Thought Leaders: Sydney Finkelstein on Why Smart Executives Fail
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Sydney Finkelstein is the Steven Roth Professor of Management at the Tuck School of Business at Dartmouth College, where he teaches courses on leadership, top management teams and managing mergers and acquisitions. Professor Finkelstein is the author of *Why Smart Executives Fail:And What You Can Learn from Their Mistakes* . Based on a six-year study of 51 companies, the book identifies the fundamental reasons why major mistakes happen, points out the early warning signals that are critical for investors and managers alike and offers ideas on how an organization can develop a capacity of learning from corporate mistakes.

RD: Tell us about the research that went into the book and why you felt that there was a need to write about these huge failures?

SF: There are a couple of reasons. Number one is that most business books out there are either written by retired leaders who talk about how they won the war or by consultants who may have studied a few companies and identified attributes that are associated with success. While you can learn quite a bit from books like that, what they never do is look at the other side. What are the major pitfalls facing organizations? We know that things go wrong, but we very seldom spend much time thinking about it. That is also true in business school where we train our students almost entirely by looking at best practices. They walk out of schools with a toolkit on how to deal with important managerial and strategic problems, but we do not often spend time looking at worst practices. In many ways, my research and my book is an attempt to rebalance the scales in that regard.

RD: You found that almost all of these failures fit into four business passages. What are these passages and what is common about them?

SF: What's common is that all of these passages are major and challenging stages of an organization's life. They are challenging, they are difficult and at times when the margin for error is very slim. As a result, when companies or executives behave in certain ways, bad things can happen. They occur when there is a new venture, a merger and acquisition, a major innovation or change in the industry and when faced with intense competitive pressure. All of those things are challenging and as a result the margin of error for executives is reduced. They are much more vulnerable to having some dangerous things happen to their organization.

RD: Why don't you give us a short example of each of these things, along with some illustrations of the challenges and how people didn't live it up to them?

SF: Let me give you one example that illustrates several of them at once. Motorola once dominated the analog cell phone business. In fact, in the US in 1995 they had 65% market share. If you look at their market share today it is down to approximately 18% and that's after recovering over the last year or so under new leadership. They made a set of decisions not to shift towards digital technology and to stick with analog, even though the market was very clearly shifting towards digital. This is a good example of a fundamental shift in the industry. It's also an example of a company having to deal with new and challenging competitive conditions. Companies like Nokia and Ericsson were really bit players in the telecom business in the early 90's and today Nokia is a global leader that has done exceptionally well. This story illustrates both of those vulnerabilities.

Motorola also more broadly illustrates the challenge of new ventures. During the midst of this transition from analog to digital, Motorola was also responsible for the creation of the Iridium satellite phone system. Iridium was the idea that two people could communicate no matter where they were in the world. It was a great idea and a tremendous new venture, but they made a series of blunders and mistakes in developing the innovation. In the end, the total investment was in the neighborhood of $5 billion and the company went bankrupt. The assets were then bought out of bankruptcy court by a group of investors for $25 million. The remarkable thing about Iridium is that despite all the mistakes, with $25 million in capital costs, it's a big time winner for the folks that bought the assets. The phone is now used in the military and on oil drilling platforms. It is a good product that fits a very small niche, which is something that Motorola didn't understand. Therefore, it did not warrant spending $5 billion to develop.

Another example of one of these passages can be seen with the Boston Red Sox. Elijah Pumpsie Green was the first African American ball player to appear in a major league baseball game for the Red Sox, which was 12 years after Jackie Robinson broke the color barrier. The Red Sox were the last team in the league to add African American players to their roster. Why did that happen? It is the type of question that we, unfortunately, know the answer to. If we remove the unethical nature of this example, we can see that the Red Sox made a decision not to adapt to a fundamental change that was taking place in their industry. In this case they were limiting their talent pool by excluding African American ball players.

In both of these instances, the Red Sox and Motorola, the key decision makers knew what was going on and had a tremendous amount of data, but despite that they didn't change or adapt. In the book I use the term, "choosing no to cope" to describe this behavior. When an organization stumbles we always hear excuses about changes in the industry, government regulations or technology. All of those things happen and have an impact on organizations, but in the 51 companies I studied those externally driven explanations were never enough to account for failure. In the final analysis it is about people who behave in certain ways.

RD: In the chapter on mergers and acquisitions you reference the many studies showing that M&A's fail 50-75% of the time. Is there comparable data on the success or failure rate of any of these other passages? Earlier you mentioned that new ventures have a pretty dismal track record; is there any data on what that track record is?

SF: The most recent data that I have seen about new ventures, those that have been started by an independent company, is that about 50% of them cease to exist within two to three years. For the other passages there is no general data that has ever been collected, it is more anecdotal. Judging from my travels and my research, there is no shortage of failures in those other instances either.

RD: As a savvy HR person, it would be very beneficial to help my management team navigate through these passages. In your experience, what is the role of HR in these passages?

SF: There are several different things that HR can do to help leaders through these passages. Number one is leadership development. HR has a huge role to play in that up and down the organization. How often during the leadership development process are we able to view metrics on how individuals learn from mistakes or how they involve others in decision making? One of the biggest problems in the organizations I studied is the inability of people to be honest with their superiors. There are some obvious reasons why you might not want to be. Whose responsibility is it to ensure that people will be honest and truthful and provide the feedback that needs to be heard? I think that is the job of every leader, every person who has people reporting to them. We don't do a very good job in helping people learn the techniques of open fair debate, especially when those debates represent contrary points of view. Leadership development is an important area where HR professionals can be very influential.

Coaching is also very important. HR professionals can introduce coaching in an effort to avoid defensive and delusional behaviors. Additionally, they can help with early warning systems. One of the issues that came up in my research was the necessity to determine what could go wrong before it is too late. HR is very well placed to help the organization with an early warning system that could help avoid some of the pitfalls and disasters that I describe in my book.

RD: In the book you talk about the four passages and you talk about some specific problems that are associated with those ventures. You also go deeper and talk about the causes of failure that underlie all four of those transitions. Can you give us your key findings and tell us about these causes?

SF: I found four major underlying explanations for failure. Unfortunately, we have dozens of examples for each one but I will try to stick to just a few.

Executive mindset failure is when an organization's strategy is wrong. For example, you believe the strategy is analog when in fact it is digital. LA Gear is another example. They thought they were competing against Nike and Reebok, when what they were really doing was manufacturing fashion accessories for teenagers in Southern California. Getting the strategy wrong mostly occurs because of a series of wrong assumptions that executives make. When I work with companies on these ideas one of the first things we do is drill down behind the assumptions of an initiative or strategy. We write them down and then look at them to see if they are right. You need to state very clearly what those things are. Sometimes when you write them down it is easier to see that these assumptions might not be correct.

Getting the strategy wrong is never a good thing, but it was never enough to lead to the failures that I saw in my research. You typically have to do something else. The most common of those is what I call, "delusions of a dream company." This happens in organizations that have been very successful and take pleasure in telling everyone else just how great they are. As a result, they begin to adopt a set of processes and methods that shut out other contrary sources of information. When you walk into these organizations and talk to the CEO's, it is remarkable to hear what they have to say. One CEO told me that they took particular pride in being a company of positive thinkers. No one is going to say it is bad to be a positive thinker, but I am a bit concerned if everyone is saying exactly the same thing and doing the same thing. If you have a company full of positive thinkers, then you don't have any negative thinkers. Negative thinkers often have a willingness and talent to push back and challenge which is what you really need in an organization.

These failures often occur because businesses don't act on vital information. Something is wrong with their information and control systems. You need to ask questions like: Is the right kind of information coming into your organization, how it is coming in, where it is going and how it is being shared? There are dozens of questions you can ask about information and control systems and while it may not be exciting, you don't have to go very far to see the consequences of getting this wrong. Tragically, after 9/11 we saw how critical information was dropped, filtered or never passed along. People should ask themselves how confident they are that they are getting the right information to the right people at the right time and that those people are motivated to do something about it.

The fourth explanation for failure is leadership pathology. What I tried to do in the book was isolate the specific behaviors that were most associated with failure and disaster. In the book I talk about the seven habits of spectacularly unsuccessful people. Those are the habits that I kept on seeing amongst executives and senior leaders that I wanted to capture.

RD: Why don't we get into each of these more in-depth and talk about the seven habits of spectacularly unsuccessful people?

SF: Let's start with executive mindset failures. There are so many examples of this. The 'one best way' example is a powerful one. That is when an organization has a particular way of thinking and they continue to stick to that game plan, despite the fact that evidence suggests it is not the right thing to do. When you keep on sticking with yesterday's answers, there are some real dangers. Rubbermaid illustrates this example as well as any. In 1993, Rubbermaid was named one of America's Most Admired Companies in Fortune magazine. In that article they talked a lot about how innovative the company was. In the late 1990's there was a significant market shift towards big box retailers like Kohl's, Target and Wal-Mart. These companies went to Rubbermaid and said that they loved their innovation but they wanted to make sure that they could deliver products in a way that was consistent with their warehousing and logistics systems. They also told Rubbermaid that they wanted them to lower their prices. This was a disaster for Rubbermaid and it sent them into tremendous turmoil because everything they did was based on being an innovative leader. The market was telling them that while innovation was fine, they also wanted cost control and logistics expertise. The writing was on the wall for a long time and they should have known that these changes were occurring, but they denied it. They believed that innovation would win the day. Rubbermaid ended up being acquired by a conglomerate and it was a big fall from being America's most admired company.

"Delusions of a dream company" is another good example. During the Internet era, we had a huge number of people who believed that if they were an Internet company then they were a superior businessperson. If you didn't adapt to the Internet, you were considered a dinosaur. There was a tremendous amount of arrogance associated with that. There was a new economy and an old economy and the implication was that if you were working in the old economy then you just weren't that smart. Many of the Internet companies believed that they had developed a set of business models that made tremendous sense and were a huge advantage over everyone else. As a result, competitors were wrong, customers were wrong and suppliers were wrong. Everybody else was wrong, except these Internet start-ups because they had re-defined how business worked. Of course, as we all know, the laws of supply and demand are not quite as vulnerable to trends in the economy and we have numerous examples of Internet companies that really stumbled. Webvan was an online grocery company that spent $1.5 billion on setting up warehouses and distribution centers around the country. The company ended up failing and losing money because they didn't charge customers anything for their service. Webvan really thought that they were redefining everything that was good about the grocery business. The truth is that online grocery delivery is not that complicated and the companies that have succeeded at it are older offline grocers. They already have customers and infrastructure and products and those things are a lot tougher to create than an Internet customer interface. We have numerous examples of organizational breakdowns as well. Saatchi & Saatchi is a global advertising company, headquartered in the UK, founded by two brothers. They won many awards in their early days in advertising but they broke a lot of the rules – some ethical and some business. As they grew they decided to define their organization as a services company, instead of just an advertising company. It wasn't enough for them to be the number one advertising agency; they wanted to be number one across the board. They ended up acquiring dozens and dozens of companies; first it was advertising agencies, followed by consulting firms, and then they even tried to buy a bank. As they expanded further and further away from what they were really good at, they found that they really stumbled and struggled. What's interesting is that they didn't do any of the things that were important to acquisition process; things like due diligence, negotiation, bargaining for the right price and integration. They would offer companies a very, very high price based on minimal due diligence because they just wanted to grow as fast as possible. They built a house of cards that ultimately collapsed and the Saatchi brothers ended up being forced out of the company. Under the leadership of the new CEO, the company has recovered in recent years. This is one of the few stories in the book of a company that has resurrected itself from disaster to become a world leader.

The **seven habits** of spectacularly unsuccessful people take a variety of forms. In small doses, many of these habits are important to the success of leaders. It is only in large doses that these habits become toxic. As you read the book there is something of a Greek tragedy element to it. Some of the things that get you to the top, if left unchecked, can be responsible for your downfall.

The **first habit** is 'they see themselves and their companies as dominating their environments.' In small doses we want all of our people to believe that they can have an impact on what is going on around them, but in large doses that can lead to them believing that they are dominant over people or that they are preeminent over everyone and everything. This is the closest leadership analog to the delusions of a dream company. How do you become a delusional organization? By having leaders that adopt the illusion of personal preeminence, which means that they believe they have everything figured out and have no need to learn from anyone else.

The **second habit** is 'the company is mine – there is no clear boundary between their personal interests and their corporation's interests.' In small doses this goes along with aligning the interests of an individual with the organization. Identifying with your company is, of course, a great thing to do. The problem is when that identification goes to an extreme and you don't just identify with the company as the place where you work, but you identify with the company as being the most important part of your life. In extreme cases, you don't work for the company, the company works for you. When that happens it is a slippery slope to all sorts of unethical and even illegal activities.

Habit number three is about knowing all the answers. There is no one who is going to go to work and not be able to solve problems and make decisions. The problem is when you believe that you have to make all the decisions and solve all the problems. What you are doing is shutting people out. Entrepreneurs are the most at risk of falling into this trap. When starting out you don't have the luxury of having other people around you, but as you grow it is essential to have a group of high-quality individuals around you that you can rely on to make decisions.

The **fourth habit** is, 'my way or the highway – they ruthlessly eliminate anyone who isn't 100 per cent behind them.' In my research I found that a significant number of people left their organizations three months to a year before the really bad stuff hit the business press. Why do people leave? It always sounds like a good reason, but it usually boils down to one of two things. The first reason is because they feel that the boss has all the answers and they don't have an opportunity to have an impact. The second, more common reason is that they know some bad things are going on and they don't want to be there when it comes out.

Habit five, 'It's my company and I want to star in the commercial – they are the consummate company spokesperson, obsessed with the company image.' This is pretty self-explanatory. Some leaders believe that image and public relations is more important than what the products or services the company offers.

Habit six refers to overlooking or disregarding major obstacles. I mentioned the Iridium phone system before, which is a good example of this. This one is a very serious problem for entrepreneurs because in the early stages of an organization you have to believe that you can overcome obstacles. The problem is that when you get bigger, you can no longer behave in the ways that you originally did in order to become successful.

Habit seven is that they stubbornly rely on what worked for them in the past. There are so many instances in my research where leaders were unable or unwilling to imagine that the market was changing. This unwillingness to change and adapt is a critical failure factor and one that we want to be hyper alert to.

RD: Can you tell us a bit about some of the key things that smart executives can do to learn?

SF: Number one is to know what the wrong things to do are. Number two is to be open-minded. A leader should recognize that no matter how smart or successful they are the business landscape is littered with hundreds of companies and people who were equally smart and talented but failed because they refused to be open-minded. Open-mindedness is a state of being; you can do it if you want to do it. That is the most important thing that I can advocate.