You Should Be So Lucky

Think good skills determine corporate performance?

BY MICHAEL E. RAYNOR

I've been thinking about Thanksgiving for a while now. In Canada, where I live, the celebration is in early October. (Much of my professional life is connected to the United States, so really, my entire fourth quarter is just an increasing tempo of holidays from Canadian Thanksgiving to U.S. Thanksgiving to Christmas to . . . .) But no matter which side of the forty-ninth parallel you're on, Thanksgiving is an important celebration because it reminds us to be humble. In giving thanks for the beneficence that surrounds us, we have an opportunity to acknowledge explicitly that we really can't take all (most? much? any?) of the credit for what we have or have accomplished.

The historical connection of Thanksgiving celebrations with the harvest is especially salient, for farmers understand as few city slickers could that you can do everything right, but if forces beyond your control (and often your understanding) don't cooperate, all is for naught. Circumstance matters—a lot. After all, as the saying goes, "I'd rather be lucky than good."

In fact, the nature of life on Earth is, in no small part, a function of luck. The late Stephen J. Gould in his book *Wonderful Life* argues that even the flora and fauna that populate the planet to this day owe their existence to fortuitous happenstance. Examinations of the Burgess Shale in the interior of British Columbia reveal a diversity of basic body plans during the Cambrian explosion of life 520 million years ago that is difficult to comprehend. A weeding-out process took place that was doubtless due to natural selection, but Gould argues compellingly for the role of chance: when there were few breeding exemplars of new approaches to multicellular life, an inopportune mudslide here, an unfortunate run-in with a predator there, and wham-o—no more *Hallucegenia*.

It's unfortunate that the salutary lessons of Thanksgiving and Professor Gould don't permeate the analysis of business performance. Take, for instance, "success studies." You're familiar with them, I'm sure. They're among the best-selling business books in the canon: *In Search of Excellence*, *Good to Great*, *The Breakthrough Company* . . . they just keep on coming. (I'm working on my own version of such a study, so I hope there's room out there for at least one more.) But there is an unspoken assumption underneath all such studies that Thanksgiving reminds us to question: Is remarkable performance always caused by remarkable behavior? Or does luck, fortune, chance—pick your poison—play a significant role in determining outcomes?

Some folks have made a stab at addressing this question, and their results are sobering. In a 2002 *Strategic Management Journal* paper, Robert Wiggins and Timothy Ruefli looked at a sample of more than six thousand companies and found only thirty-two that achieved what they called "sustained superior performance" over a twenty-year period—that is, a level of performance that was significantly above average over that time.

My own work in this area, in collaboration with Andrew Henderson at the University of Texas at Austin, has led to similar conclusions. We looked at a dataset of more than twenty thousand companies over forty years and found fewer than four hundred with performance profiles distinguishable from the rough and tumble of randomness. In our work, a particularly compelling fact emerged: The level of variation in the underlying system is high enough that it takes a long period of especially strong

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performance—often ten to fifteen years of results in the top 10 percent of the population—for a company to rise above the noise and distinguish itself.

Most case studies of successful companies don't even ask whether they are studying luck or skill, never mind hazarding an answer. In addition, many such studies look at ten years or less of data, which means the odds of picking a "better than lucky" company by luck alone (a notion that turns research design into an Escher drawing) is close to zero. Finally, with so few companies statistically delivering better-than-lucky performance, the most charitable implication I can draw is that most success studies usually are not studying firms with demonstrably exceptional performance.

The ramifications of this go beyond the rarified air of best-selling business books. If most companies aren't delivering demonstrably exceptional performance, what is the justification for granting demonstrably exceptional compensation to senior executives? Rare indeed is the pay-for-performance contract that seeks to pay only for performance by separating out the effects of luck from the contributions of the skill and effort of the executive. Compensation experts such as Graef Crystal have been arguing for such devices as market-indexed options for almost two decades, but this appears to remain a fringe practice.

Although few have been totally blind to the role of luck in affecting and even determining outcomes, what I've concluded is that it's not skill that determines the broad contours of who wins or loses, with a good or bad bounce breaking the ties, but lucky breaks that shape our world, with, at most, some better positioned to exploit those breaks than others.

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What is it that makes luck so dominant in the determination of outcomes? Almost every system of even moderate complexity is subject to random variation. Because of this, in any system with a large number of players engaged in repeated attempts to win, some will pile up seemingly remarkable streaks simply as a consequence of that randomness. And the greater the randomness, the longer and hence more seemingly astonishing a given player's winning streak might seem. MIT's Rebecca Henderson illustrates this point as follows: "I begin my course in strategic management by asking all the students in the room to stand up. I then ask each of them to toss a small coin. If the toss comes up tails, they are to sit down, but if it comes up heads, they are to remain standing. Since there are around seventy students in the class, after six or seven rounds there is only one student left standing. With the appropriate theatrics, I approach the student and say, '*How did you do that? Seven heads in a row!* Can I interview you in *Fortune*? Is it the T-shirt? Is it the flick of the wrist? Can I write a case study about you?'"

She's actually killing two birds with one coin. First, this shows how poorly human intuition copes with randomness: We see remarkableness in what is actually entirely mundane and predictable. Second, she skewers our collective penchant for explaining what warrants no explanation. Human beings need stories to make sense of the world, and we concoct whatever we must to feed that addiction. It's why we're so good at identifying patterns; just think of the Zodiac or the last time you saw a duckie in the clouds.

The prominence of luck, and our singular ability to ignore it, is downright dangerous. Much of what passes for advice on how to succeed—in business, in investing, in romance—appears to be based on an examination of randomness. That advice, if followed, amounts to tinkering with complex systems we only partially understand, and that almost always increases the unpredictability of the system itself. (Think of the last time you tried to adjust to a skid on an icy road: Over-steer to the right, then over-correct back to the left, repeat as needed. If you're lucky, you'll eventually get back on track. If you're not, you'll slide off the road.) Following advice from success studies can have much the same effect because bold changes to complex systems usually increase randomness.

The moral of the story, then, is to remember that luck matters more than you realize. We all have more for which to give thanks than we are typically willing to acknowledge. The overriding role of luck means that we must be humble in making claims of our own merit, and circumspect when taking advice based on the study of alleged greatness.