THE LAW OF UNINTENDED CONSEQUENCES AND STRATEGY:
(Be Careful About What You Wish For—You Just Might Get It)

AN ILLUSTRATION OF THE LAW OF UNINTENDED CONSEQUENCES

According to an article in ***Insight on the News***, a 48-year old Englishman, Mike Madden, developed a bird-feeding hat designed to hold nuts, suet and seeds that were pleasing to the palates of his fine-feathered friends. On his first "test walk" with the hat, unfortunately, a large gray squirrel spied the offerings from his perch in a tree. The squirrel immediately jumped down for the smorgasbord and hit Mr. Madden with enough force to knock him down. Reflecting on the event while he was recovering from whiplash, on pain-killing medication and wearing a neck brace, the erstwhile inventor allowed as to how the squirrel "attack" was an unintended consequence. (He also indicated that the project has been dropped from further developmental efforts.)

History is full of examples of "The Law of Unintended Consequences." During the Middle Ages, it was determined that the plague was related to fleas. Everyone knew that dogs carried fleas, so they began killing the dogs. Unfortunately, the fleas that carried the plague were living on rats, not dogs. In fact, until their elimination, the dogs had been doing their part to keep the rat population in check. Unintended consequence: more rats, with more fleas, and more plague. On a more positive note, the victims of the plague left closets full of garments that were able to be recycled into paper. This ultimately allowed the new technology of that time, the Gutenberg printing press, to take hold in a really big way.

BUSINESS STRATEGY AND UNINTENDED CONSEQUENCES

So what do an aggressive squirrel, fleas and the first printing press have to do with strategy? Plenty. Any time management sets a course for a new direction, on the way to a new vision, unintended consequences can result. Some will have a positive impact, and some will have a negative impact. The challenge for senior management is not always easy. Managers should try to determine potential consequences of new strategies in advance and develop plans robust enough to avoid unintended negative consequences, yet flexible enough to leverage unintended positive consequences.

> *Example: Recent financial reporting scandals show some ugly unintended consequences of executive compensation plans under which senior managers received stock options based on short-term financial performance of their companies. The idea behind the options-as-rewards pay schemes, at first blush, seemed reasonable: reward key executives for making the sound business decisions that drive corporate value up. The unintended consequences came in the form of the "cooking the books" with a major loss of confidence in their companies and in the markets in general.*

How could the stock option strategy be improved to avoid these unintended consequences? Several steps are being taken to avoid these problems in the future:

- *Booking options as current period expenses eliminates the "funny money" aspect of the bonuses;*
- *Having more, independent, outside directors on the boards should help keep pay practices in check;*
- *Tying executive compensation to stock growth, profitability* ***and*** *cash flow could help avoid the problem; and*
- *Allowing others in the company (besides just the top people) to participate in the programs could help as well.*

UNINTENDED CONSEQUENCES AND STRATEGIC PLANNING

The previous example discusses problems with public company strategy and unintended consequences. Similar problems face managers of closely-held companies and of nonprofits. The key is to think through the possible outcomes in advance, and be ready to adapt in order to achieve the organization's goals.

General Considerations: Planning to Plan

Effective planning should not occur in a vacuum. It requires rigorous fact finding to allow the managers to make good decisions. The more advance research that goes into a company's strategic planning, the less likely it is that surprises, or unintended consequences, will occur. Managers preparing for strategic planning should:

- Obtain broad input from the members of their organization;
- Obtain feedback from trusted outside partners, vendors, and customers;
- Identify key external trends within their markets and among competitors; and
- Determine existing, leverageable strengths and competencies, as well as areas that require more attention to remain competitive.

In any event, this front-end data gathering is the foundation for good planning. To borrow an analogy from the construction industry, the superstructure is only as good as the foundation under it.

Decision-Making Processes

Of course, once management has gathered the background information for planning, decisions have to be made. Decision-making processes include those processes and procedures used to review and share information, as well as the processes used to actually make decisions about the future of the organization based on the information. Managers responsible for group planning sessions should consider the following factors to make sure that the decisions they develop are reasonable and prudent:

- Establish ground rules for individual conduct at the meetings and enforce them;

- Avoid a "rush to judgment—allow adequate discussion for issues of key importance to the organization.
- Determine which issues need consensus (every one ***buys in*** and will support it, whether or not the ultimate answer is one they would "vote" for) and which can be accomplished through a majority vote;
- Identify objective criteria to measure critical choices against and weight the criteria as to importance;
- Establish a common "scale of satisfaction" to measure the performance of each choice against each criterion (what exactly does a score of "1" mean, and what would justify a score of "10" on a ten-point scale?);
- Discuss rationally (check the egos at the door) the pros and cons of each choice; and
- Prioritize the issues that the organization will pursue (there are still only 24 hours in a day, and everyone has "real work" to do once they leave the session.)

Rolling Out Decisions and Strategies for Maximum Impact

When it comes to strategizing with minimal unintended consequences, one of the most important considerations is communication. Management cannot over-communicate the firm's strategic intent. It is imperative to continually reiterate the key messages from the strategy sessions in order to help get traction.

Just as important is the need to get successive layers of personnel involved. This is done partly by communication, but also by engaging them in implementation planning. The rubber meets the road at the front line employees. Unless management has involved them adequately throughout the process, unintended consequences will appear and potentially derail any change initiatives. In fact, anticipating key constituents' reactions to new initiatives is imperative to avoid unintended consequences.

> *Example: A national professional association is developing new guidelines for its members to follow in carrying out their day-to-day work with their clients. The committee working on this initiative has identified how various segments of the membership might react to the change, (which may be seen as controversial by some of them.) The committee will conduct some research through opinion surveys of the segments to verify their initial take on the project. It will then follow up with a targeted, two-way communication plan, which will be started while the guidelines are under development. The association is stacking the odds in favor of a successful project, and working to avoid unintended consequences.*

EXAMPLES OF UNINTENDED CONSEQUENCES TIED TO STRATEGY

The following examples will illustrate unintended consequences arising from strategies that seemed to make sense when they were chosen and implemented.

Operations Strategy
A paving contractor without a hot plant had to pay uncompetitive prices for its asphalt. Through quantitative analysis, the contractor was able to demonstrate how the purchase of its own plant would pay for itself over the life of the loan needed to finance it. The analysis was based on current market pricing of paving and on current and projected costs of materials, before and after the plant acquisition. The unintended consequence: competitors who had been selling material to the contractor dropped their prices on subsequent bids, cutting the margin on projects the contractor was bidding for. The good news is that the hot plant is still paying for itself, if not as quickly as originally hoped for.

Go-To-Market Strategy
A construction management firm looked at ways to diversify outside of the industries in which it had built its business. Its existing work was comprised of a great deal of negotiated projects, resulting from strong relationships with key people at the customers' organizations. The contractor acquired a couple of firms in a different geographic area that specialize in other markets. The success has been limited because the two types of work require different delivery systems, the subcontractors and suppliers are different, and the construction manager does not have the relationship with them that it does with its supplier and subs in its primary market. The unintended consequence: an unforeseen need to devote more of its management and financial resources to the new market than originally anticipated, in order to make it work.

Compensation Strategy-I
A wholesale distributor developed a pay scheme for its outside sales persons. The pay plan called for commissions to be paid on gross sales as collected, with higher percentages payable over a range of increased sales. Unintended consequence: the sales people built sales up all right, but gross margin starting sliding backward. Now the distributor pays on gross margin on collected sales.

Compensation Strategy-II
A specialty contractor developed a multi-factor formula for compensating project managers and superintendents based on project profitability and overall company profitability. The formula had various, measurable factors that were considered for year-end bonus allocations. Unintended consequences: at the end of the year, when the auditors were looking at the expected profit in uncompleted jobs, the information they received led to interim margins on many jobs that were higher than the final gross margins calculated in subsequent years upon job completion. Additionally, implementing other organizational changes was difficult because the behaviors required for the changes were not included in the compensation model.

Growth Strategy
A contractor was operating comfortably within an existing range of annual contracting volume. He was able to operate within this range very profitably, beating the industry averages year after year. Then, he decided to grow the business, adding more project managers and superintendents. Unintended consequence: over a period of two years, he actually lost money. Before expanding, he was able to keep up with the jobs by staying personally involved in all of the details. When he grew to the next step, however, he could not be everywhere at once and lost touch with the details. His old accounting and management information systems were not up to the task, and did not provide him with the information he needed to manage the jobs from a distance.

AVOIDING THE TRAP OF UNINTENDED CONSEQUENCES

Looking at the previous examples, it would be easy to take an "arm-chair-quarterback" approach and ask how these things could happen. The fact of the matter is that they did happen. These are all strategies implemented by successful organizations that know what they are doing and know how to make a profit. It could happen to anyone. Managers can avoid having these or similar unintended consequences in their businesses by:

- Getting the facts before making critical decisions (enough to have a reasonable understanding of the situation);
- Taking time to work through what the facts mean;
- Getting broad participation, both internally, and from external advisors;
- Removing the egos—staying rational; and
- Discussing implications of strategic choices before implementing them.

"The Law of Unintended Consequences" is not a government-imposed statute. Savvy managers can work around it.

Dom Cingoranelli, CPA, CMC assists organizations and managers with group processes, problem solving, and business growth, strategy and performance issues.