Compounding Frontline Judgment

Rethinking the Theory of the Firm for the Age of Autonomous AI

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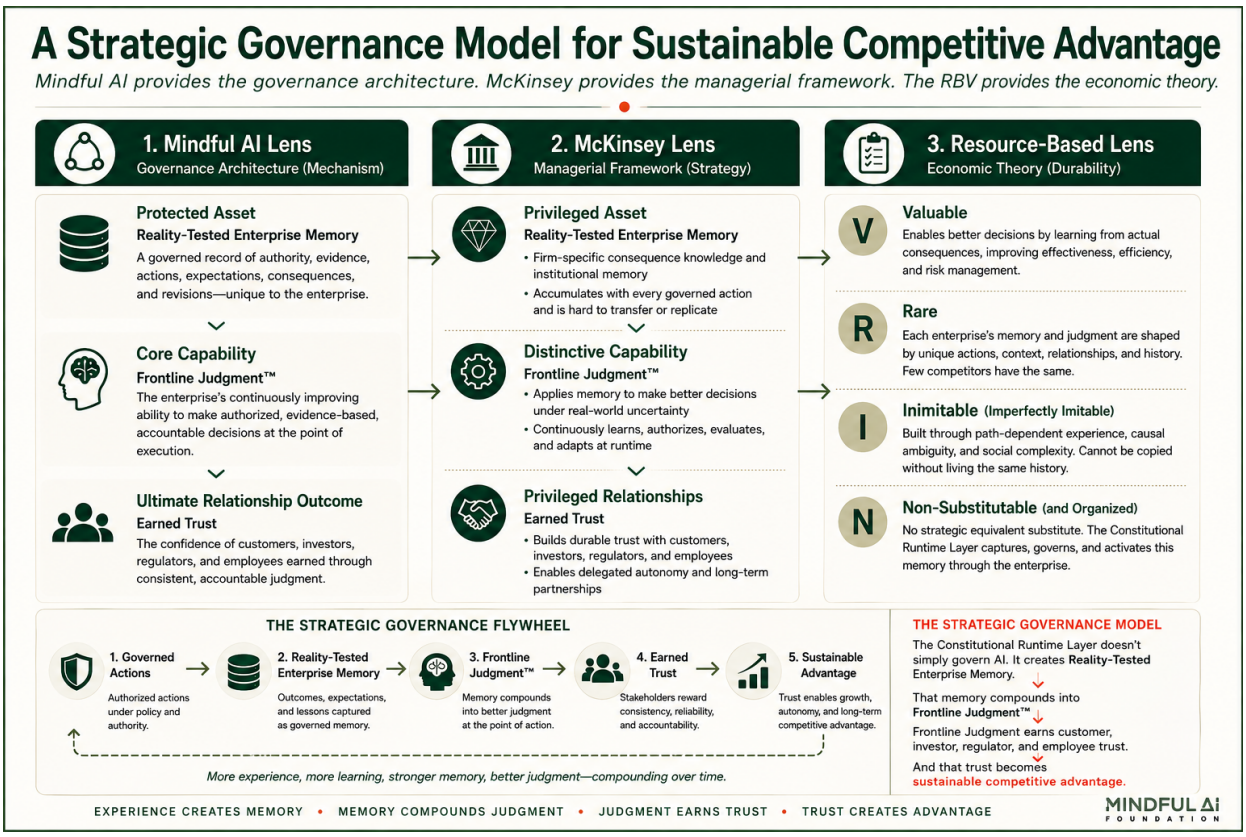
Most executives still hear the word governance and think about compliance, controls, risk committees, or brakes applied to innovation. But once autonomous systems begin acting on behalf of the enterprise, governance can become productive infrastructure. A Constitutional Runtime Layer can preserve who acted, under whose authority, using what evidence, subject to which policy, with what expectation, and with what observed consequence. In other words, it can turn each consequential action into a durable unit of organizational learning.

The resulting asset is Reality-Tested Enterprise Memory. It is not simply a log of what happened, nor a transcript of what a model said. It is the governed history of the organization's own judgment: authority, evidence, commitments, actions, outcomes, and revisions linked across time. Because that history is produced by the firm's own encounters with customers, regulators, competitors, technologies, and shocks, it is path-dependent. Another firm can license the same foundation model and purchase the same cloud infrastructure, but it cannot purchase the same lived sequence of consequential decisions.

Exhibit 1. Three Complementary Views on Strategy



Over time, enterprise memory compounds into Frontline Judgment. Better judgment earns trust because customers, investors, regulators, and employees experience an organization that is more consistent, more accountable, and better able to explain why it acted. Trust, in turn, permits greater delegation, deeper relationships, and greater strategic freedom. The loop is therefore cumulative: governed action creates memory; memory improves judgment; judgment earns trust; trust expands the conditions under which the enterprise can act. This is the Strategic Governance Model.

Theories of the firm, reconsidered

For more than half a century, strategy scholars have returned to a deceptively simple question: *why do some firms consistently outperform others?* The answers have changed as the economy has changed. Ronald Coase asked why firms exist at all and located the answer in the costs of coordinating through markets. Michael Porter shifted attention to industry structure, positioning, and the configuration of activities. The Resource-Based View turned inward, arguing that durable advantage comes from resources that are valuable, rare, difficult to imitate, and effectively organized. The Knowledge-Based View made knowledge itself the critical resource, while Dynamic Capabilities emphasized the ability to sense change, learn, and reconfigure the organization as conditions move beneath it.

None of these theories has become obsolete. But all were developed before enterprises began delegating consequential decisions to autonomous systems operating continuously and, increasingly, at machine speed. That development changes the strategic question. The issue is no longer simply why firms exist, where they position themselves, or what resources they possess. It is how a firm continuously creates better judgment when intelligence becomes abundant and action becomes increasingly autonomous.

Exhibit 2. Theories of the Firm in the Age of Autonomous AI

Theory	Core question	Traditional strategic resource	Mindful AI extension
Transaction Cost Economics (Coase)	Why do firms exist?	Coordination efficiency	Autonomous systems increase the need for governed coordination at machine speed.
Competitive Strategy (Porter)	How do firms outperform rivals?	Positioning and differentiated activities	Superior execution increasingly depends on governed autonomous decisions.
Resource-Based View (Barney)	What makes advantage sustainable?	Valuable, rare, inimitable, organized resources	Reality-Tested Enterprise Memory is continuously created through governed experience and can become path-dependent and difficult to imitate.
Knowledge-Based View	What is the firm's critical resource?	Organizational knowledge	Governed experience converts knowledge into institutional memory and Frontline Judgment™.
Dynamic Capabilities	How do firms adapt?	Sensing, learning, and reconfiguration	The Constitutional Runtime Layer institutionalizes learning from consequences and accountable revision.
Strategic Governance Model (Mindful AI)	How does a firm continuously improve judgment as autonomous systems act?	Reality-Tested Enterprise Memory → Frontline Judgment™ → Earned Trust	Governance becomes the process by which a new strategic resource is created and compounded over time.

Seen this way, the Strategic Governance Model does not displace the major theories of strategy. It connects them. Transaction Cost Economics explains why coordination may move inside the firm. Porter explains how differentiated activities create superior positions. RBV explains why certain resources can support durable rents. The Knowledge-Based View explains why what the organization knows matters. Dynamic Capabilities explains why adaptation matters. Strategic governance adds a further proposition suited to autonomous AI: the firm can design a runtime architecture that converts governed experience into an accumulating strategic resource.

Three lenses, three different questions

The three columns in Exhibit 1 should not be read as rival theories. They operate at different logical levels. The Mindful AI lens supplies the mechanism: governed action creates Reality-Tested Enterprise Memory, which compounds into Frontline Judgment and earns trust. McKinsey's managerial framework supplies the executive vocabulary: the memory is a privileged asset, Frontline Judgment is a distinctive capability, and trust is a privileged relationship. The Resource-Based View then asks whether those resources can sustain advantage. The answer depends on whether they are valuable, rare, difficult to imitate, and organized so that the firm can actually capture their value.

This distinction matters because the central contribution of the Strategic Governance Model is not another taxonomy of competitive advantage. RBV already tells us what a durable strategic resource looks like. The new question is how such a resource is continuously created. Strategic governance supplies the missing process. Each governed action generates a new observation about the relationship between expectation and reality; each observation can update institutional memory; each update can improve future judgment. Competitive advantage is therefore not merely possessed. It can be produced through a disciplined governance loop.

> **"The old strategic bottleneck was the generation of options. The new one is the governance of commitment."**
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> *Michaels, Leiblein & Mikkilineni, "As AI Gets Better, Strategy Gets Harder" (2026)*

When intelligence becomes abundant, judgment becomes the bottleneck

The emerging debate around artificial intelligence often assumes that the strategic prize will belong to firms with the largest models, the richest data, or the fastest agents. Those capabilities certainly matter, but they are diffusing rapidly. Frontier models improve, open alternatives narrow the gap, and the cost of generating plausible options continues to fall. As intelligence becomes more widely available, advantage must migrate toward something that is harder to buy, copy, or rent.

That migration is already visible in the decision process. In our recent paper, *As AI Gets Better, Strategy Gets Harder*, we argued that AI changes the balance between variation and selection. AI can generate more candidate actions than the tacit models of experienced managers can screen, and organizations can therefore scale authority faster than they scale judgment. The result is not necessarily better strategy. It can be faster overcommitment. The paper makes the point bluntly: "judgment is not a trait. It is a function." Historically, firms obtained that function from seasoned managers whose mental models compressed years of causal learning into decisions. In an autonomous enterprise, that function increasingly must be engineered into the decision architecture itself.

This is why our answer to the question of what becomes scarce is not another model. It is Frontline Judgment™: the enterprise's continuously improving ability to make authorized, evidence-based, accountable decisions at the point where actions create real-world consequences. The strategic problem is therefore no longer merely how to generate more intelligence. It is how to convert abundant intelligence into disciplined commitment without losing the capacity to learn from what reality sends back.

Why this becomes harder to imitate over time

The strongest connection to RBV is path dependence. A competitor may replicate software features, copy a governance schema, or hire away individual employees. It cannot reproduce the exact sequence of decisions through which an enterprise learned what its customers tolerate, what regulators challenge, what failure modes recur, what exceptions matter, and which forms of authority produce coherent outcomes. That sequence is historically contingent and socially embedded. The longer the loop runs, the less the asset resembles a transferable database and the more it resembles institutional character made explicit.

This also clarifies the role of trust. Trust is not the protected asset itself because it lives partly outside the enterprise and can be withdrawn. Nor is judgment the underlying stored resource, because judgment is exercised rather than warehoused. The protected resource is the institutional memory from which judgment can be practiced repeatedly. Frontline Judgment is the distinctive capability that memory enables. Earned trust is the privileged relationship that results when stakeholders repeatedly experience accountable judgment. The concepts therefore belong to different places in the causal chain, and keeping them separate makes the model more strategically precise.

From abundant intelligence to disciplined commitment

We began with a question about where competitive advantage migrates when intelligence becomes abundant. The history of strategy suggests that advantage rarely remains where technology first creates it. Information technology rewarded firms that learned to accumulate and deploy knowledge. Autonomous AI may reward firms that accumulate something subtler: judgment that has been tested against reality, preserved institutionally, and improved without severing the chain of responsibility.

The Resource-Based View describes what makes a strategic resource durable. The Strategic Governance Model proposes how a new resource can be continuously created. Every governed decision adds to Reality-Tested Enterprise Memory. Every consequence can refine Frontline Judgment. Every cycle gives the enterprise another opportunity to earn trust. Governance, in this account, is not the opposite of speed. It is the architecture that allows speed to become experience and experience to become advantage.

The defining question for CEOs is therefore no longer simply, *"How do we deploy more intelligent machines?"* It is, *"How do we build an organization whose judgment becomes more trustworthy every time an autonomous system acts?"* In an age that can generate almost unlimited possibilities, the scarce strategic capability may be the discipline to know which ones deserve commitment.

Governed action creates memory. Enterprise memory compounds judgment.

Judgment earns trust. Trust creates advantage.

What CEOs should ask now

The practical implication is not that every decision should be automated or that every historical action should be preserved forever. The more useful question is whether the organization is designing autonomous decision systems that can learn without losing accountability. When a consequential action occurs, can the enterprise reconstruct who authorized it, what evidence supported it, what outcome was expected, what happened, and what changed afterward? When the governing model is revised, does the organization preserve the history of the judgment that preceded the revision? And when a model, vendor, or cloud is replaced, does institutional memory survive?

These questions move governance out of the compliance department and into strategy. A firm that treats models as the crown jewel will continually chase the next model. A firm that treats Reality-Tested Enterprise Memory as the crown jewel can substitute models while preserving what it has learned. Its advantage is not that it possesses intelligence unavailable to others. Its advantage is that it becomes progressively better at deciding what intelligence deserves to become action.

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