget imperative collides with the competitive challenge. If you are (in reality or due to anchors) constrained by your budget when an unexpected threat or opportunity pops up, then you are constrained in your options to respond to the threat or exploit the opportunity. If your competitors work the same way (and they probably

do), you might not suffer too much. However, when new competitors (or newly aggressive existing competitors) charge in, your (real or unconscious) constraints can produce a debilitating competitive disadvantage.

The competitive disadvantage can trigger a downward spiral that's hard to wrest from a heavy budget anchor:

- A competitor takes a share, so sales go down.
- As sales go down, budgets go down.
- As budgets go down, the ability to respond to the competitor goes down.
- As responses weaken, the competitor takes more market share, and so on.

A strategist in a large company described this conundrum: We have enough money to buy bullets, but not enough to buy a scope for the rifle that will let us aim accurately.

Why do upstarts beat incumbents? Upstarts supposedly think outside the box or break the rules that constrain the incumbents. The budget anchor is one such constraint. An upstart thinks of investment, while an incumbent thinks of budgets.

WHAT TO DO

Watch the thinking that goes on in your company's strategy sessions. Are there unstated assumptions about the inviolability of the budget? Is there an important opportunity or threat that people are trying to fit inside the budget, rather than thinking about spending what's necessary to deal with the challenge?

Of course a budget isn't only an unconscious anchor. It's also a corporate

reality, and failing to adhere to the budget can affect careers. Just be sure that adherence to the budget is a clear, conscious, intentional decision rather than a reaction to invisible anchors, especially if those controlling the budget don't recognize that they are dragging budget anchors.

What can you do if you believe that the budget does not accurately reflect the need to exploit an opportunity or react to a threat? It is important to show how a different level of spending would be of benefit. At ACS, we've used business war games to convincingly demonstrate the severity of a competitive threat, leading top management to resolve disagreements on spending and performance goals. We've also used strategy-simulation models to let strategists know how much they'd have to spend to achieve a performance goal.

Finally, note that budgets themselves are partly influenced by anchors and other assumptions — we should spend X percent of sales; this year's budget is last year's plus an adjustment of Y percent; we've got to keep spending to Z to boost the stock price. Other strategy-related issues have anchors of their own: for example, a new-product launch costs \$A, it takes B years to become profitable, the pricing sweet spot is \$C.

Remember, a ship moves only after it raises its anchor.

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