Strategic Governance of Agentic AI

From Knowing to Doing

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Strategic Governance is the recurrent process through which an enterprise produces and revises judgment under uncertainty.

In the Agentic AI era, that process must become explicit, architectural, and testable.

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Abstract

For nearly a century, scholars have offered different explanations for why firms exist and why some outperform others. Coase emphasized coordination costs; Porter, competitive position; Barney, strategic resources; Grant, knowledge; and Teece, adaptation. These theories survived because each captured a different requirement of enterprise organization. What remained largely unnamed was the recurrent function connecting them: the production and revision of judgment under uncertainty.

Autonomous AI makes that function newly visible. Intelligence and action can now scale faster than institutional judgment. We propose Strategic Governance as the process through which firms preserve the conditions of consequential action, compare declared expectations with observed consequences, convert the resulting residuals into Reality-Tested Institutional Memory, and continuously improve Frontline Judgment™. The Constitutional Runtime Layer is the practical architecture that makes this possible at machine speed.

The paper advances three falsifiable propositions. First, preserving ex ante expectations alongside ex post consequences should improve subsequent judgment. Second, the resulting institutional memory should be path-dependent and therefore imperfectly imitable. Third, the authority defining and revising the criteria by which actions are judged must remain structurally separate from the operational systems being evaluated. Together, these propositions turn Strategic Governance from a management framework into a testable theory of enterprise learning and durable advantage in the AI era.

> ***The strategic bottleneck is moving from generating options to governing commitment.***
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> *Michaels, Leiblein & Mikkilineni, "As AI Gets Better, Strategy Gets Harder" (2026)*

1. Six theories, six requirements

For almost ninety years, scholars have returned to a deceptively simple question: why do firms exist, and why do some consistently outperform others? The answers accumulated rather than displaced one another.

Coase asked why economic activity sometimes occurs inside firms rather than through markets. Porter asked why firms in some competitive positions outperform others. Barney turned inward to resources that are valuable, rare, difficult to imitate, and effectively organized. Grant identified knowledge as a critical resource. Teece made the firm dynamic, emphasizing sensing, learning, and reconfiguration as conditions change.

These theories survived not because strategy failed to choose among them, but because each captured a different requirement of enterprise organization. A firm must coordinate. It must position. It must possess differentiated resources. It must know. It must adapt. Yet beneath these requirements sits a recurrent function that becomes visible when we ask not what advantage is made of, but how an enterprise repeatedly decides what deserves commitment.

That function is judgment. And judgment must be produced and revised continuously because the world against which the enterprise acts does not stand still.

Theory	Primary requirement	What Strategic Governance connects through time
Coase	Coordination	Judgment about what should be organized inside or outside the firm.
Porter	Position	Judgment about where and how to compete.
Barney / RBV	Strategic resources	Judgment about what deserves investment, protection, and organization.
Grant / KBV	Knowledge	Judgment about which knowledge matters and how it should be applied.
Teece	Adaptation	Judgment about what changes to sense, seize, and act upon.
Strategic Governance	Judgment production	The recurrent process that converts governed experience into revised judgment.

2. The missing function

Consider what senior managers actually do. They encounter incomplete evidence, form expectations, commit resources, observe customers and competitors, absorb regulatory and technological shocks, and then decide again. Some assumptions survive contact with reality; others do not.

Transaction Cost Economics requires judgment about boundaries. Competitive Strategy requires judgment about position. RBV requires judgment about resources. The Knowledge-Based View requires judgment about what knowledge matters. Dynamic Capabilities requires judgment about when and how to adapt. The theories identify different organizational requirements; judgment connects them through time.

This suggests a broader representation of the firm. The enterprise is not merely a bundle of contracts, activities, resources, knowledge, or capabilities. It is also a system for producing and revising judgment under uncertainty. That function has always existed. What has changed is its substrate.

3. When intelligence becomes abundant

Historically, enterprises accumulated judgment largely through people. Experienced managers compressed years of causal learning into decisions: what counts as signal, what evidence matters, when waiting is wiser than acting, and when a commitment is too difficult to reverse.

AI changes the economics of this process. Foundation models can generate analyses, recommendations, and possible actions at extraordinary scale. Agents can increasingly translate those possibilities into action. APIs connect those agents directly to enterprise systems. Intelligence becomes abundant faster than judgment does.

The scarce resource therefore begins to move. The question is no longer simply whether an enterprise can generate intelligent possibilities. It is whether the enterprise can decide which intelligent possibility deserves to become consequential action. This is the Strategic Governance Imperative.

An organization can now scale authority faster than it scales judgment. It can scale action faster than accountability. Without a corresponding governance architecture, greater intelligence can produce faster overcommitment rather than better strategy.

Judgment is not a trait. It is a function.

The management challenge is to engineer that function when action moves to machine speed.

4. From strategic governance to frontline learning

The Constitutional Runtime Layer operationalizes Strategic Governance by preserving the conditions under which consequential action occurs. For every governed commitment, the enterprise should be able to reconstruct who acted, under whose authority, on what evidence, under which policy, expecting what, and what actually happened.

The final two questions change the nature of the record. Most enterprises already preserve outcomes: revenue moved, a customer churned, a loan defaulted, a regulator objected, a product succeeded. What they often fail to preserve is the expectation that existed before the outcome became known.

An expectation reconstructed after the result is known is a story. An expectation recorded before the result is known is a measurement. Once expectation and outcome are preserved together, each consequential action becomes a small experiment.

Declared expectation	→	**Authorized action**	→	**Observed consequence**	→	**Residual**	→	**Institutional memory**	→	**Frontline judgment**

The residual, the distance between what the enterprise expected and what reality returned, is the information-bearing quantity in the loop. Frontline learning is the process by which that residual changes what the enterprise knows and how it will judge the next commitment.

5. What compounds

The vocabulary matters because five related concepts play different roles in the theory.

Concept	Role	Meaning
Consequence Ledger	Technical record	The linked record of authorization, expectation, action, outcome, and revision.
Reality-Tested Institutional Memory	Strategic asset	The accumulated history of the enterprise's own encounters with reality.
Frontline Learning	Update mechanism	The process by which expectation-outcome residuals revise institutional memory.
Frontline Judgment™	Organizational capability	The ability to apply accumulated learning at the point where consequential commitments are made.
Earned Trust	Relationship outcome	Confidence earned when stakeholders repeatedly experience accountable judgment.

The enterprise does not learn merely from outcomes. It learns from the distance between what it expected and what reality returned. Institutional memory accumulates; Frontline Judgment improves as that memory is brought to bear on subsequent commitments.

6. Why the advantage can become durable

This brings Strategic Governance back to the Resource-Based View. If every enterprise can purchase the same foundation models, cloud infrastructure, and governance software, why should the mechanism create sustainable advantage? Because the architecture and the accumulated learning are different objects.

The outward-facing layer, the governance schema, protocols, and constitutional architecture, should be portable and potentially standardized. The inward-facing layer is what happened when this enterprise, operating under those rules, encountered these customers, regulators, competitors, technologies, failure modes, and shocks.

A competitor can license the same model, purchase the same cloud, and copy the same schema. What it cannot purchase is the accumulated history of expectation and consequence produced through another firm's encounters with reality. The source of imperfect imitability is therefore not secrecy. It is history.

A rival can adopt your constitution. It cannot adopt your case law.

7. When reality changes the criterion

Not every error means the same thing. Sometimes reality merely fluctuates: demand falls temporarily, a supplier fails, or a quarter disappoints. The enterprise absorbs the disturbance and continues to judge against the same criterion.

Sometimes an encounter changes what counts as a good decision. A regulatory regime changes permanently. A new technology destroys an established cost structure. Customers cease valuing something they once paid for. AI makes a previously scarce capability abundant. These are not fluctuations. They are scars.

A fluctuation teaches the enterprise how to perform better against an existing criterion. A scar teaches the enterprise that the criterion itself has changed. Strategic Governance must therefore support not only learning within a governing model but governed revision of the model itself.

FLUCTUATION	SCAR
Criterion survives. The system learns how to perform better against the same standard.	Criterion changes. The system must preserve why the old standard failed and who may authorize the revision.

8. The out-of-band requirement

A second-order governance problem follows immediately. If a system is free to act, observe its own results, and redefine what counts as success, poor performance can be made to disappear by rewriting the standard. Targets are restated. Metrics are redefined. Exceptions become precedents. Nothing malicious is required; the system merely adapts its evaluation function to its behavior.

This suggests an architectural invariant: the system being evaluated cannot possess unconstrained authority to rewrite the criterion by which it is evaluated.

Strategic Governance therefore requires structural separation between execution and authority. The Constitutional Runtime Layer must preserve the governing specification, the expectation under which action was authorized, the observed consequence, and any subsequent revision to the criterion. This is not simply audit. It preserves the causal history of institutional judgment.

The checker cannot be the checked.

Authority to revise the criterion must be structurally distinct from the system whose actions are being judged.

9. Three falsifiable propositions

A strategic framework becomes a theory only when it states what evidence could show that it is wrong. Strategic Governance rests on three propositions.

Proposition 1 · Frontline Learning

Preserving ex ante expectations alongside ex post consequences should improve subsequent judgment for recurring classes of consequential decisions.

Test: decision quality should improve relative to environmental uncertainty. If organizations accumulate expectation-outcome records and subsequent judgment does not improve, the compounding mechanism is wrong or incomplete.

Proposition 2 · Path-Dependent Institutional Memory

Reality-Tested Institutional Memory should be imperfectly imitable because it is generated by the firm's own sequence of governed encounters rather than by the governance schema itself.

Test: if a competitor can copy the published architecture and achieve equivalent decision quality without accumulating comparable experience of its own, the claimed source of imperfect imitability is misplaced.

Proposition 3 · Structural Separation

Systems in which the authority defining success is structurally separated from the operational systems being evaluated should exhibit less criterion drift and more reliable learning.

Test: if systems allowed to redefine their own success criteria perform no worse on criterion drift, accountability, and learning quality, the claimed architectural necessity of out-of-band governance is overstated.

10. Knowing to Doing: what CEOs should do now

The practical question is not whether every decision should be automated or every action preserved forever. It is whether the enterprise is designing autonomous decision systems that can learn without losing accountability.

- When a consequential action occurs, can the enterprise reconstruct who authorized it, on what evidence, under what policy, expecting what consequence, and what actually happened?
- When the governing policy changes, does the enterprise preserve the judgment that preceded the revision?
- When the foundation model, agent framework, cloud provider, or software vendor changes, does institutional memory survive?
- When reality makes the old definition of success obsolete, who possesses the authority to change it, and is that revision itself on the record?

These questions move governance out of the compliance department and into strategy, and from knowing to doing. A firm that treats its models as the crown jewel will continually chase the next model. A firm that treats governed institutional memory as the crown jewel can change models while preserving what it has learned.

11. From the theory of the firm to the governance of the firm

The theories with which we began do not disappear. They become easier to connect. Coase explains an important condition under which activities move inside or outside organizational boundaries. Porter explains how differentiated activities create superior positions. Barney explains the characteristics a resource must possess to sustain advantage. Grant explains why organizational knowledge matters. Teece explains why the enterprise must continuously sense and adapt.

Strategic Governance adds the recurrent process through which judgment is produced and revised as the enterprise encounters reality. It therefore does not replace the existing theories. It connects them through time.

Autonomous AI makes that connecting function newly visible because it separates two things organizations could once afford to leave entangled: intelligence and judgment. Intelligence generates possibilities. Judgment determines which possibilities deserve commitment. As intelligence becomes abundant, the second becomes more valuable.

In the AI era, sustainable advantage may therefore belong not to the firms that possess the most intelligence, but to those that become progressively better at deciding what intelligence deserves to become action.

Governed action creates memory. Memory enables frontline learning. Frontline learning improves judgment. Judgment earns trust. Trust expands the enterprise's freedom to act.

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