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Why Smart Executives Fail
And what you can LEARN FROM THEIR MISTAKES
By
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Many great corporate mistakes are due to managerial inaction as much as to inappropriate managerial action. Companies as diverse as Rubbermaid, Schwinn, Encyclopedia Britannica and the Boston Red Sox fell into serious trouble because they did not respond to critical challenges when they had the opportunity.

We didn't think we would find that executives expressly chose not to respond to change even when they knew it was happening. But, at Motorola, key decision makers had an abundance of information on the public's preference for digital cell phones, and each of the former CEO's we spoke with confirmed the Motorola executives saw the change happening but chose not to respond.

Businesses that seemed at first to have nothing in common turned out to have failed for exactly the same reasons and in much the same way. Even the excuses from failed managers turned out to be the same in case after case. As it turned out, the really devastating failures turned out to have a surprisingly limited number of causes.

THE RESULTS

I. Great Corporate Mistakes

We realized that most failed during four major business passages: creating new ventures, dealing with innovation and change, managing mergers and acquisitions, and addressing new competitive pressures.

We realized that precipitous business failures are caused by four destructive patterns of behavior that set in, without anyone noticing them, well before a business goes under. These four syndromes involve:

1. Flawed executive mind-sets that throw off a company's perception of reality
2. Delusional attitudes that keep this inaccurate reality in place
3. Breakdowns in communications systems developed to handle potentially urgent information
4. Leadership qualities that keep a company's executives from correcting their course

Chapter 2

New Business Breakdowns

General Magic, a technology powerhouse tackles a glorious technological challenge by investing billions of dollars to solve a problem that, as it turns out, few customers needed solved. Result: Iridium. One of the largest conglomerates in the world decides, or actually its CEO decides, to enter a highly competitive, capital intensive business because he want to.

On November 1, 1998, after launching a $180MM advertising campaign and an opening ceremony where VP Al Gore made the first phone call using Iridium, the company launched its satellite phone service, charging $3000 for a hand-set and $3 - $8 per minute for calls. The results were devastating. By April 1999, the company had only ten thousand subscribers. Facing negligible revenues and a debt interest of $40MM per month, the company came under tremendous pressure. In April, two days before Iridium was to announce quarterly results, CEO Staiano quit, citing a disagreement with the board over strategy. John Richardson, an experienced insider, immediately replaced Staiano as interim CEO, but the die was cast. In June 1999, Iridium fired 15% of its staff, including several managers who had been involved in designing the company's marketing strategy. By August, Iridium's subscriber base had grown to only 20,000 customers, significantly less than the 52,000 necessary to meet loan covenants. Two days after defaulting on $1.5 Billion in loans – on Friday, August 13, 1999 – Iridium filed Chapter 11 bankruptcy protection.

One of the main problems with Iridium's offering was that terrestrial cellular had spread faster than the company had originally expected. In the end, cellular WAS available. Due to Iridium's elaborate technology, the concept to development time was eleven years.

Because Iridium's technology depended on line of sight between the phones and the orbiting satellite, subscribers were unable to use the phone inside moving cars, inside buildings, and in many urban areas. "You can't expect a CEO traveling on business in Bangkok to leave a building, walk outside on a street corner and pull out a $3000 phone."

AGAINST ALL ODDS: The Tale of Samsung Motors

The announcement of from Samsung Group Chairman Kun-Hee Lee regarding the company's entry into the motor vehicle business sent a ripple through the public and private sectors of the industry.

Many believed that there were more and better investment opportunities, and that the motor business was not a good choice at all. Of course there were a lot of objections. Despite these objections, Samsung Motors pushed forward with its plan.

Background

Samsung was founded in 1938 as a noodle making company by the late Chairman Bong Chull Lee, with only 30,000 won or $30 US. Kun-Hee Lee succeeded his father in 1987. During a celebration of Samsung's 50th anniversary in 1988, the new chairman declared a "second founding" of the Group and announced his intention to expand Samsung into a leading world-class corporation of the 21st Century. Indeed, by 1999, Samsung had grown to be the second largest corporation in Korea with 47 companies in five broad industry categories (electronics, machinery and heavy industries, chemicals, financial services, and others such as hotels, department stores and a theme park) 161,000 employees, and total revenues of $93.5 Billion.

By late 1997 an economic crisis of unprecedented scale had hit the entire region. For Samsung to be competitive, it annual production capacity would have to be at least 240,000 units; however, the company didn't have enough capital to achieve such capacity without adversely affecting its finances. Even well established automakers such as Nissan and Mazda were in serious financial trouble due to declining sales and eroding market share.

To finance the venture, the company had to borrow huge amounts of capital from banks that, in turn, needed approval from the government to issue such large loans.

In the face of so many drawbacks, it would have taken a miracle for the car business to work. Indeed, the cars themselves were impressive pointing out how execution and product quality are necessary, but not sufficient, requirements for business success. Despite rave reviews, Samsung Motors sold fewer than 50,000 cars (mostly to employees) even though the $3 billlion Pusan plant was able to produce more than 240,000 per year. During the first half of 1998, Samsung Motors posted a net loss of 156 billion won and its debt surged to 3.6 trillion won compared to 2.6 trillion won at the end of 1997. Many observers believed that Lee had no choice but to give up his car-making aspirations. In early 1999, Samsung Motors went into a bank receivership and sough ways to salvage the business.

In May 2000, Samsung Motors's creditors agreed to sell 70.1% equity to Renault for $560 million. Industry analysts considered the deal a bargain, given Samsungs estimated $5 billion investment in the venture, including the $3 billion Pusan factory.

It is clear that Samsung should not have gone into autos in the middle 1990's at the peak of the local and global glut.

There is a difference between a "good idea" and a "good business idea" – in a word: PROFITABLITY.

Having owners as managers can cause all kinds of bad things to happen. In interviews with Korean managers, all unanimously agreed that Samsung had blindly entered into the automobile business. They claimed that the majority of the Group's employees, including many managers, opposed the idea because it wa believed that going into the overcrowded auto market without any existing competency in producing and selling cars was too risky.

Regardless, Lee's leadership was so strong that executives and managers at Samsung were unwilling to challenge his decision. One added, "What could they do? Samsung is virtually owned and managed by Lee and nobody could have stopped it.

Attention to value creation often lags when CEO/Owners call all the shots. In a world of checks and balances, when there is no real countervailing force to a CEO, individual preferences prevail and can dominate.

The Schwinn Bicycle Company made it to the fourth generation until a combination of narrow-minded decisions by CEO Ed Schwinn brought it to ruin (and bankruptcy.) "With Eddie Schwinn's huge ego, the company was run into the ground. He started outsourcing in China, and while the quality was poor, Schwinn eventually ended up teaching them how to make bikes, and as the same time allowed Giant (the Chinese supplier) to become a formidable competitor of Schwinn."

Even with enormous capital, you might not win.

When build-out costs are in the billions and customer demand is lagging far behind, businesses die. To say that eventually enough customers will come on board to justify the enterprise is to place a project's implicit cost of capital near zero. No business survives without customers, and when they don't come to play, the clock keeps ticking anyway.

Pearl S. Buck wrote in What America Means to Me that "Every great mistake has a halfway moment, a split second when it can be recalled and perhaps remedied." This is particularly true for ventures with long concept-to-development times. These projects may seem to be good investments during initial concept development, but by the time the actual product or service comes to market, both the competitive landscape and the company's ability to provide the service or product have often changed significantly. One approach to this problem is to evaluate these ventures as real options.

Management matters, a lot.

New ventures, like old ventures, depend on management. What we don't know is how much so. The principal-principal problem has been a disaster for many companies precisely because of the considerable direction CEO's have in making new ventures work. Yet, two critical issues seem to keep coming up in the new ventures we studied that place managers not as the solution, but as the problem: the remarkable tendency for CEOs and executives of new ventures is to believe that they are absolutely right, and the tendency to overestimate the quality of managerial talent by relying on track record, especially in situations that differ markedly from the present new venture.

When you start believing your own hype (something venture capitalists call “sucking your exhaust”), real problems can happen. Hype doesn’t buy you much – unless you want to wake up competitors and encourage your own people to become complacent. CEOs should come with the same disclaimer as mutual funds: Past success is no guarantee of future success.

There is a natural tendency to attribute the success of a company to its leaders. Celebrity CEOs and dream teams are no replacement for the basics of business; a logical business model, attention to real customers, development of valued capabilities, and effective competitive strategy. There are no guarantees in business, but we can safely say that CEO and management teams that aggressively focus on these core issues will be a better bet than those that don’t – regardless of how many times they’ve been on the cover of Business Week.

Two thoughts:

1. Don’t fall in love with your product or service. That’s your customers’ job
2. Expect the unexpected

Chapter 3

Johnson & Johnson and the Stent Business

Pushing short term profits at the expense of long term reputation and market position cannot be a good thing. We know it, and J&J knew it, so why did it happen?

There are three explanations:

1. Live by the merger, die by the merger
2. corporate arrogance and complacency
3. Not understanding customers and competitors

Growth in its medical sector business actually came from acquisitions three times as often as it did from internal development.

Guidant CEO Ronald Dollens told us, “Where are the horses to regenerate the product? After the merger, people are ready to cash out and don’t retain that competitive edge.”

Moving to an A&D (acquisition and development) philosophy is not a bad idea if you are aware of the inherent limitations to this approach. As long as there is a commitment to continue buying new product ideas from inventors and entrepreneurial companies, this approach can work. But, don't assume that old acquisitions are automatically going to generate new ideas.

The stent was a blockbuster product. It "took off so fast the company did nothing but spend their energies trying to make it. They were making stents that within forty-eight hours were implanted in patients. They could hardly keep up." It's not hard to see how complacency creeps in, especially when things are going well. With time, J&J has recognized these mistakes. Former CEO Ralph Larsen acknowledged, "We stumbled on this one … this isn't the most glowing example of our success." Robert Croce told us, "You've got to … innovate and stay ahead of the game and never get complacent."

The threat of entry into the US market by a competitor stent was significant, yet JJIS didn't see it. The notion that customers and competitors should be taken seriously is not a particularly difficult one to understand, yet companies we studied fell into this trap time and time again.

What Happened to Rubbermaid?

Rubbermaid's trademark and core competence – product innovation – was at the root of the company's success. Innovation and speed of roll out gave Rubbemaid a monopoly in many product categories, allowing it to firmly establish its products before competitors could even copy the designs. By late '80s Rubbermaid produced over 365 products per year. The core of that process – intense consumer contact, little market testing and cross-functional teams – created a killer combination of speed and innovation.

If you were making commercial kitchen products, you spend weeks at McDonald's learning what products were needed and how they were used.

The 1990's brought a shift in power from manufacturers to retailers as consolidation took hold. Powerful retailers such as Wal Mart – which accounted for 14% of Rubbermaid's total sales – were demanding, and getting lower prices, higher service levels and just in time delivery. At the same time, Rubbermaid's bargain priced competitors were making substantial strides in product quality and moving more quickly to replicate the company's new, innovative products, giving retailers a real alternative to Rubbermaid.

The Meltdown

How does a company go from "Most Admired" in Fortune's annual survey to number one hundred three years later? The answer – in the case of Rubbermaid – was a desensitized leader who missed the most telling signs of change in the industry, and an organization so wedded to the past that it had become slow, unresponsive and stagnant.

With this single minded devotion to innovation, Rubbermaid lived for decades in a cushy world of premium prices, ineffective competition, and malleable customers. Suddenly, (actually it was more of a decade long change) the strategy collapsed as newly powerful customers, retailers, demanded better prices and services that energized competitors were more than happy to provide.

With less differentiation in quality or features, the basis of competition turned to price, which Rubbermaid was not prepared for.

Neglected manufacturing and distribution

After years of product proliferation, Rubbermaid's production and distribution systems became a morass of complexity and inefficiency. Delivery and fulfillment were equally inept. On-time deliveries were as low as 75-80%, disrupting customer' JIT inventory and management systems. "They've been such lousy shippers. Not on time, terrible fill rates and their products cost too much. They show you a new product line and then tell you they can ship only a third of what you want."

One of the more remarkable findings from our research is how often great companies stumble.

Motorola and the Cell Phone Business

The story begins in 1928, when the Galvin Manufacturing Corporation was found by brothers Paul and Joseph Galvin. Two years later the company launched the first practical and affordable car radio under the brand name Motorola, which blended Motor and Victrola. From this start, Motorola developed a series of innovations ranging from the first hand held two way radio for the US Army (The Walkie Talkie of WWII) to the first television to sell under $200 (in 1948). The company launched the world's first pager, which became an instant hit in hospitals. Then came cell phones.

Cellular telephony was developed by Bell Labs in the '70s, but it wasn't until companies such a Motorola built their own capabilities that the business took off. As former CEO Robert Galvin said, "We were the unbridled leader in analog devices around the world." From 1922 to 1995, Motorola seemed to prove that even a huge company, if managed correctly, could rack up impressive growth, as revenues grew an average of 27% to $27billion in 1995, while net income surged 58% a year over the same period to $1.8 billion.

The shift:

As a rule of thumb, digital networks could accommodate around ten times more subscribers than their analog counterparts for a given chunk of radio spectrum, due to the easy to manipulate (and compress) characteristics of digital technology. In essence, digital technology would spread fixed costs over a broader user base. It was this attribute that made it so attractive to service providers.

Without a digital phone to offer telephone carriers, Motorola pushed hard to move its analog phones, creating considerable resentment from some customers. Motorola had the capability to make digital cell phones and had extensive data to indicate the market was demanding digital. It could have competed from the start, it not won the digital cell phone wars, but chose not to.

It turns out that people and organizations conspire to sometimes produce irrational behavior, as they sometimes do brilliant behavior.

"Some of the leadership in the business at that time was focused too much on the short-term profits and they weren't spending enough for the future."

Gary Tooker, former CEO, Motorola on July 5, 2001

There is more to the story than just that. For years, the company followed highly decentralized management system, with significant delegation of responsibility to the operating businesses. While such autonomy often breeds focus and attention to detail, at Motorola it also created a "company of warring tribes" that was exacerbated by strong division based incentives. First the warring tribes mentality disrupted coordination across divisions, so Motorola lost considerable time when it decided to develop the chips necessary for digital cellular in-house instead of outsourcing.

Second, like many decentralized organizations, Motorola relied on division based incentives to motivate divisional managers. "Decision makers thinking (in the cell phone division) was colored by the up-front costs they would entailed by shifting from analog to digital." Motorola's compensation system created a short-term disincentive to take on the costs of the transition to digital cell phones.

In the end, the Motorola story brings us right back to leadership.

History Counts!

If you really want to understand a company, you need to understand its history. "Every time we stumble significantly, it is because we have been so successful in one generation of the technology that we don't focus on replacing ourselves with the next technology quick enough." Every company needs a "healthy spirit of discontent."

Inertia pervades all sorts of organizations, shutting down opportunities to adapt and change in accordance with new demands. If you get the feeling that your company seems like its sometimes stuck in the mud, you're not alone.

Corporate Kills

Corporate is responsible for such activities as setting the core principles that govern how the company and its managers and employees should conduct themselves, hiring and firing business managers, reviewing the work of business managers, approving budgets and strategies, and allocating resources, among others. Nowhere in this "To Do list does it say that the executives should install dangerous incentives, abrogate responsibility for oversight, or micromanage business managers, yet these are precisely the pitfall that create organizational rigidities.

It is remarkable how often corporate got in the way of innovation and change in the companies we studied.

… key decision makers knew that their world was changing, yet chose not to respond in a timely fashion – sometimes not at all. Executive after executive, when faced with severe challenge, chose not to cope.

Innovation is not a thing that just happens. It is a natural outgrowth of a culture of open-mindedness, and a CEO who is not a central player in that game will find the innovation challenge much more difficult. As a one time CEO of Pepsi, Andrall Pearson said, "Innovative companies are led by innovative leaders."

Mergers & Acquisitions – Chapter 4

Snapple was Not Gatorade

It is human nature to want to return to the site of your greatest victories and relive the experience all over again. This is nowhere more true than for CEOs of large, complex businesses – people who remember clearly the accolades for a past success and, even more importantly, the personal satisfaction that came with that success.

Yet, it is by looking to the past that many companies stumble, particularly when they believe that the lessons of the past will apply equally to the present. The past for Quaker was the highly successful expansion of the Gatorade brand after 1983.

What they did not see is all that was different between the products. Snapple was an image drink while Gatorade was a fluid replacement product; Snapple's success was based upon quirky marketing that created a cult drink, while Gatorade was aggressively segmented and promoted in a more traditional fashion; Snapple relied on entrepreneurial distributors, while Gatorade used a warehouse system. As former Triarc CEO Michael Weinstein told us, "Quaker believed he Gatorade model could be applied to Snapple, but this just scared the system. Smithburg never got it."

Sony Goes Hollywood

Masaru Ibuka and Akio Morita founded Tokyo Tsushin Kogyo (Tokyo Telecommunications Engineering Co.) in 1946 with a mission to be "a clever company that would make new high technology products in ingenious ways." With the development of the transistor, the cassette tape and pocket sized radio by 1957, the company renamed itself Sony, from the Latin word sonus meaning “sound.”

What can we learn from Sony’s acquisition of Columbia Pictures? Yes, they sunk a tremendous amount of money into the movie studio, and yes, they did abdicate management and even oversight to two Hollywood insiders that ended up costing them even more money. But consider the logic behind the deal. Remember that Sony – then as now- is first and foremost a hardware company, yet it believed that the establishment of a new hardware technology required availability of related software demanded by the marketplace.

The Saatchi & Saatchi Vision; To be Number One.

What does it mean to be number one? For S&S, being number one was a code word for being on top of the world, beating everyone, and making sure that everyone knew you had won. To be number one was to be bigger, better, more powerful and more dominant than anyone else.

What do you do when your vision is to be number one? They never said number one in advertising, they just said to be number one. You may very well ask, “What is the point?” In their case, “Their greatest desire was to be talked about.” But it was apparent that their vision had no bounds. In their case, “It’s not enough to succeed, others must fail.” Their decision to be number one overwhelmed everything else. As the focus on growth and nothing but growth took off, fundamental mistakes in mergers and acquisitions followed. With leaders at the top pushing to be number one, and incentives created for senior executives to make deals, the firm made one acquisition after another, yet never developed a competency in M& As. It is a story of vision without restraint, driven by intense ambition and striving ego, and a cautionary tale for other CEOs possessed by boundless competitive instincts and overwrought vision.

All synergies are not created equally. The first lesson you must remember about synergies is that they are almost always much more difficult to realize than they appear. The more significant the synergy potential, the more momentous the challenge. When synergy potential is modest, as it might be if two companies share few activities or customers, achieving these benefits will be relatively straightforward. For example, combining treasury and legal services isn’t difficult, though its yield is limited. As synergy potential becomes progressively more encompassing, the complexity of reaching the pot of gold increases.

Synergies that are difficult to attain, and hence will take longer to realize, are not worth as much as those that are more immediate.

How Do You Know if the Acquisition was Wise?

Acquisitions should only take place when they advance the overall strategy of the company in compelling ways. CEOs must be able to convincingly say, “By making this deal we will improve our competitive position in the marketplace.”

The second test is whether the combination of assets will create more value than it destroys. Richard Parsons, CEO of AOL Time Warner, had this thought front and center when he said during a crisis in 2002, “The whole should be – and will be, under this management team – greater than the sum of its parts.”

Key questions to ask are:

- How will you as a corporate parent generate the expected synergy benefits
- In what ways might you destroy value
- How can you minimize those costs

Is your acquisition justified? There should be absolute clarity within the organization on the purpose of the acquisition and why it is important. Not only will you motivate people, but an acquisition justification can serve as a beacon to point the way during the problems, complexity and confusion that inevitably occur during integration.

Is your core competency in M&A? Successful companies develop critical core competencies that drive their competitive strategy.

Is your M&A strategy tailored to your organization? The appropriate strategy for any company is one hat is tailored to its own capabilities, people, and overall competitive strategy. What is needed in another company is not necessarily the same as in yours.

Do your due diligence:

Due diligence is all about the details, and they are often there for the taking. Along with massive publicly available data on public and many private companies, there is nothing to keep a prospective acquirer from conducting its own data collection. How many people work at the target’s factory? Count the cars in the parking lot. What do a target’s office buildings look like on the inside? How solid is the target’s finances? Look at the red flags such as cutbacks in new project investments, reductions in advertising, and other discretionary expenditures, and open jobs not being filled. How good are the target’s products and services? Buy them, use them, reverse engineer them. What do suppliers, competitors, distributors and customers say about them? Ask them.

Script the first fifteen plays.

Like legendary former SF 49er coach Bill Walsh, laying out the first integration moves in advance opens up more management time and thinking space to deal with the issues and problems that could not have been anticipated in advance. Among the most important of these plays is inevitably the first payroll. There is no better way to signal to employees of the acquired company that you don't care about them than to mess up their first paycheck.

Prepare for the unexpected.

If there is one certainty about integration, it is that the unexpected will occur. To help fight the inevitable fires that break out, it sure helps to have talent in reserve, as Eaton does with its "navy seals" teams ready to move to unplanned trouble spots to put our fires.

We don't need change.

Most people tend to prefer stability to change. It may be no surprise, then, that classic denial has found a place in acquisition lore.

Special efforts are required to avoid losing customers after a deal. To protect themselves, Eaton appoints both integration manager and operating managers to help ensure that attention does not get diverted away from customer during integration activities.

Employees.

There is a real risk that some of your most valuable people will see the merger as an opportunity to go elsewhere. You cannot afford to neglect key people. The primary question asked by most employees during an acquisition is, "What happens to me?" Your response is the lens through which they will evaluate their personal decision to stay or to leave, to fight and disrupt or to accommodate and adjust.

Chapter 5 – Strategy Gone Bad

Doing the Wrong Thing.

Strategy is what a company does or does not do, to fulfill its vision in a competitive marketplace.

There are three things you should know about strategy:

1. To have a solid strategy, you must know the "who, what, and how" of your company. Who are you selling to? What are you selling? How are you selling it?
2. Strategy is just as much about what you decide not to do as it is what you do. If you try to do everything, then you don't really have much of a strategy. This is one of the toughest things for executives to grasp.
3. Not all strategies are created equal. Strategies should be based upon real internal competence that customers value enough to pay for and that competitors cannot easily replicate.

Blinded by the Light – True Believers in Trouble

We are driven by a natural desire to avoid uncertainty, so when we see certainty in direction and action – certainty in strategy – we're impressed. But certainty is not all it's made out to be. How many times have we seen executives in organizations fully ensconced in a world of their making … while the rest of the world goes off in another direction?

Snow Brand was so concerned about meeting its profitability targets that managers felt bound by no constraints. Cutting corners was acceptable and senior management had little interaction with what was going on in the production plants. Even after the milk scandal was well established, Snow Brands CEO let other executives take responsibility without stepping up himself.

The Boston Red Sox created an organization that clung to its racist tendencies while other teams were slowly adapting. What was missing was a clear signal from the top that such behavior was no longer acceptable or at least was going to be viewed as counterproductive.

There is real danger in the status quo and the risk is highest when true believers take over the organization.

The culture of the company, along with the strategists who pull the levers, are the two soft spots in strategic analysis that are the leading indicators of action or inaction. If you understand An Wang and his demons, then you know a lot about what Wang Labs is going to do. If you understand the history and culture of the Boston Red Sox, you are a little less surprised that they are the last major league team to integrate. Take a close look at your culture and strategists – they provide a true reflection of your company's strategy.

Moving Forward

Why do fundamental execution errors continue to occur? Why do successful companies have so much trouble questioning their own actions? Why do organizations adopt systems and procedures that destroy rather than create value? Why are many leaders not just unable to cope with change, but also seemingly unwilling to deal with change? What are the clues that can warn us of potential trouble to come? Why do leaders and organizations find it so difficult to learn from their experience? And above all, how can we develop leaders and organizations that in don't keep making these mistakes, that don't fall into the traps that exist in every

organization, and that can rise up above the noise and confusion and chaos of everyday business to excel rather than fail?

Things to remember about strategy and managing competitive threats.

- Competition is nothing more than a group of people in another company who believe that they can offer something to customers that is superior to what you presently offer. Paying attention to what those competitors are doing for your customers is critical.
- There are many ways to assess your strategic position in a marketplace, but something as simple as the "who, what how" framework can be powerful. Who are you selling to, what are you selling to them and how are you selling it?
- To understand the strategy of a company, you need to understand the strategists. Without knowing about An Wang's history, could you really understand why his company made the decisions that it did?
- Do you view your competitors as worthy opponents? Beware of the overconfidence that can come with being a market leader. There are too many examples of industry leaders losing position to newcomers who weren't accorded adequate respect.
- Listen to all sources of information you can find in deliberating on strategy, especially salespeople who are in daily contact with customers. Access to diverse sources of information is valuable to avoid becoming a company of true believers who disregard data that might tell another story.
- Executives who run into trouble tend to rely too much on their own personal preferences that are not backed up with sufficient supporting evidence. GM's robotics solution was based on assumptions that would not have been supported if debated openly.
- Pay special attention to struggling CEOs trying to turn around a desperate situation with one well timed initiative or decision. Often the result will be even worse.
- Don't assume that managers left to implement a senior executive's strategy will actually do what was originally intended. As happened at the Boston Red Sox and Snow Brand Milk, their goals, motives and methods can lead them badly astray. Leadership at the top is one of the best ways to establish common principles that managers can rely on in doing their jobs.

Part II

The Causes of Failure

The four destructive syndromes we discovered were breakdowns in how executives perceived reality for their companies, how people within an organization faced up to their reality, how information and control systems in organizations were mismanaged, and how organizational leaders adopted spectacularly unsuccessful habits.

Chapter 6

Brilliantly Fulfilling the Wrong Vision

The special Forces moved in with remarkable efficiency. Every phase of the operation had been planned in advance. The soldiers couldn't predict exactly how the opposition would respond, but the alternative scenarios had been thoroughly rehearsed. Each time an unexpected obstacle arose, the team know how to handle it. Their high tech communications system kept them in constant contact with each other. Their weaponry was devastating. By the time the operation was over, they had killed or captured everyone in the base they were attacking, suffering few casualties. There was only one problem: The base they had captured belonged to friendly forces. The Special Forces neutralized the personnel they were there to support.

How did this happen? One suggestion was that the Special Forces had been dropped off at the wrong town. Another suggestion was that the target had been chosen by aerial reconnaissance with no one on the ground verifying the choice. Still another suggestion was that the base had been occupied earlier by enemy forces, but that the battle lines had recently changed.

Whatever the source of the error, the soldiers carried out the operation brilliantly. They were simply operating with a picture of reality that was obviously inaccurate.

Most business failures are like that. The real problem is that the company was carrying out the wrong operations. The real causes of nearly every major business breakdown are the things that put a company on the wrong course and keep it there. But there is one blind spot that appears somewhere near the center of almost every major business disaster: a seriously inaccurate perception of reality among executives.

The Magic Answer

The most seductive of all strategic mis-intentions is the "magic answer." This is what managers have fallen for when they let all their decisions be guided by one principle they believe is the secret to success. Pursuing the magic answer leads managers to focus on one principle or one model to the exclusion of all others. It encourages one big bet that is often the wrong one.

Most magic answers attribute excessive importance to one single causal factor.

A Holy Grail

A Holy Grail in business terms, is a strategy that remains forever unattainable. Unlike a magic answer, which attributes excessive importance to one single causal factor, a Holy Grail attributes overwhelming importance to a causal factor that doesn't even exist! They are usually remarkable, but the truth is that they don't exist.

The Wrong Scoreboard

A wrong scoreboard is simply an inappropriate measurement of success. A company using the wrong scoreboard might have a fairly realistic idea of what it is trying to do in other respects, but it has chosen the wrong indicator to judge how well it is doing. Any time company executives put too much emphasis on a barometer that doesn't accurately reflect its true level of success, the company risks doing itself damage.

The most common example of wrong scoreboard is market share. In many contexts, of course, market share is an important indicator of how well a company is doing. But it doesn't measure the value a company is actually creating, nor the value it can capture.

A Different Game

A company's perceptions of reality often become obsolete not because times have changed, but because it has moved into a new area where its version of reality is no longer valid. In an attempt to leverage its core competencies, it will attempt to apply those competencies to another market that seems on the surface to be very similar.

Toro went from building lawnmowers to manufacturing snow throwers, a natural extension of product directed toward potentially similar customers. Yet, the surface similarities – seasonal market, midrange price, homeowner customers – masked a simple, yet critical, difference.   Grass grows, but snow does not always fall. Then, despite one snow-less winter, Toro continued to make snow throwers, only to be hit with another season without snow. As former Toro CEO David McLaughlin said, "We were blind to the risk."

Make Sure Your Company's View of Reality is Valid

What seems obviously false with the benefit of hindsight seemed obviously true at the time. IN fact, most cases, the false reality seemed so obviously true that no one thought to question it.

This is perhaps the biggest lesson of all. If you want to catch your company before a mistaken picture of reality has done too much damage, you have to stop and question the things that seem obvious. You have to take the prevailing assumption, the things that go without saying and scrutinize them to see if they are really true.

But there is still something else to consider when it comes to evaluating pictures of reality – how long the reality will remain valid.

To prosper for an extended period of time, a company needs to have an adequate understanding of what parts of its reality could change. What are the most common ways in which our perception of reality could be wrong?

The Wrong Competitors

One of the simple ways in which businesses inaccurately predict change is by focusing on the wrong competitors. Usually, this happens because executives assume that the companies that have been their main competitors in the past will continue to be their main competitors in the future.

A Static Business Model

This means that they behave as though business in the future will follow the same models it has followed in the past. When a big change does occur, requiring the company to adopt a new business model, these executives are left totally unprepared.

Making Sure Your Company's Predictions of Change are Realistic

Making sure that you've got an accurate picture of reality means verifying that the facts you assume to be true really are true. Making sure that you've got an accurate picture of what could change means making allowances for things you can't know. It means distinguishing between business conditions that, for better or worse, are likely to remain the same and those that, for better or worse, are likely to change.

There are five questions that can help you to verify that your company is predicting change accurately. Answering these questions is less a matter of collecting new information than a matter of being open to new possibilities.

1. Have you taken into account the possibility that several unlikely events could occur at once?
2. Have you distinguished between projected innovations that require routine engineering and those that require new discoveries?
3. Have you paid enough attention to the small-scale level at which large-scale changes must be implemented?
4. Are you focusing on the right competitors, especially newcomers?
5. Have you given enough consideration to the ways in which your entire industry could suddenly be transformed or become irrelevant?

Chapter 7 – Delusions of a Dream Company

Many of the executives whose business figure prominently in this book were not only arrogant – they were proud of it. People who dealt with GM and IBM in their glory days remember vividly the condescension with which these companies regarded everyone outside their ranks. Daimler-Benz had the same reputation more recently. Saatchi and Saatchi was the probably the most arrogant ad agency the world has ever seen. The explosive growth of Mossimo, Oxford Health Plans and LA Gear was partly fueled by a belief that they were "rewriting the book" for their industries and hence, had little to learn from anyone. Webvan, Etoys, and most of the other dot coms made little secret of the disdain they had for traditional businesses.

Iridium's arrogance was positively stratospheric, reaching, in fact, all the way into space. The air of superiority such companies adopt gradually affects the way people inside the company behave, even among themselves.

"We're Better Than You Are. Period!"

An Wang and his engineers at Wang shook their heads dismissively at each new product IBM introduced because they found these products so technically inferior to their own.

In addition to being unable to learn from other firms' successes, companies with this attitude have no way to learn from other firms' failures. They attribute such failures to the other firm's overall inferiority. They didn't recognize that these failures are often due to errors any firm could commit, and that these errors need to be consciously avoided.

"You can't argue with success." And, as long as the company appears to be successful, there is little motivation to change. But, by the time it becomes undeniably obvious that the old model isn't working and won't start working again soon, the company's fortunes are often past reviving.

Somewhat surprisingly, the same sense of mission that can lead a company to resist change can also lead it to make changes no one has asked for.

We Don't Need Customers Telling us How to Run Our Business

The single worst aspect of this excessive loyalty to the company mission is that it prevents companies from hearing what their customers are trying to tell them.

Having a "we are the experts" culture is a problem that can afflict any kind of company, high tech or low tech, if it has a vision of excellence that takes on a life of its own. Even Starbucks, which has so far avoided the qualities of a zombie business, had a brush with this kind of thinking some years back when customers asked for skim milk in their coffee lattes. Senior executives argued that Starbucks high quality, dark roasted coffee did not taste as good with skim milk. One executive even said that offering skim milk, "is not in keeping with the quality of our coffee. That is bastardizing it. It's getting tot he point that we'll do anything the customer wants us to."

Businesses that let their sense of mission take precedence over everything else don't just pay insufficient attention to their customers; they also pay insufficient attention to their suppliers, and this can be just as big of a problem.

Numerous dot coms failed to listen to what their suppliers were telling them about the costs of actually delivering what the dot coms were selling. Like hundreds of other companies blinded by their own vision, each of these organizations moved inexorably toward disasters hat could have been reduced or avoided if their executives had listened to what their suppliers were saying.

The swiftness with which a company will be called to account for not listening to customers and suppliers will depend on its competitors. Johnson & Johnson demonstrated this dramatically in its stent business. Cardiologist customers had asked for circulatory stents that were comparatively easy to handle, they were flexible, and that came in varying lengths. But J&J's 90% market share and its "we are experts" culture prevented it from paying sufficient attention to its customers' requests.

No Negative Feedback, Please.

A relentlessly positive attitude shuts our critical information from outside the company. In addition to shutting out crucial information from outside the company, relentlessly positive attitude suppresses the most crucial information from inside the company. People will avoid mentioning unsettling information or ideas because bringing up such things sounds negative

Any innovations that could result in big improvements will have to come from senior management because everyone else will be uncritically doing what they've been told.

Telling Everyone Will Just Make Things Worse

When people are scared to draw attention to unwelcome information, it's a slippery slope to becoming involved in cover-ups.

Never Settle for Less than Perfect.

When companies adopt internal metrics, they tend to settle into an almost irrational perfectionism. They aim for high standards in every operation without stopping to ask if these standards are appropriate. This determination to excel, regardless of whether it serves any business purpose, can easily get out of control.

As former IBM CEO Lou Gerstner said in evaluating the problems that beset IBM as it moved into its period of decline. "My view is that the company had been so successful for so long it stopped comparing itself with competitors and started gauging itself by internal measures. That's a recipe for trouble.

The only way to find out if a new product or a new business model will work is to try it out. Companies in the grip of perfectionism are unable to recognize this. They can't distinguish between failures due to negligence and failures due to something innovative that didn't pay off yet. So, they tend to punish the "failures" associated with exploring new possibilities, taking reasonable risks, and offering innovative solutions. In the worst cases, these companies make a habit of finding someone to "take the fall" for each failure. These policies discourage the kinds of innovation that companies most need to stay competitive and profitable.

Perfectionist companies are especially prone to excuse their failures by blaming them on "unforeseeable events beyond our control." They'll argue that failure was due to an unlikely combination of factors that won't happen again for a long time. This would mean that, however large the failure may have been, it wasn't anyone's fault and there's no need for major reforms

Protecting Your Company from Company Pride

First, if you want to prevent your company from turning into a zombie, you have to counteract any tendency on the part of employees to congratulate themselves too often.

In addition to making a general effort to avoid excessive pride, there are a number of specific tactics a company can employ to protect itself from complacency. One tactic is to create internal advocates for the competition. These internal advocates are people inside the company whose job is to appreciate or champion other firms' strategies and technologies, and present arguments for adopting them. Such advocates are usually most effective if they work in teams that can support each other's efforts.

It's also useful to have someone inside your company watching to see what can be learned from competitors' problems and failures.

An even more effective tool for bringing in new ideas and new practices is to launch joint ventures with partners who have very different strengths. To benefit as much as possible from these joint ventures, your company needs to make clear to its employees that a major goal of the joint venture is to maximize learning from the partner company.

Protecting Your Company from its Own Idea of Excellence

Michael Dell said, "You have to be self-critical to succeed. If you sat in on our management meetings, you would find that we are a remarkably self-critical bunch with a disdain for complacency that motivates us." Bill Gates issued similar warnings, "Companies fail when they become complacent and imagine that they will always be successful."

The answer according to such leaders, is to stay alert for information that could signal how the company vision might need to be changed. This means constantly making sure that the improvements the company most wants to provide are the ones that customers most want to have. It means never creating new offerings simply for the sake of creation, but always considering customer needs.

Protecting Your Company from Its Positive Attitude

Even if executives are in close touch with customers, there is no way they can spot all the developments that might have a drastic effect on the company's future. This means that it is extremely worthwhile to reward any employee who finds flaws or potential problems in the company's policies and procedures.

Once you know potential problems, you have to bring them to the attention of the people who need to act on them.

Protecting Your Company from Perfectionism

In rebuilding IBM, for example, Lou Gerstner said, "The first thing we had to do is reorient ourselves from a highly introspective view of the world to an obsession with the marketplace, both customers and competitors." Giving IBM a more realistic idea of where it was genuinely delivering value was a key step in bringing it back from disaster.

Protecting Your Company from Too Much Team Spirit

One technique for fostering dissent is to request a minority report whenever the company is considering an important new course of action. The job for those drafting this report is to make a strong case as possible for whichever alternative seems to be the second strongest candidate. This practice tends to expose unexpected aspects of each course of action.

Another technique is to build these contrasting visions into routine operations so that, much of the time, minority reports aren't even needed. One of the most effective ways to do this is to create cross-functional teams and diverse work groups whose members will see things differently. Such heterogeneous groups have been shown to be much better than homogeneous groups when it comes to developing new knowledge.

Policies and Techniques to Keep Your Company Responsiveness to Outside Developments

Compensate for Company Pride

1. Create internal advocates for strategies and technologies introduced by competitors and by other outside firms that are tackling analogous tasks.

2. Give someone the job of monitoring competitors' missteps and making sure that they're avoided
3. Use partnering to bring in new ideas and new practices.

Compensate for the Company's Vision of Excellence

1. Make sure that the improvements the company most wants to provide are the ones the customers most want to have.
2. Make each top executive personally responsible for dealing with important customers.

Compensate for the Company's Positive Attitude

1. Reward employees who can find flaws or potential problems in the new company's procedures
2. Make heroes of the "Paul Reveres", who ride through the company warning that "the British are coming."

Compensate for Company Perfectionism

1. Change goals when the old goal is being fully met, rather than simply "raising the bar."
2. Get senior managers to set the example when it comes to acknowledging and learning from failures.
3. Use external benchmarks, especially for routine operations and centralized support services.
4. Use devices such as "Mistake of the Month" to reward experiments that are unsuccessful when it comes to producing financial returns but highly successful when it comes to producing knowledge returns.

Compensate for Team Spirit

1. Request minority reports and reports that aim at presenting the strongest contrasting position.
2. Create cross-functional teams and diverse work groups whose members will see things differently
3. Seek critical evaluations from genuine outsiders
4. Preserve potentially innovative groups, so they can support each other's efforts.

Compensate for Public Relations Reflexes

1. Keep the liability lawyers and public relations people out of basic planning and decision making
2. don't think in terms of "damage control". Think instead of eliminating the damage and its causes.

Chapter 8 – Why Businesses Don't Act on Vital Information

This is a major puzzle. It's not plausible simply to blame the size of the bureaucracies involved. It's not convincing, for example, to say that the organization in question simply had too many layers, or that it was swamped with too much information. Many huge corporate and governmental organizations, with may superfluous layers, still manage to cope with awesome quantities of information every day. Information that points to the possibility of a major disaster should be relatively easy to flag and to handle with special dispatch.

Information, What information?

The first step in following the information trail is to look at what happens o the information when it first comes to the attention of any employee. Usually, the vital information will enter the system not once, but many times. The employees who receive information will typically have several opportunities to assess its importance. The crucial question then is: Does the employee who is likely to receive the information have a basis for recognizing that it is truly important? Does the employee, for example, know that the danger signaled by the information is a real possibility?

All too often, employees are slow to recognize the importance of new information because no one has ever shown them that they need to take the implied danger seriously. It never occurred to Coca Cola employees, for example, that a handful of complaints from school children in Belgium could represent a serous threat to the value of Coca Cola brand in Europe and even, to some extent, around the world.

Once employees recognize the importance of some information they've received, they need to know where to direct it. Often the employee's immediate superior will be no better equipped to deal with the information than the employee. The appropriate person to take charge has to be someone who can act on the information or who can get the information quickly to another person who can act on it. When there's a lack of clarity about who's responsible for what, especially outside the employee's own department, this in itself can prevent a vital piece of information from being acted on until it's too late.

I Have It; You Need It; Now What?

The result is that many companies can't act on vital information because there are no regularly established communications channels between the people receiving the information and the people who need to act on it.

To make sure that crucial information has some chance of being acted upon, an organization should establish a way to flag any potentially vital information so that it gets special attention. There should be an easy way for ordinary customers and employees who would know about possible problems to get their observations directly to senior management. Confirmed information with the potential to affect several departments should be automatically forwarded to those departments. Then the person responsible for making sure that the information is acted upon should follow up with a phone call. Once the relevant person receives the information, that person has to accept responsibility for the vital information and agree to take appropriate action.

Missing Motives or Why Should I Tell You?

This brings us to motivation. If employees know how to recognize and direct vital information, and if communication channels exist so that they can easily reach the appropriate people with that information, the next question is whether they are adequately motivated to get the information to the appropriate person. This can't be taken for granted. Indeed, a close examination of companies that assume their employees would automatically pass on vital information shows that not only is there usually no incentive to do so, there is often an incentive not to.

Sometimes employees are reluctant to share vital information because they fear being ridiculed or taken less seriously in the future if the information doesn't turn out to be so vital.

If executives have too much to gain from the success of a project, they tend to have difficulty providing balanced information on what its chances of success might be and whether it should be cancelled. This problem becomes even worse when managers are rewarded largely in stock options. Unlike actual stock grants, options have no downside risk. If the stock goes down, the option is simply never exercised. On the other hand, if the stock goes up, the option holder can collect all the gain. Iridium CEO Edward Staiano, for example, received a huge number of stock options that would be worthless if he pulled the plug on Iridium saving investors from further losses. Meanwhile, if Iridium Soared, Staiano would become very rich. This kind of situation can make an executive extremely reluctant to pass on information that puts his or her project in a bad light.
Missing Oversight, or "I Hear What I Want to Hear."

When all the necessary pieces for the proper handling information are in place, someone still needs to check to make sure that they're actually working the way they're suppose to. This means that executives overseeing each facet of a business must do more than examine the reports that are routinely forwarded to them. They must actively seek out potentially important information that might not otherwise be coming to their attention.

Many executives fail to discover the extent to which their picture of reality is mistaken simply because they assume that people working for them are relaying information accurately.

Even if a corporate board is interested in scrutinizing the company more closely, many of them are ill equipped to do this. Sometimes the board members are celebrities and figureheads who simply are not spending enough time and effort on their directorship.

One of the most striking things about oversight breakdowns at all levels is that organizations are especially likely to bypass their routine checks and controls in the urgent and exceptional situations where they are most needed.

The Board Just Works, OK.

What really counts for board effectiveness is something that isn't so easily captured in statistics and averages, yet is inherently understood by many directors. How boards function as a group – the nature of their interactions among themselves and the CEO, and what they consider important to look into and what they don't plays a huge part in board effectiveness.

Most modern boards don't make the cut. Here's how the present day CEO of Saatchi & Saatchi, Kevin Roberts describes directors on many boards: "Their average age is ten years off the pace, experience is pretty similar. Generally speaking, they are don't rock the boat guys at the end of their careers who have been there, done that… aren't driven or hungry anymore and… haven't seen a consumer for so long that they are totally out of sync with what the company is trying to sell."

Boards played a role in many of the business breakdowns we studied. At GM, as Roger Smith was spending $45MM on robotics, the board looked the other way for years. At Mattel, directors backed CEO Jill Barad even after a series of missed targets and disastrous acquisitions.

The Exceptional Personality

Investors and corporate boards who think that the best way to judge a business venture is to look at a person's track record should remember that the biggest business disasters are usually created by personalities with the most impressive track records. It's not just because they're the ones given the biggest opportunities to create business disasters. And it's not just because they have personality traits that have a downside as well as an upside. It's because when they are put in charge of major projects, they usually aren't required to operate with the same degree of scrutiny and with the same checks and balances that constrain lesser mortals.

Let's Leave Them Alone

When outsiders acquire a company, especially if they are foreigners, there are special factors that can prevent them from receiving vital information about the business and acting on it. Part of the problem, of course, is that they don't know as much about the milieu in which the company operates, and they don't have their network of contacts within the company. But often a bigger problem is something that might be called the "fear of fixing" syndrome. Outsiders spend millions or billions on the assets and do little after the acquisition to manage, let alone integrate, the acquired firm into the parent company. Foreign acquirers – particularly in very big acquisitions – tend to adopt an especially "hands-off" manner. The catch is that by acquiring the business, they will often have greatly reduced the incentives for local managers to run the business well.

Chapter 9

Seven Habits of Spectacularly Unsuccessful People

The Personal Qualities of Leaders Who Preside Over Major Business Failures

To be spectacularly unsuccessful requires some very special personal qualities. We're talking about people whose failures were breathtakingly gigantic, who have taken huge, world-renowned business operations and mad them almost worthless. They have caused thousands of people to lose their jobs and thousands of investors to lost their investments. They've managed to destroy hundreds of millions or even billions of dollars of value. Their destructive effects is so beyond the range of ordinary human beings that on a scale normally associated with earthquakes and hurricanes.

Habit 1.

They see themselves and their companies dominating their environments.

Successful leaders are proactive because they know that they DON'T dominate their environment. They know that no matter how successful they have been in the past, they are always at the mercy of changing circumstances. They need to generate a constant stream of new initiatives because they can't make things happen at will. To be successful for more than a fleeting moment, every business venture needs to be one that customers and suppliers interact voluntarily. This means that no matter how successful the company, its overall business plan will need to be continually readjusted and renegotiated.
Leaders who see themselves and their companies dominating their environment forget these things. They vastly underestimate the extent to which they are controlling events and vastly underestimate the role of chance and circumstance in their success. They think they can dictate terms to those around them. They think they're successful and that their company is successful because they made it happen.

Many a CEO believes that he or she is personally able to control the things that will determine the company's success for failure, a tendency labeled the illusion of personal preeminence.   That as far as they are concerned, everyone else in the company is there to carry out their personal conception of what the company should be.

To these leaders, the people they interact with are instruments to be used, materials to be molded, or audiences for the leader's performance. When business leaders think this way, they often use intimidating or excessive behavior to dominate the people who surround them. In most cases, it is not unconscious or intentional. They want to be Larger Than Life, Legendary or Awe Inspiring!

Those leaders who succumb to this also succumb to an illusion of corporate preeminence, too. This is a belief on the part of the CEO that his or her company is absolutely central to suppliers and customers alike. Rather than looking to satisfy customer needs, the CEO who believe they run "permanent companies" often act as though their customers are the lucky ones, fortunate to be able to have their needs satisfied so effectively.

Leaders who suffer from an illusion of corporate preeminence often believe that the superiority of their company's product makes it invulnerable

Even when competitors who offer better designs or better prices challenge the company's products, executives who suffer from an illusion of corporate preeminence will continue to believe that their company is secure simply because of its status in the business world.

At Schwinn, for example, managers boasted, "We don't have competition. We're Schwinn."

Habit #2. They identify so completely with the company that there is no clear boundary between their personal interests and their corporation's interests.

This is a habit that can be remarkably easy to slip into. CEOs are especially prone to identify too much with a company if they believe that they are personally responsible for the company's success.

When CEOs and their employees are unable to separate the CEO from the organization, they're well on their way to a "private empire" mentality. The CEOs begin to behave as though they own their companies, even when they don't, and they begin to act as though they have the right to do anything they want with them, which isn't true.

CEOs who succumb to this mentality often use the corporation to carry out personal ambitions when these are not a good way to generate profits.

Legendary automotive executive John DeLorean provides a stunning demonstration of how thoroughly identification with a company can ruin its chances of success when he tried to launch a new car company. At first, the prospects for his venture seemed excellent. But as soon as De Lorean decided to name the car he would manufacture after himself, the whole enterprise took on a different tone. He changed the design of the company's first model from a vehicle for the middle classes to the "supercar" later featured in Back to the Future movies. He also greatly increased the amount he was spending to build his automobile factory in Northern Ireland. Essentially, his ego demanded that everything associated with his own name be first class. This made the environment he created for his workers into a model for factories everywhere. But it also made him almost psychologically incapable of controlling costs. Later, when it became increasingly obvious that DeLorean's car company was in serious trouble, DeLorean couldn't bear to recognize it because it would have seemed as though he was betraying himself.

Decisions Express the Executives Personality.

When CEOs identify too much with the company, they tend to make business choices to suit themselves, not the company. Cabletron neglected marketing largely because cofounder Craig Benson never liked marketing. Stephen Wiggins, CEO of Oxford Health Plans, saw himself as too much of a computer expert to be running a company that would settle for mass-market software.

Perhaps the most surprising thing that happens when CEOs identify too much with their company is that they become LESS careful with the company's assets. They take big risks with other people's money, NOT because it's other people's money, but because they are treating it as their own money and they happen to be big risk takers. Very often, it's making big bets and managing to collect on them that got the CEOs into their top jobs in the first place. Once in charge, these CEOs aren't likely to abandon the risk-taking style that made them rise above their peers

The Darkest Side of Identifying with Company.

When leaders identify with their companies too much, they become increasingly likely to use corporate funds for personal reasons.

Once executives are covering some of their personal expenditures with company money, it becomes increasingly difficult to keep the personal and corporate separate.

Habit 3. They think they have all the answers.

In a world where business conditions are constantly changing and innovations often seem to be the only constant, no one can "have all the answers" for long. Leaders who are invariably crisp and decisive tend to settle issues so quickly that they have no opportunity to grasp the ramifications. Worse, because these leaders need to feel that they already have all the answers, they have no way to learn NEW answers. Their instinct, whenever something truly important is at stake, is to push for rapid closure, allowing no periods of uncertainty, even when uncertainty is appropriate.

People around the CEO sometimes encourage this sort of "decisive behavior" because they find it reassuring. They want to follow a leader who has the answers. The fact that they are invariably following a leader who doesn't have all the answers – even though they know logically that this has to be the case – is very frightening.

One of the critical side effects of a CEOs fixation on being right is that opposition can go underground, effectively closing down dissent. Once this happens, the entire organization will grind to a halt, whether or not these CEOs were actually right or wrong in their judgments.

Control Freak Leaders who adopt the ideal of executive competence usually try to have the final say on everything their company does.

The more these leaders can control their companies, the less they feel threatened that their success depends on things outside their control. Thus, personal control for these leaders is both an extension of what they see as their executive role and protection against their own vulnerabilities.

Ultimately, executives "with all the answers" trust no one. Only they can be relied upon to make the final call on any issue where the answer isn't obvious. This is how they put their personal imprint on every aspect of their company's operations.

Habit #4. They ruthlessly eliminate anyone who isn't 100% behind them.

Roger Smith of GM was especially successful at getting rid of any executives and board members who saw things differently than he did – sometimes by having them fired, but often by sending them to some distant outpost where they'd have no further influence at headquarters. Jill Barad at Mattel removed her senior lieutenants in relatively short order if she thought they had serious reservations about the way she was running things. At Fruit of the Loom, an insider reported, "It almost became a badge of honor to get fired by Bill Farely. At Rubbermaid, Wolfgang Schmitt created such a threatening atmosphere that firings were often unnecessary. Ed Schwinn simply left the room when senior Schwinn executives began outlining what they saw as the problems in the company.

Habit #5. They are consummate company spokespersons, obsessed with the company image

The public tendency to judge a CEOs success by the current price of the company's stock greatly reinforces this fifth habit, because the fastest and easiest way to improve the share price is to put on a good show for the media and for investors.

Habit #6. They underestimate major obstacles

CEOs who succumb to this sixth habit tend to wave aside obstacles as though they are minor difficulties, when many of them are, in fact, major hurdles. They assume that all problems are solvable, when many problems, in fact, are either insolvable or else solvable at too great a cost.

Executives coming off a string of successes are particularly prone to underestimate obstacles.

In some cases , the habit of treating all obstacles as minor as an essential part of the leader's personal style. Executives who employ this approach are able to glide over many obstacles through a combination of charm and momentum. They draw people into their projects, inspire them with the self-confidence to do whatever's necessary, and let those associates scramble around to keep the enterprise rolling. By refusing to get rattled by potential setbacks, they help others to do the same.

Full steam into the abyss when CEOs find that the obstacles they had casually waved aside are proving more troublesome than they anticipated, they tend to deal with the problem by escalating their commitment.

Some CEOs feel an enormous need to be right in every important decision they make, partly for the same reasons that they feel responsible for their company's success. If they admit to being fallible, their position as CEO seems frighteningly precarious.

Once a CEO concedes that he or she has made the wrong call on an important issue, there will always be people who'll say tat they weren't up for the job.

The effect of these unrealistic expectations is to make it exceedingly hard for a CEO to pull back once he or she has chosen a particular course action. What's more, if your only option is to keep going in the same direction, then your response to an obstacle can only be to push harder. This is why leaders at Motorola and Iridium kept on investing billions of dollars to launch satellites even after it had become apparent that land-based cells phones were a superior alternative. "People do not like to admit that their past decisions were incorrect," explains a management expert who has studied the problem in detail. "What better way to affirm the correctness of those earlier decisions than by becoming even more committed to them?

Habit #7. They stubbornly rely on what worked for them in the past.

In their effort to achieve stability in a world of change, they sieve on yesterday's answer. In their desire to make the most of what they regard as their core strengths, they cling to a static business model. Like Ed Schwinn of the bicycle company, they insist on providing a product to a market that no longer exists.

Defining Moments Executives often revert to harmful or inappropriate strategies as the result of a "defining moment" earlier in their careers. At one point, they chose one particular policy that resulted in their most notable success. This becomes their "defining moment". It's usually the one thing they are most known for, the thing that gets them their subsequent jobs, the thing that makes them special. The problem is that once people have experienced this defining moment they tend to let it define them for the rest of their careers. And if they become the CEO of a large company, they let their defining moment to some extent define their company as well.

When confronted with a crisis later in their career, these executives tend to whatever they did in their defining moment. For William Smithburg of Quaker, the defining moment had been his successful promotion of Gatorade. The problem was that he tried to repeat that behavior when it came to dealing with Snapple. For An Wang, the defining moment was probably his successful launch of a word processor with systems that well all proprietary. Unfortunately, he tried to repeat that behavior when it came to PCs.

The Seven Habits of Spectacularly Unsuccessful People

1. They see themselves and their companies as dominating their environments, not simply responding to developments in those environments.
2. They identify so completely with the company that there is no clear boundary between their personal interests and corporate interests.
3. they seem to have all the answers, often dazzling people with the speed and decisiveness with which they can deal with challenging issues.
4. they make sure that everyone is 100% behind them, ruthlessly eliminating anyone who might undermine their efforts.
5. they are consummate company spokespersons, often devoting the largest portion of their efforts to managing and developing the company image.
6. They treat intimidatingly difficult obstacles as temporary impediments to be removed or overcome.
7. they never hesitate to return to the strategies and tactics that made them and their companies successful in the first place.

Questions to Ask When Looking for Early Warning Signs

Unnecessary Complexity

1. Is the company's organizational structure convoluted or complex?
2. Is its strategy unnecessarily complex for an otherwise simple problem?
3. is its accounting overly complicated, nontransparent or nonstandard?
4. Is it employing complicated or nonstandard terminology?

Speeding Out of Control

5. Does the management team have enough experience to handle growth?
6. Are there small, yet nontrivial, details or problems that seem to be getting overlooked by management?
7. Is management ignoring warnings now that could lead to problems later?
8. Is the company so successful or so dominant that it is no longer in touch with what it needs to do to remain on top?
9. do the unplanned departures of senior executives signify deeper problems?

The Distracted CEO

10. Do I have unanswered questions about the CEOs background and talent?
11. Is the CEO spending too much money to fulfill personal missions that don't necessarily benefit the company?
12. Are company leaders so consumed by money and greed that they're taking questionable or inappropriate actions?

Excessive Hype

13. Is it possible that the excitement around the company's new product is just hype?
14. Could the excitement around the company's merger or acquisition be hype?
15. Is the excitement around the company's prospects just unfulfilled hype?
16. Is the latest missed milestone part of a pattern that could signify deeper problems?

A Question of Character

17. Are the CEO and other senior executives so aggressive or overconfident that I don't really trust them?

Unnecessary Complexity

Whatever form it takes, unnecessary complexity is a warning sign because it tends to create bigger problems than it solves.

But why make something complex in the first place? Occasionally, executives rely on complexity to provide legitimacy to a course of action. In other words, it provides cover. They often hide flaws or overshadow simpler options. Management or investors can get so caught up in grandness of the plan or the details of the execution or the gee-whiz factor of the technology, that they forget to ask whether it is a good idea in the first place.

Complicated Accounting

Despite many who believe otherwise, accounting rules are not intentionally designed to be complicated. The goal of accounting is to illuminate the true financial performance of an organization, not to confuse or hide it. If it's confusing or unusual or inconsistent, it's time to take a close look. Don't be fooled by those who call it innovative; Enron's use of off-balance sheet partnerships was very innovative. A good rule of thumb is" Nonstandard or unusual accounting can make a company look better than it is, and it often is a warning sign that the company is actually worse than it appears.

Three of the biggest US bankruptcies ever – Enron, world Com, and Conseco,- followed a pattern of aggressive and creative accounting arrangements ranging from off-balance sheet manipulations (Enron) to systematic capitalization of expenses (WorldCom) to shifting acquisition accounting to and from the income statement (Conseco). Internet companies were notorious for pushing the accounting envelope.

Complicated Terminology

Internet entrepreneurs and managers created a whole new vocabulary of business terminology. Rather than "strategy", Internet startups boasted "Business Models". Online companies and venture capitalists emphasized the importance of "reach" and "stickiness" when what they really meant was that Internet startups needed "customers" to make "repeat purchases." They didn't compete in a "market"; they competed in a "space."

They talked about how the "new economy" needed new rules to accommodate a changed world, since the old accounting standbys such as EPS and P/E ratios weren't very effective when you had no "E". In the end of course, the standard accounting principles were just fine, as they accurately captured the fact that these companies were not creating value for shareholders.

For example, Nortel Networks asked investors to focus on a measure it called "net earnings from operations," which excluded amortization of goodwill and development costs, and gains and charges. In 2000 Nortel reported "net earnings from operations" of $2.31 billion, or seventy-one cents a share, while according to generally accepted accounting principles the company actually lost $3.47 billion or $1.17 a share.

Racing Before They Walk

Picture a company that is growing at breakneck speed. Now add in an inexperienced management team, and give them lots of money and little adult supervision. Each of these elements can bring a company to grief, but when all four are present at the same time – as they were in many of the Internet startups during the boom years – watch out.

Broken Windows: Little Mistakes That May Foreshadow Big Ones

You don't have to tour a company's facilities to see broken windows. As with any warning sign, it's all about knowing what to look for. For manufacturing companies, it might be minor quality problems now that lead to bigger ones later.

Follow the cash. Don't be deceived by relying on a company's net income as the only measure of financial health. You have to look at a company's ability to cover its debt. In much the same way that banks assess personal income and expenses when writing home mortgages, corporate lenders issue covenants to ensure that a company has adequate resources to cover the cost of debt. When companies go bankrupt, it is usually because lenders have decided to cut their losses because loan covenants have been violated.

Finally, don't be afraid to look at an even simpler measure – cash in the bank. It may well be the single most important factor of health for a company, especially in technology and biotech.

Large companies with experienced management teams have sped past a lot more than mere broken windows. At J&J's stent business, management failed to notice that the building was on fire before it was too late. The smoke was there for anyone to see – the erosion of the European market share and the lack of ongoing innovation in a business that requires it. As a manager, these are your warning signs. But as an investor or board member, the real warning sign is when conditions such as these are present and no one seems to be doing anything about it. As John Keogh, president of an insurance company that writes policies to cover corporate directors and officers told us, "My experience anecdotally is that where there is smoke, there is fire. So, if you find a problem in one piece of business, it's probably an early indicator of a bigger problem. When management finds there is a bigger problem, the sooner they deal with and manage it, obviously the better. It's the ones that take longer to come to the surface that tend to be the ones that destroy companies.

Success and More Success

Here's a surprise. Want to know one of the best generic warning signs you can look for? How about success, lots of it! Leaving aside the unfortunate reality that many of the companies we studied were quite successful before the really bad stuff happened – Rubbermaid, Motorola, J&J, Wang Labs, Sony, Conseco, Snow Brand Milk, LCATM, Barneys, the list goes on – there are several reasons to always be on the alert. First, the zombie business of Chapter 7 were uniformly successful at one time, but developed a host of delusional policies and attitudes that were an outgrowth of success. Second, companies that are successful in their marketplace act as an advertisement for others to enter the same arena. Third, success breeds arrogance. Even a company as powerful as Microsoft wasn't immune to the perils of success, and probably should count itself lucky that the antitrust suit ended up where it did. Fourth, it's easy to let our guard down when we're awash in profits.

Finally, success creates its own momentum that in the scheme of things is remarkably difficult to maintain. Few companies evaluate why business is working. But, without really understanding why success is happening, it is difficult to see why it might not. You have to be able to identify when things need adjustments. Otherwise, you wake up one morning and it looks like everything went bad overnight.

Executive Departures

How clear can a pattern be? A revolving door at the top is often a strong signal that there has been executive failure at a company. It may be an indication of Unsuccessful Habit #4 or it may reflect inside information senior executives are acting on.

The Distracted CEO

The next time you attend an annual meeting of a company whose stock you own, there's something you can do to prepare. Look up the section of the proxy statement that describes the activities of board committees and compare the number of times the compensation committee met in the past year to the number of meeting the audit committee. If the compensation committee is convening more often, much more often, look out! When asked why, board members will say that executive compensation is very complex and merits in-depth consideration. But does that imply that the company's financials aren't complex and hence merit less attention?

The easiest way to spot a company that is distracted is to look a the CEO. Organizations take their lead from the top and distraction or misdirection at the CEO level can have serious consequences. Studying a CEO for signs that he or she has become sidetracked will never yield a black and white answer, but there are some patterns that emerged in failures we studied that provide some clues.

The People

There is of course no certainty that a CEO with a checkered past will be untrustworthy in the future, but if we don't pay attention to the data we collect, the odds are that we'll be unhappily surprised. Just as careful underwriters of D&O insurance find that past lawsuits are a predictor of lawsuits to come, we've got to go with the pattern of data we discover. That is the essence of what an early warning sign is, after all.

And when we consider the data emerging form the companies we studied, one other fact that seems to stand out is the high number of family run businesses that ended up in ruins. Scwinn, Barneys, and Rite Aid were run by follow up generations to the founders and all went bankrupt or close to it. Whether this power is turned into positive or negative outcomes cannot be predetermined, though the fact remains that CEOs in a family line have not been vetted in the same way that executives working their way up a hierarchy have been. The one thing we should expect with some confidence, however, is that companies run by a founder's family are likely to produce more volatile results because their power gives them the freedom to choose high risk strategies that can yield widely varying outcomes.

The Behavior

The types of behavior that are exhibited by CEOs in the throws of Napoleonic fervor tend to be so blatant that they can't be missed.

What's remarkable about all these people is that while they chose to live the high life, socializing with celebrities and politicians, and spending lavishly on pet projects or misdirected strategies, the companies for which they had fiduciary responsibility suffered huge losses. Being a CEO is more than a full time job, and perhaps the same can be said for being a jetsetter, Hollywood celebrity, or well connected Washington lobbyist.

How about when a company begins building a new world headquarters designed to serve as the corporate symbol. Or my personal favorite when a company decides to acquire naming rights for a new sports arena or stadium.

The End of Hype: Missing Milestones

One of the best warning signs that a company may be relying on hype is the missed milestone. Whenever a company announces that its quarterly earnings are below forecast, the market reacts negatively to the news.

Jill Barad went through a streak of missed earnings targets, yet each time she would pronounce that better times lay ahead. Her assurances to investors were taken at face value, and when she couldn't deliver, her credibility was gone and so was she.

A Question of Character

Perhaps the single most important indicator of potential executive failure is the one that is hardest to precisely define – the question of character. A person who has high ethical standards and deep competence, who desires to succeed by helping others to be better than they would otherwise be on their own, who can face reality even when it's unpleasant and acknowledge when something is wrong, and who engenders trust and promotes honesty in the organizations they create and lead.

Tony Galban, a D&O underwriter at Chubb, zeroed right in on this issue: "The three things behind every bad D&O liability situation are greed, cronyism, and denial. And if you were to watch people on the witness stands over the last six or eight months you would see an extraordinary amount of denial, some of which is almost not credible."

Predicting Is One Thing, Doing Something About It Is Quite Another

Hockey superstar Wayne Gretzky was said to have the uncanny ability to "see" where the puck was going to be before anyone else. Larry Bird and Magic Johnson were said to have similar abilities on the basketball court, knowing where players would be and threading passes to them as if they had eyes in the back of their heads. No doubt, some of this ability was built into genetic code of these athletes, but there was a tremendous amount of hard work and study put in as well. Most great professional athletes are known to be students of the game. Appreciative of the sport's history, yet keenly aware that the learning process never stops, they are constantly looking for new trends or patterns that can make them better players.

The business world is not all that different in this respect.

How Smart Executives Learn

Imagine a place where asking questions only gets you into trouble. A company with a long record of attacking insiders and outsiders alike who don't toe the party line. A firm that actively seeks to cover up or destroy potentially damaging information, and ruin the careers of those who try to bring that information to light.

How Would You Answer These Questions:

- Do you believe that the CEO and other senior executives in your company are open to different ideas?
- Does the typical employee or manager believe that he or she can bring mistakes to the attention of the bosses without personal repercussions?
- Does your company have a formal or informal process for learning from mistakes?
- Is it standard practice in your company to challenge people who say, "This is the way we've always done it!?!
- Are there a set of corporate values that people really believe in and use to decide how to handle the gray areas of business?

How Smart Executives Create Close Minded Organizations

Rather than relying on one person to foretell the future, however, wouldn't companies be better off if the entire organization was built, challenged and empowered to create the future? When two of the most celebrated CEOs of the past twenty years - Jack Welch of GE and Bill Gates of Microsoft – are unable to see the potential of the Internet until many others already have, is it reasonable to expect CEOs to have the right answers to highly uncertain problems? Rather than expecting the CEO to know, we should be expecting CEOs to create an organization that will know. Rather than turning to the CEO for a vision of the future, we should be turning to the CEO to define the purpose of the organization, and to create an organization that will have the energy, resilience, culture and talent to manage the unknowable.

It's a huge challenge, creating an organization with the capability to take on the world, and the capability to learn from its mistakes and the mistakes of others and adapt, but at least it is a realistic – and not inevitably futile – challenge. The heroic CEO is not one who can predict the future, for in the uncertain environment that dominates business today such a forecast is surely more luck than talent. The heroic CEO is one who creates an organization capable of meeting the challenges that are constantly emerging, who builds creativity, open-mindedness, a disdain for bureaucracy, and honesty into the DNA of organizational life.

Shifting from heroic model of all knowing and powerful CEOs to organizations of open minded people who ask questions and learn from mistakes is one of the most challenging of all transitions.

The transition to a more open-minded organization is not always a smooth ride. At Boeing, one of he key steps along this road was the arrival of Harry Stonecipher, who came over from McDonnell Douglas when Boeing acquired that company. He didn't take long to shake things up. "our problem is us!" he exclaimed at an executive meeting. The furor that followed speaks volumes about Boeing's insular culture at the time.

So what does a culture of openness look like? Openness means fighting the natural tendency t cover up unfavorable or distasteful information. It requires leaders to set the standard for learning from mistakes – an unnatural act in many organizations. Leaders who are unable or unwilling to build a culture of openness create organizations that almost choose not to learn. They are defensive, not open.

A culture of openness is a culture where people feel safe to say what they really think and to act on it. You have to encourage information flow rather than force it. Boeing CEO Phil Condit put it this way: "If you are trying to find problems rather than encouraging them out of the organization, you build a culture where people try to hide the problem. It gets down to can you find it? Can you see it? As opposed to the dialogue that is, "Have we got any issues that we need to address?" Is there anything festering within the organization?"

At Southwest Airlines a powerful people centered culture means, “We’re not going to punish each other for mistakes. We’re going to learn from them.”

When leaders don’t acknowledge their mistakes, the signal to the rest of the organization is sometimes, “Carry on.”

Executives not only must be prepared to admit when they’re wrong, they also need to create opportunities for others to safely provide feedback. How many CEO’s have someone who can tell them that they’re wrong, that their pet project is really a dumb idea?

Consider what the New York Times Company emphasizes in its cultural value statement. “Treat each other with honesty, respect and civility. Take risks and innovate, recognizing that failure occasionally occurs. Give and accept constructive feedback.” The company’s “Rules of the Road” encourage a “culture that is open-minded as opposed to close-minded…. That is civil and honest and respectful as opposed to judgmental and critical or negative.” None of this happens without leadership.

Learning From People

The name of the game is to make it as easy as possible for people to count, to be heard, to have a voice. You might use an open bulletin board in the private elevators between floors to generate feedback and communication. Suggestion boxes in common spaces are another option. Boeing has employed an “Ethics Hotline” for years to provide an outlet for people to speak out.

A company in Australia requires each person to talk to his or her boss for one hour each month about what he or she is doing well and what mistakes are being made.

While the specific type of opportunities an organization creates for dialogue and feedback is less important, the fact that there are such opportunities is very important. People have to believe that their contributions matter and that no one will shoot the messenger.

At Home Depot, founder Bernie Marcus was known for his “Bernie Road Shows” where he would travel to divisions across the country and encourage managers to give direct feedback. He would grant immunity during these meetings so “Managers can ask any type of question no matter how blunt, invasive, or even offensive it might be.”

Julie Morath, the COO at Children’s Hospital, told us, “One of the things we did here was to really amplify the aspects of the culture that focus on safety – to increase awareness, to educate and engage people in learning about safety, and to help people feel safe to report on errors.” In order for the hospital to improve its safety record, errors must be reported. A company cannot succeed if people fear for their jobs should a mistake become known.