Using Leadership to Make Policy Work

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Introduction

Recently a group of utility regulators and industry representatives met to discuss issues that have been debated for several years. Numerous engineers, economists, and lawyers offered their solutions to the perceived problems. By the meeting's third day, several participants were wandering in and out of the room, working their BlackBerrys, or even napping, until the discussion approached topics such as: Who should be at the table? Who should really decide these issues? What happens if no decisions are reached? When these topics came up everyone perked up and paid attention, but only long enough to make sure that someone changed the subject.

What was happening here? The group was encountering an adaptive challenge that it did not want to face. These topics represented the elephants in the room—issues everyone knew were there and were willing to talk about off the record but would not engage openly. Not being a player in that process, I can only provide educated speculation on what these elephants were, but they appeared to encompass questions about whether at least some of the people and organizations at the table, who had once been the most important regulatory players in the sector, had any legitimate role in the future.

This story illustrates the difficulty people have facing an adaptive challenge. Adaptive challenges arise when fundamental changes in a group's (or an individual's) environment call for

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the group to rethink basic goals and strategies (Heifetz, 1994, pp. 3-9; Heifetz and Linsky, 2002, pp. 9-20; Laurie, 2000, pp. 3-17). Consider the problem some Eastern Caribbean islands faced a few years ago. Each island was struggling with how to modernize its telecommunications. To move forward, the islands had to rethink the long-held tradition of monopoly markets, give up some degree of independence with respect to telecommunications policy, and alter their individual relationships with Cable & Wireless. These were adaptive challenges that involved confronting new realities and relinquishing things they valued so they could grasp something they wanted even more, namely modern telecommunications.

Adaptive challenges are different from technical challenges, which are the bread and butter of regulatory work (Jamison, Rowe, and Perlman, 2005). "Technical work" applies current knowledge, whether the work is engineering, economic, financial, or administrative, and even if the knowledge is obtained from an outside expert. Examples of technical work include writing laws, conducting price reviews, and organizing regulatory agencies. For example, every telecommunications regulator in the world faces issues of network interconnection. The issues are complex and difficult, but they are well understood and can be solved by experts in engineering, economics, and law because there is general agreement on the scope of the issues and the range of possible solutions. As this example illustrates, technical challenges are often complex and controversial but can be addressed by having subject matter experts study the problems and provide alternative solutions from which regulators can choose.[2]

There is growing consensus that for an organization to succeed adaptive work needs to be viewed as important as good technical work. Ronald Heifetz and Marty Linsky (2002, p. 13) of Harvard University have found that "without learning new ways–changing attitudes, values, and

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[2] Further explanation of adaptive issues in utility regulation can be found in Jamison, Rowe, and Perlman (2005), Jamison (2004), and Jamison (2005).

behaviors–people cannot make the adaptive leap necessary to thrive in a new environment." Management consultant Donald Laurie (2000, p. 12) observed that the adaptive work of learning, embracing, and adopting new ways "lies at the core of a company's ability to succeed." Douglass North, winner of the Nobel Prize in Economics in 1993, emphasized the importance of adaptive organizations when he wrote, "The secret of success (in economic development) is the creation of adaptively efficient institutions–institutions that readily adapt to changing circumstances" (North, 2005a).[3]
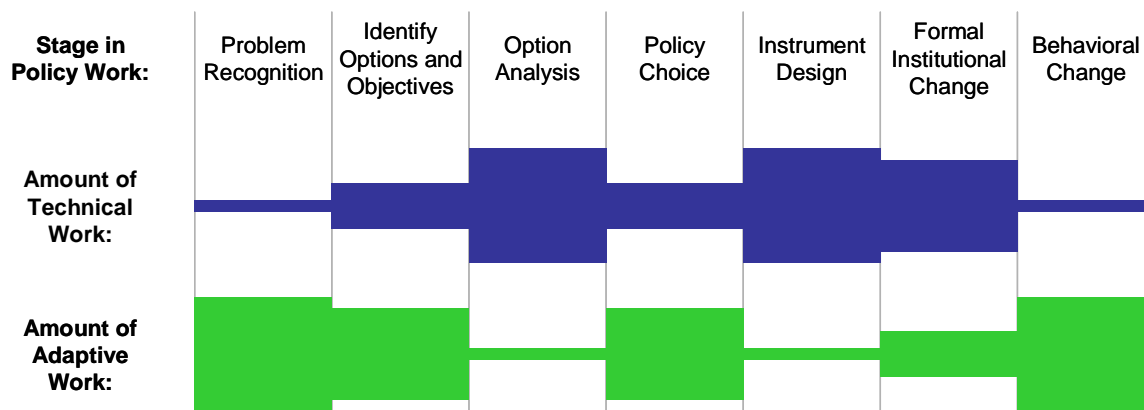
In this paper I describe the role of adaptive work in utilities policy and regulation, and how persons providing leadership can help others engage in adaptive work. The remainder of this paper is organized as follows. The next section describes the interplay between technical and adaptive work in developing and implementing utility policies. I then describe a framework for identifying adaptive challenges. The final section is the conclusion.

Interplay of Technical and Adaptive Work in Utility Policy

Difficult issues in utility regulation often involve both technical and adaptive challenges. As Figure 1 shows, these challenges need to be addressed together if utilities and utility regulators are to successfully resolve issues. At the top of Figure 1 are seven phases of work in developing and implementing a new utilities policy. Each phase involves both technical and adaptive work. The darker, solid bar shows the relative amounts of technical work in each phase and the lighter, shaded bar shows the relative amounts of adaptive work. I explain each of these phases next and their relative intensities of technical and adaptive work.

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[3] See also North (2005b).

Figure 1. Interplay of Technical and Adaptive Work in Utilities

Stage in Policy Work:	Problem Recognition	Identify Options and Objectives	Option Analysis	Policy Choice	Instrument Design	Formal Institutional Change	Behavioral Change
Amount of Technical Work:							
Amount of Adaptive Work:							

Problem Recognition

In the 1970s, engineers and managers of a U.S. automobile manufacturer gathered to study a car that had been introduced to the United States by a Japanese competitor. This was about the time that Japanese firms were beginning to make noticeable inroads into the U.S. automotive markets, which for years had been served by a cozy oligopoly dominated by General Motors and Ford. Wanting to understand the Japanese automobile that American consumers were finding so interesting, the engineers completely disassembled the vehicle and put it back together. They stared at the reassembled auto in amazement. Among the Americans' tools were rubber mallets and crowbars that were standard on U.S. auto manufacturers' assembly lines: U.S. auto assembly workers used these mallets and crowbars to force the U.S. car parts into place because the parts didn't really fit together. Not once in reassembling the Japanese car did the Americans use the mallets and crowbars. Just to make sure they had not made a mistake, the engineers and managers took the car apart again and reassembled it again, and again the parts fit perfectly. They once more stared at the car. Finally one of the engineers muttered, "Customers will never

notice." The others nodded in agreement and the group hurriedly left, having deceived themselves into thinking their world was secure. They were wrong. Customers did notice the quality of the Japanese engineering and many switched from U.S.-made cars to Japanese imports.

This story illustrates the danger of avoiding adaptive challenges and not recognizing a changed environment. The consequences of denying the existence of adaptive challenges can be devastating in critical utility industries. The California energy crisis cost the state millions of dollars, much of which could have been saved if policymakers had been willing to face hard issues sooner. In Bolivia the government did not recognize the adaptive challenge that its citizens faced when the country tried to privatize certain water utilities. Citizens revolted and the country's president lost his office.

Work in this first stage of policy development is largely adaptive work because, as we saw with the American automakers, people resist recognizing new realities, even in the face of a crisis. Confronting new realities means that people may have to give up valued traditions, accept new risks and uncertainty, admit mistakes and having outdated skills, and exert extraordinary effort to solve new problems. Leadership in this stage keeps people out of their comfort zones and engages them in the adaptive work of fully exploring new realities.

Some of the work in this stage is also technical. For example, data gathering and analyses, listening to customers and stakeholders, and conducting brainstorming sessions all apply current knowledge and skills.

Identify Options and Objectives

The second step in the process involves more technical and less adaptive work than problem recognition, but adaptive work still dominates this phase. This adaptive work includes

identifying what from the past can be sacrificed, setting aside past biases, reconsidering ideas

that were once rejected, looking at the future differently, and working through the elephants in

the room that have traditionally gotten in the way of real dialogue. The technical work includes

research on parallel problems, investigating how others are reacting to the new environment, and

brainstorming options.

Option Analysis

The work in this third stage is largely technical and includes performing quantitative analyses on

the options identified in the previous phase and examining in detail how each apparently viable

alternative might be accomplished. The adaptive work in this phase includes ensuring that

personal preferences and feelings of loss due to the forfeiture of traditions do not hinder

objective analysis.

Policy Choice

Work in this phase focuses on choosing the best policy based on previously identified objectives.

The adaptive challenges in this phase are significant because hard choices are made and certain

connections with the past are severed. Leadership is needed to ensure that adaptive work is not

avoided by, for example, discounting the hard realities identified in previous phases, obfuscating

analyses, or distracting people from the most significant, yet difficult issues.

Instrument Design and *Formal Institutional Change*

Work in these phases is primarily technical. Instrument design is the work of developing the

mechanisms that will be used to implement the policy choice. Instruments in utility regulation

include legislation, administrative rules, and licenses. "Designing" these instruments includes the development of specific formula, reporting requirements, rewards and penalties, and operator requirements. This is largely technical work that implements the choices made in the policy choice phase.

The next phase is the formal adoption and implementation of the instruments designed in the previous phase. Technical work in this phase would include passing legislation, formally creating or eliminating organizations, changing organizational structure, and creating new procedures. Some adaptive work is involved because reality begins to set in during this phase and people may renew their resistance to change.

Behavioral Change

This last phase of policy development and implementation is often ignored by policy analysts even though policy making is ineffective if it does not affect behavior. People do not always change their behavior even after new policies are formally adopted. For example, one regulatory agency's staff continued to use command and control regulation even though the agency had formally implemented incentive regulation. Another country privatized its utility, created a formally independent regulatory agency, and adopted laws allowing competition; however, the incumbent continued to enjoy a de facto monopoly for several years because informal ties between utility management, politicians, and regulators effectively kept the old system in place. If policy makers want new policies to be effective, leadership is needed to help people accept the new policies and teach them how to conform their behavior to the new direction.

The behavior change phase includes some technical work, such as holding training sessions and distributing documentation, however, most of the work is adaptive because people

must make the final value adjustments that allow them to embrace the organization's new

direction.

Conclusion

Even though Figure 1 gives the appearance of a linear process involving technical and adaptive

work, the stages overlap, organizations often digress to earlier stages, and policy issues

interrelate, causing particular stages of work on one issue to affect work on other policy issues.

This increases the importance of adaptive leadership because people must adjust their thinking to

consider the entire system of policy analysis and implementation.

Leadership for Adaptive Work

What can regulators, policy makers, and others do to make sure that people engage in

adaptive work? One step is to ensure that conflicts are brought into the open. Some groups

prefer an artificial harmony to open conflict because of cultural norms, personal preferences,

discomfort with uncertainty, or other reasons. A person practicing leadership in such situations

might mine for conflict by, for example, focusing attention on disconnects between expected

outcomes and reality or probing why people seem to overreact when someone questions the

status quo. The existence of unmet adaptive challenges results in disappointing outcomes, such

as slower infrastructure deployment, declining service quality, and widening gaps in

performance between countries. People who want to deny the adaptive challenges will make

excuses for these symptoms or try to hide them. For example, in one jurisdiction, politicians and

water system managers are keeping water prices artificially low to avoid the pain of facing angry

customers, who would prefer to not experience the costs that water use and wastewater disposal

are placing on the economy. Leadership in this instance could ensure that customers are subjected to prices that reflect economic costs so that the citizenry sees the hard choices they face between their expected standard of living, economic growth, and the environment.

To ensure that important policy options are not discarded, regulators and other policy makers should help stakeholders fully understand their adaptive challenges. Consider, for example, the case of jurisdicational separations in U.S. telecommunications regulation. Separations is the process of dividing a telephone company's revenue requirement between the federal regulator, who regulates interstate services, and the state regulator, who regulates intrastate services. In the 1960s and 1970s separations became the regulators' and the industry's instrument for transferring money between companies and geographic regions, presumably for promoting universal service. The breakup of AT&T in the early 1980s, the growth of competition since that time, and the decline of rate of return regulation made separations effectively irrelevant to regulating prices and the implicit subsidies difficult to sustain. Those of us who worked on separations issues in the 1980s and 1990s failed to bring into focus the fundamental contradiction between the idea of separations and basic trends in the industry and in regulation. We instead allowed attention to be directed towards artificial, technical fixes, such as developing new allocation formula for new technologies.

Once a conflict is surfaced, it is important to remove obstacles to identifying the underlying issues. Lencioni (2005, pp. 124-127) identifies four such obstacles: *Informational obstacles*, which are the easiest to discuss, relate to disagreements over facts and interpretations. In part because information obstacles are easy to discuss, people may assume they face information obstacles when they actually face more complex obstacles. For example, in one particular company, managers reached a stalemate over whether an employee could transfer

between divisions of the company. The managers interpreted their heated debates as a disagreement over the technical issue of when the employee could be replaced. In reality they were confronting an adaptive issue in Lencioni's next form of obstacle, *environmental obstacles*, because each division manager was concerned that if he/she gave up employees that his/her division would lose prestige within the company. Environmental obstacles are those that involve the atmosphere in which the situation is taking place, such as organizational culture, politics, and mood. These obstacles can be further complicated by *relationship obstacles*, which occur when there are personal issues between the people involved in the conflict. For example, there may be legacy events between individuals that need to be set aside if people are going to work together to solve an organization's adaptive challenges. People also need to be accepting of each others' styles for engaging in conflict or reputations for work. Lastly, *individual obstacles*, such as a lack of leadership skills, protection of egos, or inexperience make it difficult for people to focus their energies on the organization's real issues.

Another way of viewing conflicts was developed by Lord (1979) and extended by Shabman (2005). The Lord-Shabman framework identifies four types of conflict. The first is conflict over facts: "What is?" An example of a fact conflict would be a disagreement over market shares or measuring the earnings of a company. Fact conflicts can be resolved through technical work, although some stakeholders will claim disagreements over facts in order to hide other conflicts. For example in one jurisdiction, the regulated companies engaged in an extended debate over the effects of rate of return regulation to obscure their real agenda, which was to obtain pricing flexibility.

The second type of conflict in the Lord-Shabman framework is interest conflicts, which occur over differential impacts of regulatory policies. Consider for example the water pricing

issue described earlier. Part of the issue relates to differences in geographic effects: Without a change in pricing policies, customers in region A will experience a water shortage while customers in region B will continue to enjoy low prices and adequate supply. If policy makers allow prices to rise, customers in both regions will experience the price increase. Customers in region B will clearly feel worse off, but customers in region A might feel better off or at least not as bad off as customers in region B.

The first two types of conflict are transactional in that people can engage in economic exchanges to resolve the conflicts and no one has to engage in adaptive work. In contrast, resolving the third and fourth types of conflicts (conflicts over values and authority) requires adaptive work.[4] Value conflicts are conflicts over what should be. These conflicts reflect preferences over, for example, the relative importance of economically efficient pricing and the effects of price changes on different consumers' standards of living. Other value conflicts are disagreements over the importance of traditions or the merit of taking risks. Authority conflicts, which are disagreements over who will make decisions that determine direction and order, are a special form of value conflict. For example, in some Caribbean countries, conflicts occur between ministries and regulatory agencies over who will decide new policy directions. The U.S. Federal Communications Commission ordered U.S. telecommunications companies to lower their settlements payments to telecommunications carriers in the Caribbean, resulting in a conflict over jurisdiction with Caribbean governments. People differ in how they value alternative authority arrangements, so changing authority requires adaptive work.

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[4] In certain situations stakeholders may be able to engage in transactions, such as logrolling, to mollify authority and value conflicts. However, such transactional approaches to resolving adaptive challenges only delay the adaptive work because shifts in the external environment will always disrupt the agreements.

Conclusion

In this paper I examine the interplay between technical and adaptive work in utilities policy. I find that proper adaptive work is necessary for proper technical work to occur, or at least for proper technical work to have its legitimate impact. This interdependence of technical and adaptive work highlights the importance of adaptive leadership.

Heifetz and Linsky (2002) have described leadership as disappointing people at a rate they can endure. The disappointment comes from bringing attention to the gap between aspirations and reality. If the disappointment is too severe, people back away from reality and go into denial. If the person practicing leadership is able to meter this disappointment at a rate that people can endure, then the stress can stimulate people to adapt to new realities and perform the high quality technical work that is essential in regulation.

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