

THE ECONOMY THAT KEEPS BECOMING · CHAPTER SEVEN

A Firm Read as Weather

Chapter Seven of The Economy That Keeps Becoming

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Santa Anna, A. (2026). A Firm Read as Weather. In The Economy That Keeps Becoming (ch. 7). Luminous Prosperity Inc. https://doi.org/10.5281/zenodo.23989460
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THE LICENCE

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Published by Luminous Prosperity Inc. for Haute Lumière. Author ORCID 0009-0008-3244-0306.

DOI 10.5281/zenodo.23989460 · this record's page: business.hautelumiere.life/library/the-economy-that-keeps-becoming/07-a-firm-read-as-weather/

Please cite as: Santa Anna, A. (2026). A Firm Read as Weather. In The Economy That Keeps Becoming (ch. 7). Luminous Prosperity Inc. https://doi.org/10.5281/zenodo.23989460

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A NOTE BEFORE YOU READ

This work is offered for education and leadership development. It is not legal, financial, accounting, investment, medical or psychological advice; take the advice of a qualified professional who knows your circumstances. Companies and events are described from the public record as the author understands it; characterisations are the author's analysis. Examples are illustrative, and no particular outcome is promised to any reader.

ABSTRACT

The firm in this chapter is a composite. It is called Larkfield here, it makes scheduling and records software for independent veterinary clinics, and it does not exist. It was assembled for teaching from the patterns of several small software companies, and every figure attached to it below was set by the writer to make the arithmetic clear. Where a figure comes from a public source, the source is named. Where it does not, it is Larkfield's, and should be read as an illustration. On a Tuesday in February, Larkfield's founder sits at a pale oak table in a converted mill with her two most senior colleagues and the page described in chapter 2: the First Map of Loops. Larkfield has sixty people, four hundred and ten clinic customers, and annual revenue of nine point two million dollars. Ninety-four in every hundred clinics renew each year. The founder's question is the one every leader of a company that size eventually asks. Growth has slowed, the board would like a plan, and she has three possible directions and money for one.

CHAPTER SEVEN

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A Tuesday in February

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The earlier chapters set out the theory: Brian Arthur's increasing returns and lock-in, the fair critiques of both (chapter 3), and the living-systems reading that asks what each loop carries (chapter 4). This chapter works them through on one firm, in the order a leader would use them, with the finer points that only show up in practice.

Ammanuel Santa Anna's book has a sentence worth keeping beside the page before beginning, because two of the three lock-ins on Larkfield's map turn out to be about how the firm charges:

> *Money is not neutral. It is a design system, and the design shapes the behavior.*[44]

The living-systems reading does not offer an answer to the founder's question. What it offers is a better question, and on that Tuesday the better question turns out to be worth more than any of the three directions on the table.



The first map

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The first map

The founder starts with the reinforcing loops, written as sentences.

Referral. The more clinics use Larkfield, the more clinic managers recommend it to colleagues at regional veterinary meetings, and the more clinics use it. Larkfield's own records show that thirty-eight of every hundred new customers in the past two years named a referral from an existing clinic.

Learning. The more clinics Larkfield serves, the more edge cases its support team sees, the better the product handles the odd realities of veterinary scheduling (emergency surgeries, boarding animals, mobile vets), and the more clinics it can serve well.

Hiring. The more the firm is known as a calm place to work, the easier it is to hire experienced engineers from larger companies, the better the product becomes, and the more the firm's reputation grows. The founder is less sure of this loop; she writes it down with a question mark.

Then the lock-ins.

The integration. Nine years ago, to win its first large customer, Larkfield built a connection to one particular practice-management system used by many clinics for billing. Everything since has been built on top of it. Seventy of every hundred support tickets now involve that integration in some way.

The annual contract. Larkfield sells only annual contracts, paid in advance, because that is how its first customers wanted to buy. Smaller clinics have asked for monthly terms for years.

The Thursday release. The product ships updates every Thursday evening, a habit from when the firm had four engineers and one of them preferred to work late on Thursdays. Nobody now remembers why, and the support team spends every Friday dealing with the consequences.

Finally, the El Farol question from the first map. The founder's main forecast is that independent clinics will keep consolidating into larger groups, which would shrink her market. She writes the second half of the question: if every competitor holds the same forecast, they will all chase the consolidating groups, and the independent clinics that remain will be served by nobody in particular. That observation, written in pencil on the Tuesday, changes the rest of the plan.

Testing the lock-ins

Chapter 3 offered a Lock-In Test, and its first rule matters here: treat every suspected lock-in as a hypothesis with a price on it.

The Thursday release fails the test as a lock-in. The alternative, releasing on Tuesday mornings when the full team is present, has no credible case against it, and switching costs one conversation and a calendar change. It is a habit with no reason left. The founder moves it that week. It is the smallest decision on the page and the support team mentions it for months.

The annual contract is more interesting. The evidence that smaller clinics want monthly terms is strong: requests logged by the sales team, and three lost deals in the past year where the clinic named payment terms as the reason. The switching cost is real but bounded: a change to billing, a change to how revenue is forecast, and some risk that existing customers will move to monthly and the firm will receive less cash in advance. The founder decides to test it rather than switch, which is the subject of the probes below.

The integration is a true lock-in in Arthur's sense. It began by accident, when the first large customer happened to use that billing system. Everything depends on it. It is inflexible: replacing it would mean rebuilding the core of the product. And it is plausibly inefficient: the support load suggests a more modern connection would serve clinics better. But the Lock-In Test's fifth section asks which loops hold it in place, and the answer is instructive. The integration is held in place by the learning loop. Nine years of edge cases have been handled inside it. To replace it is to lose much of what the firm has learned.

This is the point at which many firms make an expensive mistake. They see the lock-in, decide it is bad, and fund a large rebuild. The living-systems reading suggests something slower: change the loops that hold the arrangement, rather than the arrangement itself. The founder decides that every new piece of clinic logic will be written so that it does not depend on the old integration, and that the integration will be retired gradually as less depends on it. The lock-in will loosen as the loops that feed it are redirected.



What the accounts cannot see

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What the accounts cannot see

Chapter 4 introduced the Loop Audit, which asks of each reinforcing loop who acts, who receives the consequence, and whether the person acting ever sees it. On Larkfield's page, one loop stands out.

The referral loop is Larkfield's most valuable asset, and nobody inside the firm can see it working. The clinic managers who recommend the product do so at regional meetings, in conversations Larkfield never hears. The sales team records "referral" as the source of a new customer and nothing more. The engineers who build the features that clinic managers praise never learn which features those are. The loop is run-

ning, generating thirty-eight of every hundred new customers, and its feedback reaches nobody who could feed it.

Santa Anna's book describes the same blindness at the scale of a national economy, in a passage about forests:

> *In standard economic accounting, a forest has value only when it's cut down. Standing, it contributes nothing to GDP.*[45]

Larkfield's accounts treat its referral loop the same way. The loop has no line in the budget, no owner and no measure. It appears only after the fact, as revenue attributed to sales. If it weakened, the first sign would be a slower year, months after the cause.

The founder's response follows the book's prescription: suture the loop. She asks the support team to call ten clinics that referred others in the past year and ask one question, what they told their colleague. She asks that the answers be read at the next engineering meeting, unedited. It costs perhaps fifteen hours of staff time. It is the second probe below.

The evidence on what to build

That leaves the founder's original question: which of three directions to fund. The three are a version of the product for large clinic groups, a version for horse and farm veterinarians, and a payments service for clinics.

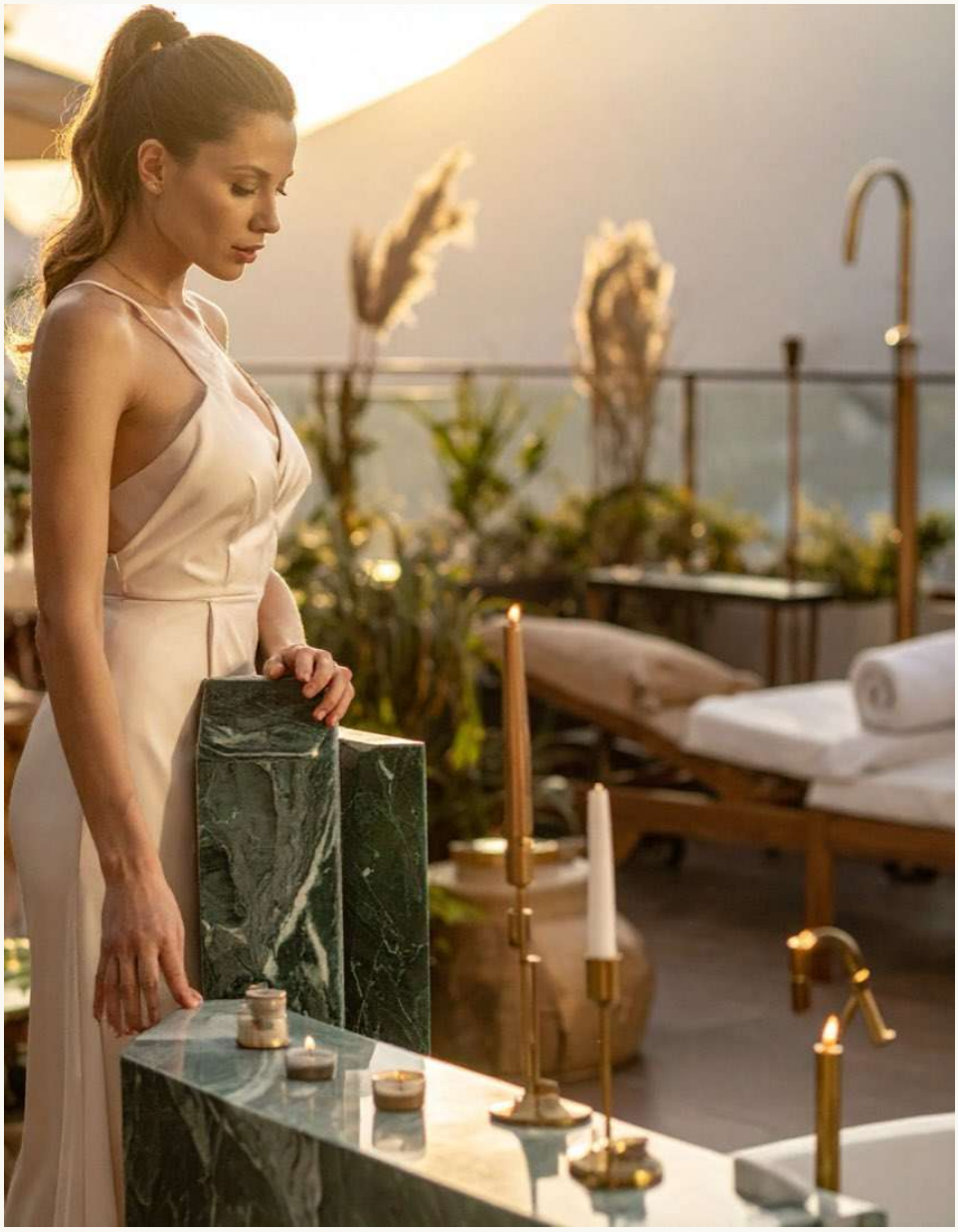
Here a piece of public research is useful, though it was not written about software firms. In 2007 César Hidalgo, Bailey Klinger, Albert-László Barabási and Ricardo Hausmann published "The Product Space Conditions the Development of Nations" in *Science*.[46] They mapped which products countries export and found that products cluster: countries that make one product tend to make others requiring similar capabilities, and countries tend to move into new products that are close, in this sense, to the ones they already make. Two years later Hidalgo and Hausmann extended the argument in the *Proceedings of the National Academy of Sciences*, treating a country's productive knowledge as a set of capabilities that combine, and showing that the diversity of what a country makes carries information about its future growth.[47]

The research is about nations, it is built on export data, and its predictive claims have been debated; it cannot tell a sixty-person firm what to build. What it supplies is a principle consistent with Arthur's path dependence: capabilities grow by adjacency. Each thing an organisation learns to do makes some next things easier and leaves others as far away as ever.

Read that way, the founder's three options sort themselves. The large-group product is adjacent to what Larkfield knows, but every competitor is chasing it, as the El Farol question showed. The payments service is far from Larkfield's capabilities; it would need new expertise in regulation and risk. The farm-vet

product is adjacent, since scheduling and records are much the same, and it serves exactly the population of independent practices the competitors are leaving. It also feeds the learning loop with a new set of edge cases, and the referral loop through a new set of regional meetings.

The founder does not commit to it. She probes it.



Three probes, twelve weeks

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Three probes, twelve weeks

The Cynefin framework, discussed in chapter 3, recommends that in complex conditions a leader *probe, sense, respond*: run small, safe experiments and amplify what works. The Luminous 100's reading of solutions-focused practice asks the question that sets the tone for doing so, which is to look first

> *where in the living system is the desired future already expressing itself, even in small ways?*[48]

Larkfield's founder runs three probes over twelve weeks, each with a prediction written down in advance, as chapter 3 recommended.

Probe one: monthly terms. Offered to new clinics with fewer than four vets, in two regions only. Prediction: at least six new small clinics in twelve weeks, against a baseline of two in the same regions over the same period last year. Stop condition: if existing customers in those regions ask to switch in numbers that would reduce advance cash by more than five per cent.

Probe two: the referral loop. The ten calls, read aloud to the engineers, then repeated monthly. Prediction: at least two features named by referrers that the engineers did not know were valued. Measure: the list itself.

Probe three: the farm-vet product. Not a product, but six clinics invited to use the existing software with a small set of changes, for free, in exchange for a weekly fifteen-minute call. Prediction: at least four of the six still using it at twelve weeks, and at least one referral from among them.

None of these is large. The combined cost, in Larkfield's arithmetic, is about four per cent of a year's engineering time and some forgone revenue on the free trial. Santa Anna's book makes a case for exactly this scale of response, writing about economic practices more broadly:

> *Perhaps, as E.F. Schumacher suggested, small really is beautiful — and the appropriate response to the scale of our problems is not bigger solutions but more solutions, connected through networks of mutual support.*[49]



What happened, in the composite

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What happened, in the composite

The results, like everything else about Larkfield, are illustrative. Monthly terms brought nine small clinics in two regions, and one existing customer asked to switch; the founder extends the probe to two more regions. The referral calls named a feature the engineers had considered minor, a single screen showing every animal boarding overnight, as the reason seven of the ten clinics had recommended the product; the next quarter's work includes making it better. Five of the six farm-vet clinics were still using the software at twelve weeks, and two had referred colleagues. The founder takes a proposal for the farm-vet product to

the board, with the probe's figures and the El Farol reasoning, and with a budget a fraction of what any of the three original directions would have cost.

The book's account of open-source software suggests why the referral finding mattered as much as it did:

> *The open-source movement is particularly significant for Ecstatic Economics because it provides empirical evidence for one of our core propositions: vitality-based motivation produces superior outcomes in complex creative work.*[50]

The engineers who heard what clinic managers valued in their work did not need to be told to improve the boarding screen. The restored loop carried the motivation with it.

The finer points, for a leader working this through in a real firm, are three. Write predictions before probes, or every result will look like success afterward. Change two loops at once where a lock-in is involved; Larkfield redirected the learning loop while loosening the integration. And put the feedback in front of the people who can act on it, unedited, rather than summarised by a manager on the way.

A household can run the same sequence at smaller scale. Map the loops (a savings habit that compounds, a commute that drains), test the lock-ins (the subscription nobody would choose again, the phone contract renewed by default), find the severed loop (spending whose consequence is felt only when the statement arrives), and probe one change for twelve weeks with a prediction written down. The tool below is written for a firm and works at a kitchen table.

The tools Larkfield used have instrument counterparts in the Alpha Papers: *Alpha Real Options* for pricing the probes as options, and *Alpha Wardley Map* for reading which capabilities sit next to which.

On a Tuesday in May, the founder sits at the same oak table with the same page. The pencil lines are still there, a little smudged. Beside the referral loop, in ink now, is a list of seven clinic names.

The Tool: The Loop Ledger

The three earlier pages (the First Map, the Lock-In Test, the Loop Audit) gathered into one ledger for a twelve-week cycle. Fill in sections 1 to 4 in week 1, section 5 in week 2, and section 6 in week 12.

1 · The system and the question

System (firm, team, product, household):

The decision on the table, in one line:

The options under consideration:

2 · Loops, with evidence

REINFORCING LOOP (THE MORE A, THE MORE B, THE MORE A)	EVIDENCE, WITH SOURCE	WHO ACTS	WHO FEELS THE CONSEQUENCE	DOES THE ACTOR SEE IT?	CARRIES VITALITY / EXTRACTION / BOTH

3 · Lock-ins, tested

ARRANGEMENT	EVIDENCE FOR THE ALTERNATIVE (GRADED)	SWITCHING COST	VERDICT: HABIT / SWITCH / TRUE LOCK-IN	LOOPS HOLDING IT IN PLACE

4 · The El Farol line

Your forecast:

What everyone else will do if they share it:

Where that leaves room nobody is serving:

5 · Adjacency and probes

OPTION	CAPABILITIES IT NEEDS THAT YOU HAVE	CAPABILITIES IT NEEDS THAT YOU LACK	CROWDED BY OTHERS' FORECASTS?	PROBE (SMALL, SAFE, TWELVE WEEKS)	PREDICTION, WRITTEN NOW	STOP CONDITION

One severed loop to suture during the twelve weeks: · route the feedback will travel: · read unedited to:

Two loops to change together, if a lock-in is involved: and

6 · Week twelve

PROBE	PREDICTED	HAPPENED	AMPLIFY / ADJUST / STOP

What the system now shows that the week-one map did not:

The next decision, and the next twelve-week date:

A note on method

Larkfield is a composite written for teaching. It is not a real company, its figures (sixty staff, four hundred and ten clinics, nine point two million dollars in revenue, ninety-four per cent renewal, thirty-eight per cent of new customers by referral, seventy per cent of support tickets on the integration, the probe results) were set by the writer, and its outcomes are illustrations, not evidence. The twelve-week cycle is this book's recommendation, not the finding of any study. Nothing here is investment advice.

A NOTE FROM THE HOUSE

Larkfield's ledger shows what a firm can learn in twelve weeks by working with its loops rather than pulling at levers. Where a loop has been severed, the gain is usually already there, waiting for the feedback to travel. Luminous Prosperity Inc. reads those loops inside organisations as a gainshare, paid as a share of the gain it helps find.

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