Why Smart Executives Fail

A presentation by Sydney Finkelstein, Ph.D. for

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Synopsis by Rod Cox

We're suffering an epidemic of leadership failures. By 1995, sixty-percent of the very large companies that made up the 1955 Fortune 100 list -- the Blue Chip 100 -- had gone bankrupt, been acquired, or still existed but had become invisible. By 2005, another 10-15 are likely to fail and be replaced by others. A look at those that are left -- among them GM, Ford and several financial and oil companies -- reveals a pattern of very deep pockets more than a pattern of executive wisdom. Their ability to continue operating may be built on cash reserves, size and momentum rather than on good executive performance. Thus, for some of them "failure" is a future that has not yet come to head.

What caused this monumental fallout? Bad luck? Bad timing? Product obsolescence? Or is it the legacy of smart executives -- otherwise intelligent managers who were deservedly respected in business -- who turned in astonishingly bad performances and failed miserably at maintaining the vitality of their companies?

In the largest research project ever devoted to business failure, Sydney Finkelstein and his team of Dartmouth associates conducted a six-year, in-depth examination of 51 companies. Their goal was to find what led to the failures.

After nearly 200 interviews, they were startled to find that even businesses that seem to have nothing in common failed for exactly the same reasons, and that the multi-billion dollar failures can be blamed on surprisingly few causes. Consistently, the executives of failed companies:

- chose to not cope with innovation and change
- misread the competition
- brilliantly fulfilled the wrong vision
- clung to an inaccurate view of reality
- ignored vital information
- identified too closely with the company

Why Smart Executives Fail provides a vital wakeup call for current and future organizations. Whether your interest in executive competence is from historical, investment or employment perspectives, Dr. Finkelstein's research is highly instructive. By identifying the makeup of executive failures and providing abundant examples, he shows how they can be predicted and perhaps avoided.

Dr. Sydney Finkelstein is the Steven Roth Professor of Management at the Tuck School at Dartmouth College. He the author of the best seller *Why Smart Executives Fail* now on Fortune Magazine's list of Best Business Books for Summer 2003. This presentation is based on that book. Dr. Finkelstein's writing has appeared in the *Harvard Business Review* and other journals. He is also the Director of the Tuck Executive Program at Dartmouth College. He lives in Hanover, New Hampshire.

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Common Themes

In all 51 companies the key decision makers saw the failure coming; they were smart, they had great track records, and the facts were on the table. But they chose not to act on them, or they chose to act on them ineffectively. Often there were fundamental strategic breakdowns where attention was diverted from solving customer problems to focus on the company itself. "If it's important for us, it's important" (irrespective of customer or investor interests) was a frequent motif.

Finkelstein discovered four major failed-executive themes: 1) executive mindset failures, 2) delusions of a dream company, 3) organizational breakdowns and 4) executive pathologies. Some of these occurred independently, of course, but much more often they occurred in clusters. It was very unusual for the first three to go wrong, and the fourth to go right. It was also very unusual for the fourth to go wrong, and the preceding three to go right. It became clear that a good leader can seldom pull things together when the other three are wrong. Likewise, a bad leader can subvert the first three even when they are otherwise okay.

Theme #1: Executive Mindset Failures

They got the strategy wrong. By itself, this was probably not enough to doom their companies. But when strategic mistakes were combined with organizational breakdowns and/or delusions of a dream company and/or executive pathologies, the results were disastrous.

Inaccurate view of the future -- Webvan set up a no-charge retail grocery delivery system using expensive mechanized warehouses in an industry where profits are typically less than 3%. They ran out of venture capital within two years.

Negative transfer -- Snapple attempted to use Gatorade's sports-based distribution strategy. Because the two products appeal to vastly different consumers, Snapple nearly went under.

One Best Way (The Magic Answer) -- Robotics were magic at GM in the 1980s. The company invested billions of dollars into automation, ignoring the fact that production problems, not labor, were at the root of its problems.

Ignoring change -- Internet system provider Cabeltron focuses on technology while Cisco focuses on bundling its services so as to appear invisible to the customer. In 1996, Cabeltron had $1.1B revenue and $0.1B profit against Cisco's $4.1B revenue and $0.9B profits. In 2000, Cabletron had $1.4B revenue and ($0.2B) profit against Cisco's $18.9B revenue and $3.6B profit. Customers who once may have been swayed by technology had become interested in service.

The Perfect Storm Fallacy -- Executives at LTCM (a hedge fund) allowed for the possibility that a market disruption could threaten their investments. They failed to allow for the possibility of several nearly simultaneous disruptive events. A combination of a mortgage-backed securities slump, a default on Russian loans, reluctant investors, and other events -- all of them individually predictable -- combined to deal a 92% loss to the fund.

Theme #2: Delusions of a Dream Company

Every organization and every leader makes mistakes. An organizational culture grounded on the ethics of learning from its mistakes is usually very positive. However, these companies often enjoined their people from challenging the course of the company or admitting to mistakes, and the effect was consistently negative. Internal attitudes made it impossible for anyone to raise his hand and say, "We're wrong." Mistakes went unchecked. There was a regular lack of open-mindedness and devil's advocacy. Instead,

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blind adherence to "positive thinking" became a dominant corporate value that was often at the foundation of organizational failure. Rubbermaid didn't understand the need to keep prices down because it's executives were universally confident that people truly needed the hundreds of innovative, new Rubbermaid products they designed.

Theme #3: Organizational Breakdowns

In every business failure that was investigated, the companies didn't carry out operations badly; rather, they carried out the wrong operations. In many ways, they were subject to good business school teachings gone awry. For example, incentives -- strong performance motivators when they are tied directly to productive actions -- when taken to an extreme can have a reverse effect; they can initiate "bad" or counterproductive actions.

Say a car maker incents its executives to achieve manufacturing quotas. Spurred by the incentive, an executive might direct higher production than the market can absorb. The cars languish unsold on delivery docks and dealer lots. Moreover, the bloated production figures introduce a wave of artificial financial information that sends false information to stockholders inside and outside the organization. In the companies Dr. Finkelstein examined, incentives were often abundant and anti-innovative, blocking people and organizations from moving in appropriate directions.

Theme #4: Leadership Pathologies -- The Seven Bad Habits

This is a big one. Nearly all the leaders who presided over major business failures exhibited five or six "Bad Habits." Even more remarkably, each habit was a quality that is widely admired in today's business world. They are the habits of people who are unusually talented and intelligent. But they also equipped the executives with the gift of taking what could have been a modest failure and turning it into a gigantic one.

1. **They saw themselves and their companies as dominating their environments, not simply responding to developments in those environments.** This is the belief that they dominated the world, that they were bigger than life, that they could do anything.

   Early Warning Signs -- "Our products are superior, and so am I. We're invulnerable. By virtue of my genius and my personality, I have created the world under which my company and I will operate. My company is successful because I made it happen."

   Case in Point -- Schwinn managers boasted, "We don't have competition. We're Schwinn." Executives became so proud of their company's product that they believed its sheer excellence would give them the latitude to do anything they please. After all, if Schwinn made the best product in the world, customers had to come to them or settle for something inferior.

   Learning -- This in no way discounts leaders who are ambitious and proactive. Smart executives are both. But here's the catch: successful leaders are productive 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 know that they need to generate a constant stream of new initiatives because they can't make things happen at will. They know that no matter how successful a company, its overall business plan must be continually readjusted and renegotiated.

2. **They identified so completely with the company that there was no clear boundary between their personal interests and corporate interests.** In company after company, the failed executives identified not too little with the company, but too much. Deep identity ties, as well as a fuzzy boundary between company and self, encouraged them to make unwise corporate decisions.

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Early Warning Signs -- "I am the sole proprietor. This company is my baby. (Often) I have taken a very small company and turned it into a very big one. Obviously, what I want and need is in the best interest of the company and the stockholders. "

Case in Point -- John DeLorean, a seasoned auto industry executive, launched a new Irish-built car on the best of prospects. It was to be a cutting-edge vehicle for the middle classes, produced in an atmosphere free from the stagnant constraints of the Big Three U.S. automakers. But between concept and production, he decided to name the car after himself as well as turn to it into a "supercar" two-seater for a very small potential market. He also demanded that everything associated with his name be first class. This left him psychologically unable to control start-up and building costs at his state-of-the-art factories. The company chewed through venture capital at an amazing rate, and then collapsed after producing only a smattering of highly styled, daring, unprofitable cars.

Learning -- Successful leaders don't stand too close. They resist the urge to treat the company as an extension of themselves. They know that what makes sense for them as a person seldom makes sense for a company. They nurture the capacity to take a step back and evaluate critically. They separate their own personalities from company decision-making, and their own adversaries from company adversaries. They are scrupulous about maintaining the boundary between corporate assets and their own.

3. **They seemed to have all the answers, often dazzling people with the speed and decisiveness with which they dealt with challenging issues.** The articulate "ideal" executive who makes dead-on accurate snap decisions while dealing simultaneously with multiple crises and giving high-speed orders, and who can make instantaneous sense out of information that may have confused people for days or weeks doesn't exist. Yet this super-leader is idealized in countless movies and even in executive how-to books. We've come to find them reassuring. However, testosterone-driven leaders generally do more harm than good to their organizations. They are accustomed to pushing for closure without considering ramifications. They can't possibly give the "right" answers because they don't take time to understand the problems.

   Early Warning Signs -- " I'm a genius. I believe in myself and you should, too. I know the answers. I can and should control everything. I'm not micro-managing, I'm being attentive. I don't need anyone else, certainly not a team."

   Case in Point -- An Wang was a classic rags-to-riches success story. He immigrated to the U.S. from China following WWII and entered Harvard. While there, he invented the magnetic pulse memory core, a technology that was essential in computers for the next 20 years. He started his own company through a series of technological inventions that spawned the calculator, computer and word processing age. Wang was truly brilliant, but he was unable to let go of his need to control every aspect of his company, and he allowed adversarial relationships with IBM and others to undermine a market-driven need for non-proprietary software. In particular, An Wang missed the PC revolution because he thought it was "a stupid idea" (although he later endeavored to catch up) and he insisted on passing operational control of the company to his unprepared son, Fred. In 1992, the company was forced into Chapter 11 bankruptcy protection where it languishes today.

   Learning -- Good business leaders do zero in on what is really important. They do make sense out of complex situations, and they do have a gift for decisiveness. Strategically, they may be highly inventive. But they know that no leader has all the answers all the time, and no leader can do it by himself. Good leaders depend on the collective knowledge and skills of their employees.

4. **They made sure that everyone was 100 percent behind them, ruthlessly eliminating anyone who might undermine their efforts.** Many of these managers felt that they and their vision were in constant danger of being undermined. They sought the impossible: an organization where everyone agreed and worked together all the time. Disagreers were ousted. But this fiercely demanded loyalty had its price. By

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eliminating all contrasting points-of-view, they cut themselves off from their best chance to correct problems as they arose.

Early Warning Signs -- "It's my way or the highway. If ya ain't fer me, yer agin me. Get with the plan, or get out. Where's your loyalty?"

Case in Point -- Roger Smith at GM was unusually successful at getting rid of executives and board members who saw things differently than he did. Sometimes he fired them, and sometimes he sent them to distant outposts where they had no headquarters influence. This led to the moribund GM of the 70s and 80s.

Learning -- Good leaders encourage collaboration. They welcome advice and suggestions. They recognize that everyone in the company doesn't need to unreservedly endorse the vision. In fact, they see dissenting and contrasting viewpoints as an excellent way to correct minor problems before they become major ones. They recognize that cultures grounded on the ethics of learning from their mistakes can be very positive; and that those where no one dares challenge or raise issues are bound to be negative.

5. **They were consummate company spokespersons, often devoting the largest portion of their efforts to managing and developing the company image.** Being constantly in the public eye is a lure that many executives couldn't resist. In doing so, they risked allowing their management effectiveness to become shallow. They often traded real effectiveness for the appearance of effectiveness, and valued a great performance more than a great accomplishment.

Early Warning Signs -- "I'm the spokesperson. In fact, I am the company. It's all about image. I'm a promotions and public relations genius. I love making public appearances; that's why I star in our commercials. I'm socially visible, too. I give frequent speeches and have regular media coverage."

Case in point -- Enron started out as a minor player in energy administration and trading. As it started becoming a player in the Big Game, Jeffrey Skilling and Ken Lay became more involved with creating an image of trading initiatives than with implementing the initiatives. This distracted them, and it raised unrealistic conceptions and expectations about Enron. Dennis Kozlowski (Tyco) was so obsessed with image that he had little time to attend to running the operation.

Learning -- Truly smart executives relinquish the role of spinmeister because it pulls them away from their critical focuses.

6. **They treated intimidatingly difficult obstacles as temporary impediments to be removed or overcome.** Underestimating the depth of a stream did not keep these executives and their companies from drowning. They became so enamored of where they wanted to go that they ignored major, debilitating pitfalls and obstacles. Their view of the future got in the way of the realities of the present. And when reality surfaced, it was often whitewashed for reasons of face-saving and hubris.

Early Warning Signs -- "It's just a minor blip. Full steam ahead! Let's call that division a "partner company" so we don't have to show it on our books. Don't waver!"

Case in point -- RJ Reynolds introduced the "Premier" cigarette, a smokeless version that RJR was convinced would find ready acceptance in a public that hated the health risks of conventional cigarettes. Test marketed in Japan, the cigarette stood out not for its smokelessness, but for its dreadful flavor and smell. Nevertheless, CEO Ross Johnson was unwilling to dump the hundreds of millions of dollars of already spent development cost, and the company introduced it to the U.S. market in October, 1988. It caused a furor. Safety advocates dubbed the product a "nicotine-delivery system," and word got out that it tasted not just bad, but horrible. Sales, never strong, almost evaporated, and just three months later RJR ceased production of Premier, having lost over $1 billion.

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Learning -- Good executives learn to develop strategies for defusing obstacles rather than reflexively pushing harder.

7. **They never hesitated to return to the strategies and tactics that made them and their companies successful in the first place.** Because it worked before, the executives were inclined to believe that it would work now and in the future. Often, they chose a course of action which had made themselves effective in the past; i.e., they unhesitatingly applied the one lesson that they had learned too well. They used yesterday's answers -- a default response -- to handle today's questions. They failed to consider innovations in technology, product delivery, infrastructure and market expectations. They used low-risk tactics in high-risk environments, and vice versa.

   Early Warning Signs -- "It has always worked. Let me tell you about how I handled the X project. It's my core strength."

   Case in Point -- In the 1950s and 60s, Schwinn was the #3 Most Recognized Brand in the U.S. In the early 70s, Schwinn learned of an entrepreneur in Northern California who was retrofitting cast-off Schwinn frames with heavy-duty tires to improve performance in a quirky local sport called mountain biking. Schwinn sent three Chicago "suits" to check it out. They saw no value so Schwinn stopped tracking mountain biking. Five years later mountain biking was BIG, but Schwinn didn't produce a mountain bike for yet another two years, too far behind the curve to ever catch up. In 1992, the fourth-generation company declared bankruptcy.

   Learning -- Truly smart executives learn to curb their tendency to use the thing they are most known for to handle all situations.

Motorola: A Case Study

Motorola was born in 1928 as a major manufacturer of car radios. As it grew, Motorola found a comfortable and highly profitable position as a supplier of other electronics to the auto, military, space, microprocessor and telecom industries. But by the 1980s, Motorola was burdened with all four of the major failed-executive themes: executive mindset failures, delusions of a dream company, organizational breakdowns, and executive pathologies. The company fell by the wayside when the digital age came along, and it failed to respond quickly or effectively to the changing attitudes of its customers.

This is a classic case where managerial success was dangerous. After all, analog technologies had contributed heavily to the success of the Motorola. Could 43 million analog customers be wrong? Motorola's market share of total U.S. cell phone business fell from 60% in 1994 to 31% in 1998, and then dropped to 16% in 2002. What happened?

1. **(Executive Mindset Failure) Motorola was slow to convert to digital technologies.** Motorola owned several digital patents but chose to license them to Nokia and Eriksson. In making this decision, Motorola used an algorithmic model that said "digital will not be important for at least five years." It was a classic mindset failure: sticking to comfortable yet unrealistic forecasting technologies while ignoring market data that clearly showed heavy customer demand for digital.

2. **(Delusions of a Dream Company) Executives avoided facing reality.** Despite a veneer of unity, Motorola was in many ways a company of warring tribes. Coordination breakdowns in the Motorola organizational structure and lack of holistic oversight led to a culture where adhering to the party line became more important than a having a healthy spirit of discontent. Conversations that should have happened, didn't. A challenging, questioning, forward-thinking atmosphere that should have been there, wasn't. It was a see-no-evil, hear-no-evil, speak-no-evil environment that didn't acknowledge or discuss the digital moose that lay in the middle of the boardroom table.

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3. **(Organizational Breakdowns) Executives were afraid to spend.** Management thinking was colored by heavy emphasis on incentives. The considerable upfront costs of switching from analog to digital would have negatively affected these incentives. Moreover, digital technology was counter to the analog technologies that had contributed so heavily to the success of the company. So why waste money on it?

4. **(Leadership Pathologies)** Motorola executives identified so strongly with technology-driven products that they could not switch to consumer-driven products. They boxed themselves into a corner from which there was no way out. The history and culture of the company overwhelmed potential strategic fixes.

Applying The Learning

The executives Finkelstein studied were smart and, for the most part, highly ethical yet the disasters happened. If this can happen in their organizations, it can happen in yours.

Track the warning signs as though your business depends on it. It does. Fiercely promote teams. Teams win more than leaders win, and the diversity inherent in every team makes it harder to be blindsided.

Promote devil's advocacy. Make it okay to challenge, and easy to tell the truth at all levels and in all situations. Remember that "yes" people and "yes" companies are those who choose not to cope. Allow mistakes, but avoid mega-mistakes by finding and dealing with minor ones.

Religiously conduct after-action reviews. What worked and what didn't? What are the lessons? What needs to change? Build safety nets that can't be overridden by inattention, new processes or Perfect Storm events. And bring the market close to your people. Charge each senior manager with a significant relationship and response role to each key client.

To what extent do the following exist in your own company? What is their effect upon your viability?

- Critical information has been known to be misplaced or lost.
- Much of the business model is predicated on the company's ability to use stock options as a net.
- Good news is usually accepted without question.
- The flow of information is carefully orchestrated to ensure that no one goes around official channels.

With your colleagues, consider what would need to happen to overcome them.

1. How can we do this differently? (Nokia turned the steel industry on its head by developing high efficiency mini-mills that avoided the huge overhead costs that caused stagnation for the leading steel manufacturers.)
2. What can we borrow or adapt to our needs? (Mobil hired Penski, a car racing organization, to teach it how to shave seconds off average gas pump service delivery times.)
3. How can we change the pattern, or re-arrange the process? (Starbucks changed the concept of coffee from "having a cup of" to "having a coffee experience.")
4. What could we add to make it more valuable to our customers? (Quicken introduced a bundling concept where multiple sticky bookkeeping transfer points were eliminated or made transparent.)
5. What can we eliminate to make it faster and better for our customers? (Leading airlines are saving time for customers by letting them print boarding passes at home hours before flight time.)

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If you are an executive, carefully and truthfully consider how your smart-intuitive-assertive-ingenius-charismatic-decisive-involved-positive-caring personality can subvert your organization as easily as it can support it. Learn to recognize the warning signs, and take thoughtful action where needed. You may not get a second chance.

If you are not an executive, carefully and truthfully consider that the people who run multi-billion dollar companies are everyday people -- not much different from you -- who have extraordinary strengths in one or two areas, just like you. Within the scope of your own influence, you, too, can fall into failure traps. Biased? Defensive? Steadfastly positive? Unwilling to listen to negative feedback? Sure of your own genius? Self-focused? Heed the warning signs just as if you were your own company . . . because you are.

And if you are an investor, watch for warning signs in companies before you give them a cent of your money.

About the Book

Why Smart Executives Fail is full of additional stories and learnings written with keen insight and humor. It's an engrossing read for people at all levels. Executive Forum highly recommends it. To order, click on the Powell's Books link on our website.

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