Best practice

TURBULENT TIMES AND GOLDEN OPPORTUNITIES

For those feeling storm-tossed by today's economy, Don Sull believes there's much to learn from Carnival Cruise Lines, a company that discovered that turbulence often has an upside.

The *Mardi Gras* began her maiden voyage in March 1972 with 500 passengers. As the pilot navigated out of Miami, the ship's stern ran aground on a sandbar. For most involved, the grounding was harmless. During the 24 hours the *Mardi Gras* was stranded, tourists rubbernecked from the beach, while passengers quaffed a "Mardi Gras on the Rocks", a drink improvised by a creative bartender. For Ted Arison, the founder of the fledgling cruise line, the maiden voyage was a disaster.

He had survived worse. Arison was born in 1924 in an agricultural settlement near Haifa founded by Romanian Jewish emigrants. While vacationing in Yugoslavia in late August 1939, his father, Meir, who ran a shipping company, feared the imminent outbreak of war. Meir found only one flight back to Haifa, departing the next day from Rome and fully booked. He instructed his firm's Italian agent to pay whatever it took to secure five seats and packed his family into a taxi for a 600-mile cab ride. Within days, Hitler had invaded Poland.

After escaping the Nazis, Arison returned to fight them. In 1940, the 16-year-old left the engineering programme at the American University of Beirut to enlist in a battalion of Jewish volunteers from Palestine who fought alongside the British Army in Italy and Germany.

After a series of business ventures in Israel and New York, in 1966, Arison entered a joint venture to found Norwegian Caribbean Line, the pioneer in Caribbean passenger cruises. After that partnership soured, Arison founded Carnival with a single rusted vessel infested with rodents and cockroaches. When Carnival entered the market in 1972, half a dozen established lines already offered cruises to the Caribbean out of Miami and industry leaders Norwegian and Royal Caribbean controlled seven state-of-the-art ships. Competitors derided Carnival as the "Kmart of the Caribbean" and predicted the fledgling line's bankruptcy, since the *Mardi Gras* often sailed with half her berths vacant.

Arison saw her as half full. In the midst of a recession in 1974, he bought control of Carnival for a token dollar (and assumed the company's debt of $5 million). Subsequent decades proved turbulent in the cruise line industry. The competitive landscape churned constantly, with 88 firms entering the US market and 77 exiting between 1966 and 2008. Mergers and acquisitions further complicated the picture. Innovations in ship design transformed the cruising experience. Royal Caribbean's *Oasis of the Seas,* for example, spans 16 decks and features an outdoor amphitheatre, a zip line, two rock-climbing walls and seven distinct neighbourhoods. By 2008, passenger cruise ships offered 10 times more space than that of ships launched in the early 1970s. →

→ Shocks to demand (such as 9/11) and volatility in exchange rates, fuel prices and the cost of capital further roiled the market.

Yet, Carnival endured. In 2009, Carnival Corporation was the largest cruise company in the world and controlled not only its flagship line but also Princess Cruises, Costa Crociere, Holland America, Cunard, AIDA, P&O, Ocean Village, Iberocruceros and the Yachts of Seabourn. The company provided nearly one-half of all cruises globally and was twice as large as the number two cruise line, Royal Caribbean. Carnival's rise from a single rust bucket to global leadership illustrates the role of luck in producing opportunities and of timing in seizing them.

Views of time

Business leaders are often pictured as captains of industry, standing at the bow of a ship, peering through a telescope deep into the clear horizon of the future, plotting a course and proceeding steady as she goes. Turbulence, however, presents a fog of uncertainty that frustrates long-term prediction. In turbulent markets, leaders view the future not through a telescope but through a kaleidoscope.

Arison entered the cruise industry by serendipity, not foresight. After selling his stake in the freight forwarding business he co-founded, Arison was planning to start a business shipping fresh produce when, quite by chance, he met the owner of two ships that cruised the Bahamas. The owners were wrangling with the firm that managed the ships and offered Arison the chance to take over the contract and run passenger cruises out of Miami. Arison agreed, although he knew nothing about the industry. A few months later he left for Miami to market cruises to the Bahamas and Jamaica. Before the first cruise left port, Arison faced a crisis when the owners defaulted on debt payments. Creditors auctioned off one ship and confined the other to port. With a few months before the first cruise would set sail, Arison scrambled to find a suitable replacement and called the Norwegian owner of a passenger ferry. Luckily, the ferry had been docked for months and the desperate owner agreed to the deal, even though Arison lacked funds for a down payment and an industry track record.

During turbulence, the future throws out a steady stream of unexpected opportunities and threats. Arison faced the future like a batter confronting a versatile but erratic pitcher who throws a random mix of pitches. People rarely think of the future as hurling threats and opportunities at them, partly because of how they visualize time.

Most charts depict time as an arrow moving forward from left to right on a horizontal axis, while plotting another variable – anything from mortgage default rates to petrol prices – rising and falling on the vertical axis. This depiction yields the familiar L-shaped graph which implies that we stand with our backs to the past and peer deep into a clear future horizon.

The forward-L view is entrenched, comforting *and* highly misleading. Flipping the L provides a more realistic way to visualize time during turbulence. In the backward-L view, the arrow of time is reversed and flows from right to left, from an unknown future into a completed past. The vertical axis obscures not the past but the future, leaving executives, politicians or investors to grope their way forward.

They can turn their backs to the future and review historical events that have slipped into the past. With hindsight, a string of incidents may appear to have been predictable, even inevitable. They're neither. Retrospective lines emerge in the backward-L view of time but guarantee neither continuity nor insight into the future. Events seen in the rear view mirror appear more predictable than they were.

Golden opportunities

Not all opportunities are created equal. Opportunities and threats during turbulence vary in magnitude. Arison has pursued many opportunities; some created no value, others were worth millions. (Carnival Corporation was valued at $25 billion in December 2008.) "Golden opportunities" are occasions when an entrepreneur or manager can create value in significant excess of the cost of required resources.

Over 10 years, I have studied opportunities and threats across markets and industries and found they follow an inverse power law, where the frequency of an event is inversely related to its magnitude. This pattern is common across a wide range of complex systems – including weather patterns, earthquakes and traffic – in which events arise out of the interactions of volatile variables. An inverse power law implies that individuals and firms face a steady flow of small opportunities and periodic mid-sized ones, punctuated by the rare golden opportunity. Threats follow the same distribution, with many small annoyances scattered among the occasional mid-sized risk and the periodic sudden-death threat that can undo a company.

For example, the 9/11 terrorist attacks created a sudden-death threat for airlines, presented a golden opportunity for security firms and passed largely unnoticed among Chinese appliance manufacturers. Conversely, an industry-specific change such as a sharp reduction in textile quotas will have no impact on most firms but represents a competitive tsunami for European clothing producers. Rather than describing major events in general terms, such as "black swans", it is more productive to analyse their impact on a firm's ability to create and sustain value.

Golden opportunities arise when several windows of opportunity open simultaneously. In Arison's case, demand for cruises exceeded the limited supply, established cruise lines had developed a network of catering and service providers, no existing competitor dominated the market and the Norwegian owner happened to have a ship sitting in port. Such a favourable confluence is rare; golden opportunities typically occur once or twice in a decade for most companies.

The early industry leaders, Royal Caribbean and Norwegian, lacked Carnival's boldness in exploiting major opportunities. When, to seize growing demand, Arison commissioned the first new ship in nearly a decade, his counterparts at Royal Caribbean hesitated. They enlarged two of their existing ships by carving them in half with welding torches and inserting a new midsection to increase capacity incrementally. By the time they ordered new ships, Carnival had grasped a sizeable chunk of the growing market.

Managers tend to look for golden opportunities during an economic boom. The best opportunities, however, often arise in the worst of times. Distressed sellers must offload valuable assets at bargain basement prices. In 2008, for example, ING Direct snapped up the deposits that Iceland's failing banks were forced to unload, while Spain's Banco Santander acquired two struggling British banks, Alliance & Leicester and Bradford & Bingley. To conserve cash in a downturn, companies retreat from attractive opportunities, leaving them open for rivals. While golden opportunities matter, they are not a substitute for exploiting the myriad small opportunities that arise daily. Golden opportunities may appear obvious in retrospect, but they are rarely apparent in advance. Established transatlantic cruise lines sailed between New York and Europe and their executives observed the rise of Caribbean cruising without grasping the magnitude of the opportunity.

Like waves in the sea, a break that starts out small may swell to a golden opportunity as circumstances shift. Small opportunities, moreover, can cumulate to a decisive lead. Arison and his team clawed to the top of the cruise industry one opportunity at a time. Carnival's marketing department seized a series of moderate opportunities to build demand, debuting, for instance, the first nationwide television advertisement for cruises. At a time when few tourists had taken a cruise, Carnival sent anonymous "mystery vacationers" to visit travel agencies around the country asking for a vacation tip without revealing their identity. Any agent who suggested a cruise pocketed $10; if the agent recommended Carnival, the reward was $1,000.

Many managers equate opportunity with revenue growth. The true measure, however, is whether it creates economic value, the difference between what a customer is willing to pay for something and the cost of all resources (including capital) required to produce it. Opportunities to cut costs are every bit as important to value creation as increasing sales. Founded with a rusty ship, no brand and the hovering spectre of bankruptcy, Carnival executives relentlessly reduced costs. To refurbish the *Mardi Gras,* the Carnival operations chief found an orphanage in Spain that taught teenagers carpentry, welding and electrical work; he hired more than a hundred of them to work under a US master craftsman. Where Royal Caribbean stocked bathrooms with a gift pack of more than a dozen toiletries, Carnival offered a bar of soap.

Individually, none of Carnival's marketing or cost-cutting opportunities were significant; taken together, they filled ships, increased profits and allowed Carnival to avoid the financial distress that forced nearly 90 per cent of new entrants to exit the industry. I am not arguing for execution of small improvements instead of a strategy of seizing golden opportunities. During turbulence, execution is strategic. Cost reductions enable firms to outlast less disciplined rivals when sudden-death threats descend, and unrelenting exploitation of small opportunities provide firms with the wherewithal to seize golden opportunities. A series of small wins enabled Carnival to strengthen its balance sheet and accumulate the cash to invest in new ships and fund major acquisitions. Royal Caribbean and Norwegian lacked such discipline.

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Good timing

When pursuing a fleeting opportunity, timing is everything. The variables that influence the nature, magnitude and timing of an opportunity incessantly shift: one window of opportunity might remain ajar for a while, another widens abruptly and a third threatens to slam shut. →

→ Arison excelled at darting through the windows of opportunity. In 1978, Carnival commissioned the *Tropicale,* the first new cruise ship built in nearly a decade and by the far the most expensively built to date, with an estimated price tag of $110 million. That Arison's company, six years old and barely eking out a profit, could afford such an expensive ship in the midst of a recession shocked the industry. But Arison's timing was impeccable: after decades of healthy growth, Denmark's economy suffered stagflation in the late 1970s while its economic growth rate fell by two-thirds and unemployment jumped fourfold. To bolster its shipping industry, the Danish government offered low-interest loans to finance up to 70 per cent of the cost of local shipbuilding. Carnival was first to take advantage of the new financing.

Other shifts in the broader context created demand for the *Tropicale.* In October 1978, President Jimmy Carter signed a bill deregulating US airlines; this reduced the average price of a domestic ticket by nearly one-third by 1990 and triggered a doubling of passenger miles flown. Cheaper flights to Miami stimulated cruise demand. In 1977, ABC launched its weekly "Love Boat" television series that served as a decade-long unpaid advertisement for the cruise industry as a blend of fun, romance and sex. During the show's 10 years on air, Caribbean cruise demand nearly tripled.

Good timing is not the same thing as being first. Too early to seize an opportunity can be as bad as too late. Carnival overtook a host of cruise lines that entered the industry earlier, firms whose names have slipped into history. Had Arison commissioned the *Tropicale* five years before "Love Boat" and deregulation, he might not have filled ships. Had Micky Arison tried to float Carnival in the early 1980s, the company's shorter track record and less buoyant capital markets might have lowered the stock's valuation or precluded an IPO altogether.

Getting the timing right distinguishes opportunity from innovation. Innovators, most believe, can whip up value-creating combinations at the time and place of their choosing. Innovation is important. Yet, vast swathes of innovation literature dangerously underestimate how external forces dictate the optimal timing to pursue opportunities. Costas Markides notes that Charles Schwab, Sony, Texas Instruments, Gillette and Amazon are household names, while K. Aufhauser, Ampex, Bow-mar, Auto-Strop and Charles Stack remain unknown. The difference? The unknown companies first introduced innovations that the well-known firms later commercialized. The pioneers were more creative. They were also too early, arriving before willing buyers, necessary technology and supporting infrastructure were in place to commercialize their innovation.

Carnival owes its success, in good measure, to a long list of external forces beyond Arison's control, including the completion of Miami's new port in 1964, Danish stagflation, "The Love Boat", airline deregulation and a Wall Street boom. Ted and Micky Arison and their management teams were talented, alert and tenacious. They excelled at seizing opportunities, but they could not have forced or foreseen the contextual shifts that allowed them to prosper. The windows of opportunity exist in reality, not only in our minds. We cannot open them at will.

Leaders should, of course, influence context as much as they can – for example, by lobbying governments, pre-empting competitors or shaping industry standards to their company's benefit. Arison lobbied local officials to expand Miami's port and Carnival's aggressive marketing accelerated consumers' awareness of cruising as an attractive vacation alternative to Orlando or Las Vegas. But leaders should also recognize that the forces dictating the timing (as well as the form and magnitude) of opportunities often lie beyond their grasp. Managers cannot conjure up a golden opportunity just because sales are falling, investors are clamouring for growth or the CEO reads a book on innovation.

A narrow focus on innovation not only underestimates the importance of the external context but can also lead managers to value novelty for its own sake. Royal Caribbean wins praise for its shipboard innovations, such as rock climbing and ice skating. But not every innovation boosts customers' willingness to pay enough to offset the additional costs it imposes. For all its innovation, Royal Caribbean's profitability, return on equity and market capitalization have lagged behind Carnival's. New initiatives should be measured against the

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yardstick of value creation, not creativity alone. The focus on novelty can also distract people from mundane opportunities, such as subsidized government financing for ships or low-cost labour, that create significant value despite lacking the glamour of novelty.

Lucky break

Entrepreneurs and managers cannot control the shifting contextual variables that give shape to opportunities. Being in the right place at the right time is largely a matter of luck. Entrepreneurs and managers must be alert to notice the opportunity and tenacious to seize it, but luck places it within their grasp in the first place. Arison was lucky to bump into a ship owner desperate for a new manager, lucky to be between jobs at the time, lucky to have some cash on hand and lucky to find another ship when his first two were seized.

Admitting the role of luck in success may strike you as obvious; it certainly seems unarguable to me. Nevertheless, the shelves at airport bookstores sag under the weight of best-selling business books that select successful companies, study what they did and conclude that anyone who does the same thing will reap the same rewards. But these studies overlook how churning external forces set the context for success. A review of 10 management best-sellers found that none deemed the topic of luck (or chance or timing) important enough to deserve an entry in their index.

Machiavelli estimated that fortune accounts for half of success or failure, leaving the other half in our hands. Machiavelli's approximation acknowledges the role of both luck and agency without falling into the trap of false precision. It is true that the Arison was lucky, but it is equally true that he weathered bad breaks and exploited opportunities much better than others.

Is there anything we can do to improve one's luck? Arnold Palmer's observation that "the more I practice, the luckier I get" applies: the "practice makes lucky" approach works well for opportunities that fall within the scope of past experience. Decades of finding ways to reduce costs, for instance, helped Carnival managers spot new opportunities for further efficiency gains. The juiciest opportunities, however, often differ significantly from what worked before. Arison knew a lot about freight forwarding and a little about cargo shipping but nothing about cruising when he moved to Miami. Honing established routines can blind people to opportunities that arise from unexpected places. Despite decades of experience, most established cruise lines failed to redeploy their ships to the Caribbean routes, even as the rise of transatlantic flights decimated their traditional business. Transatlantic cruise executives saw Miami as a minor port compared to New York and cruises as a frivolous distraction from the serious work of ferrying passengers across the Atlantic. Practice blinded them to opportunities.

To seize the upside of turbulence, I propose a different image of fortune. In the era before engines and electronic navigation replaced masts and compasses, a sailing ship's progress and survival depended on elements beyond its control. Not even the best seaman could predict the elements with accuracy, let alone raise the winds or calm the waves. A seasoned captain could, however, still master the sea – not in the sense that a trainer masters a horse, bending the beast to his will, but rather by harnessing favourable winds, riding out inevitable storms and remaining ever alert to the shifts in weather that demand a change in tack. ■

Resources

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Niccolo Machiavelli, *The Prince* (Robert M. Adams, editor and translator), W.W. Norton, 1980.

Constantinos C. Markides, *Game-changing Strategies: How to Create New Market Space in Established Industries by Breaking the Rules*, Jossey-Bass, 2008.

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