"You can read many books telling you how to make your company great. But if you succeed, remember that success is a potential poison. Thanks to Jagdish Sheth, one of the keenest observers of the business scene, you now can avoid the seven slow poisons that can undo your good work."

— **PHILIP KOTLER**

THE SELF-DESTRUCTIVE HABITS *of* GOOD COMPANIES

...And How to Break Them

JAGDISH N. SHETH

"When the going is good, it is indeed very easy for leaders to fall into the trap of success and lose sight of reality. Dr. Sheth has captured this aspect beautifully with several examples that make it an interesting read. What is even more important is the timing of the book. It could not have been better timed. For enlightened leaders, this book can serve as a good warning signal and provide valuable insights in managing the future of their business proactively."

—Harsh Mariwala, Chairman and Managing Director, Marico Limited

"Congratulations to Jagdish Sheth for providing invaluable insights into the self-destructive habits of good companies that so often lead to business failure. Every day brings news of painful restructurings at companies once thought to be indestructible—in most cases brought on by the very habits Dr. Sheth analyzes. This book is a must-read for executives and managers everywhere—and especially at the fast-rising global corporations in developing nations."

—Azim Premji, Chairman, Wipro Ltd.

"As an advisor to many large Indian corporations and industrial groups, as well as a manager of traditional businesses, I have seen up-close many of the bad habits Dr. Sheth so brilliantly analyzes. Yet Dr. Sheth goes further than merely pointing out these destructive habits; he clearly articulates strategies for avoiding and/or breaking them. Since I'm convinced that leadership is all about discerning such problems early and intervening to make the necessary changes, I find this aspect of Dr. Sheth's remarkable book to be especially valuable."

—Dr. Bharat K. Singh, Managing Director, Aditya Birla Nuvo Ltd.; Director, Aditya Birla Group

"There are many pitfalls on the road to building a global company from the ground up, and, once it's built, to keeping it running smoothly. Every business leader should be indebted to Dr. Sheth for so clearly pointing out the warning signs that tell us something is amiss, that destructive behavior is in evidence, and that corrective action is called for. I would advise executives and managers to ignore this book at their own peril."

—Arthur Blank, Co-founder, The Home Depot; Owner and President, The Atlanta Falcons

"Jag hits another home run. He literally provides a handbook on how not to fail in business."

—W. Cliff Oxford, CEO, The Home Shoppe

"Professor Sheth is ranked amongst today's top management thinkers. His latest book describing how good companies self-destroy is extremely timely and relevant to both Old Economy as well as New Economy enterprises. Professor Sheth's observations and analysis are internationally relevant and serve as a timely wake-up call for managers and leaders."

—Ashok Ganguly, Chairman, Firstsource Solutions Ltd.

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I would like to thank Duane Ackerman, CEO of BellSouth, who years ago asked me the question: Why do good companies fail? This thought-provoking inquiry launched the journey of investigation that culminated in this book.

CONTENTS AT A GLANCE

CONTENTS

Acknowledgments

This book's thoroughness and readability would not have been possible without the assistance of John Yow. This is the second book he has helped me complete, and again his in-depth research and uncanny knack for shaping ideas and concepts into a highly readable and entertaining tome were an important element of the final manuscript. John is the consummate Southern gentleman. Working with him was a pleasure, on both a professional and personal basis. I look forward to collaborating with him on future books.

Mark Hutcheson also provided key assistance in moving this book to a final manuscript. He provided additional research on companies, offered editorial comments and suggestions, and contributed to a number of passages. He also worked diligently to manage the manuscript process and to coordinate efforts with the publisher.

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This book would not have been written, or at least would not have been written as quickly, without enthusiastic encouragement from Yoram (Jerry) Wind, editor at Prentice Hall. As soon as I explained to him how these self-destructive habits destroy great companies, he was insistent that I move forward with a manuscript and bring the project to Prentice Hall. His enthusiasm and excitement were infectious and were a major reason why you're reading this book. I also received similar enthusiastic support from Prentice Hall's executive editor, Tim Moore.

And finally, I would like to express my gratitude to everyone at Prentice Hall who was involved with this book's review and production. This goes especially to Paula Sinnott, who was a pleasure to work with and who kept the publication process on track, and to Russ Hall, who provided valuable editorial polish to the final manuscript.

About the Author

Dr. Jagdish (Jag) N. Sheth is the Charles H. Kellstadt Professor of Marketing in the Goizueta Business School at Emory University. Prior to his present position, he was at the University of Southern California (7 years); at the University of Illinois (15 years); and on the faculty of Columbia University (5 years), as well as the Massachusetts Institute of Technology (2 years). Dr. Sheth is well known for his scholarly contributions in consumer behavior, relationship marketing, competitive strategy, and geopolitical analysis.

Professor Sheth is highly sought out as a keynote speaker at many industry, academic, and public forums. He has worked for numerous industries and companies in the United States, Europe, and Asia, both as an advisor and as a seminar leader. His clients include AT&T, BellSouth, Cox Communications, Delta, Ernst & Young, Ford, GE, Lucent Technologies, Motorola, Nortel, Pillsbury, Sprint, Square D, 3M, Whirlpool, Wipro, Alcatel, Ericsson, Siemens, General Foods, Unilever, Philips, Thysson-Krupp, ABG, Tata Group, Marico, General Mills, and many more. He has offered more than a thousand presentations in at least twenty countries. Dr. Sheth is frequently quoted and interviewed by the *Wall Street Journal*, *New York Times*, *Fortune*, *Financial Times*, *Economic Times*, and radio shows and television networks such as CNN, CNBC (India), and BBC. He is also on the Board of Directors of several public companies, including Cryo Cell International (NASDAQ), Wipro Limited (NYSE), and Shasun Chemicals.

In 1989, Dr. Sheth was given the Outstanding Marketing Educator award by the Academy of Marketing Science. In 1991 and again in 1999, he was given the Outstanding Educator Award by the Sales and Marketing Executives International (SMEI). Dr. Sheth was also awarded the P.D. Converse Award for his outstanding contributions to theory in marketing in 1992 by the American Marketing Association. In 1996, Dr. Sheth was selected as the Distinguished Fellow of the Academy of Marketing Science. In 1997, Dr. Sheth was awarded the Distinguished Fellow award from the

International Engineering Consortium. Dr. Sheth is also a Fellow of the American Psychological Association (APA). 2004 marked a stellar year for Dr. Sheth as he was awarded both the Richard D. Irwin Distinguished Marketing Educator and the Charles Coolidge Parlin Awards, which are the two highest awards given by the American Marketing Association. In 2005, he was recognized as the Society for Marketing Advances's 2005 Elsevier Distinguished Professor, and in 2006 he received the RHR International Award for Excellence in Consultation from the American Psychological Association. Dr. Sheth was named the Emory University Faculty Lecturer for 2007, the first time a business school professor has been given this honor.

A prolific author, in 2000 Dr. Sheth and Andrew Sobel published a best seller, *Clients for Life* (Simon & Schuster). His book, *The Rule of Three* (Free Press), coauthored with Dr. Rajendra Sisodia, altered the current notions on competition in business. It was published in 2002 and has been translated into German, Italian, Polish, Japanese, and Chinese. It was the subject of a seven-part television series by CNBC (India) and was a finalist for the 2004 Best Marketing Book Award from the American Marketing Association. His most recent book, *Firms of Endearment: How World-Class Companies Profit from Passion and Purpose*, was published in 2007 by Prentice Hall.

Foreword

I am surprised and flattered that my close friend and distinguished colleague chose to dedicate his new book to me. I am especially pleased that my question to Dr. Jagdish Sheth all those years ago proved to be the impetus for *The Self-Destructive Habits of Good Companies*—one of the most insightful business books to appear in some time.

My friendship with Jag (as he is known to all) goes back many years, as does my debt to his wise counsel. Jag was a trusted confidant of mine, and of BellSouth's, during years of considerable turmoil in the telecommunications industry, and he helped us challenge the status quo business beliefs that followed our company as we exited our monopoly ancestry. Jag helped us challenge the thinking of senior leaders as well as middle managers and that work influenced the culture that emerged in a competitive BellSouth.

Of course, BellSouth is but one of many companies for whom Jag has provided his invaluable expertise. The list of distinguished companies that have called upon his help is a long one and spans three continents—North America, Europe, and Asia. I'm constantly amazed at his frenetic consulting and speaking schedule, yet he still finds time to teach some of the most popular courses at Emory University's Goizueta Business School, where he holds the Charles H. Kellstadt chair. The university and the community were fortunate when Jag decided to make Atlanta his home.

This new book (the latest of several, by the way) quickly reveals the breadth of Jag's expertise and the depth of his insights. For obvious reasons, I was particularly interested in the chapter entitled "Complacency: Success Breeds Failure," especially about the complacency that results "when your past success came via a regulated monopoly." Reading again about the forced break-up of AT&T in 1984 reminded me of the painful lessons that companies in many industries were forced to learn thanks to deregulation—lessons which Jag spells out in no uncertain terms. I must say I

had to laugh when Jag's account reminded me that, after the break-up, AT&T at first wanted to rename itself American Bell International, until Judge Harold Greene intervened. Jag writes that he still has the tie that Randall Tobias gave him with the new ABI logo on it. "Hold onto it," Tobias told Jag. "It'll be a keepsake one day."

I also particularly enjoyed the chapter, "The Territorial Impulse: Culture Conflicts and Turf Wars." It's no secret that teamwork has always been a mantra of mine, and Jag's metaphor of the company structured as "a complex of 50-story office towers, connected only by common areas at the bottom and the top" speaks volumes about the way many businesses are run today.

So it is in chapter after chapter that Jag analyzes companies like Digital Equipment, GM, Firestone, and Zenith. Jag's dozens of illustrations are always incisive, but the book wouldn't be complete without, at the end of each chapter, his "warning signs" of each bad habit and, most helpful, his step-by-step approach to breaking each habit before it does its damage.

The Self-Destructive Habits of Good Companies is entertaining, instructive, and tremendously valuable. I could not recommend it more strongly.

—F. Duane Ackerman, Chairman Emeritus, BellSouth Corporation

Preface

I trace this book's origins to one of the most insightful questions I have ever been asked by a corporate executive: *Why do good companies fail?* The CEO who posed this riddle had been a great fan of the 1980s business best seller *In Search of Excellence* by Tom Peters and Robert Waterman. However, as time went by, he was struck by how many of the companies cited as exemplars of world-class corporations were either struggling or no longer in existence. This included such icons of U.S. business as Sears, Dana Corporation, AT&T, Xerox, IBM, and Kodak.

The more I pondered the CEO's question, the more curious I became as to why companies that seem to be doing so well and that are at the top of their industry, can almost overnight spiral downward into survival mode. The companies I'm talking about are not government-protected monopolies that have suddenly been cast into the churning seas of competition. I'm referring to world-class businesses that appear to have top managers, a proven track record of success, inventive products, and a seemingly unassailable competitive position. Why do *these* companies go bad?

My journey toward an answer began with archival research to identify companies that were great in their time and that had subsequently faded away. During this process I tried to understand the reasons for their downfall. The message that came out of the research was simple: Good companies fail when they are unable or, more curiously, unwilling to change when their external environment changes significantly.

Underlying this inability or unwillingness to change, I discovered the self-destructive habits successful companies acquire on their way to greatness. As my research progressed, I began to give presentations to professional managers and MBA students on my findings, and I would talk about self-destructive habits such as denial, complacency, or cost-inefficiency. I would often joke that I should write a book called *The Self-Destructive Habits of Good Companies*. Instead of making a joke of it, more and more people suggested that I write the book.

I have written about seven self-destructive habits in this book. Although I could have included an eighth or ninth habit, my purpose is not to present an exhaustive list of self-destructive habits but to identify those that are the most crucial to avoid. And if forced to narrow down this list even further, I would have to say that denial of the new reality (Chapter 2) and the territorial impulse, or internal turf wars (Chapter 8), are the two most dangerous habits.

There are three conflicting theories as to why companies die. One is population ecology or "survival of the fittest" theory: Companies die because bigger and better companies will come along and take away their business. In other words, you die by being systemically weeded out by the competition.

The second is the inevitability or "birth and death" theory. Just like the human life cycle, this theory suggests that a cycle of birth and death is inevitable for all companies. There is nothing you can do about your company's eventual demise—it's just a matter of time before fate runs its course.

My view, however, is that most companies can survive forever if they recognize and take steps to counter self-destructive habits or set up processes to keep them from arising in the first place. I felt this was possible because habits are learned behaviors, not inevitabilities. Therefore, it is important that I not only show you how to identify self-destructive habits, but also suggest prescriptive measures for curing them, and I have done so in each chapter. And while curing self-destructive habits is an admirable achievement for the afflicted, an even more sound approach is to devise preventive programs to avoid them in the first place (Chapter 9).

An underlying theme of this book is that great leadership is crucial for helping a company avoid or break self-destructive habits. Good leaders provide vision for the company. However, great leaders, in addition to being visionaries, must be grounded in the reality of current and potential vulnerabilities posed by a hostile and constantly changing external environment. Great leaders are constantly looking out for self-destructive habits that will get in the way of the exciting vision.

I hope to generate dialog from the readers of this book. I encourage you to provide stories you have encountered about any of the self-destructive habits. The Web site www.destructivehabits.com has been set up for you to post examples of companies that have been afflicted with self-destructive habits, as well as companies that have done a good job of correcting or avoiding them. I also plan to have a blog that will provide updates and commentary about the companies mentioned in this book and the companies suggested by readers. With your help, I might be able to offer a revised version of this book in the near future.

CHAPTER 1

Why Do Good Companies Go Bad?

Why do good companies go bad? Honestly, I hadn't thought too much about this question. Then a CEO friend of mine brought up the 62 "excellent" companies praised by Tom Peters and Robert Waterman in their early 1980s bestseller *In Search of Excellence*. A great many of them—including such stalwarts as Sears, Xerox, IBM, and Kodak—had faced serious hardships in the 20-odd years since. Some of them recovered. Some, as I write, are struggling mightily to recover. Some are dead or, in all likelihood, soon will be.

So why do good companies go bad? This heartfelt and insightful question launched me on a journey of discovery. I started by conducting archival research on companies that had failed during the past several decades, interviewed people from some of the failed companies, and eventually came to the conclusions presented here.

Although it is commonly believed that institutions are (at least potentially) immortal and humans are mortal, I found that the average life span of corporations is declining, even as that of humans is rising. Others have come to similar conclusions. In the best-known work in

this area, *The Living Company*, Arie de Geus found that one-third of the companies listed in the 1970 Fortune 500 had vanished by 1983, either through acquisition, merger, or being broken up. De Geus quoted a Dutch survey showing that the average corporate life expectancy in Japan and Europe was 12.5 years. Another study found declining corporate life expectancy across the major European economies: from 45 to 18 years in Germany, from 13 to nine years in France, and from ten to four years in Great Britain.

Much of the decline in corporate life expectancy is the result of a heightened level of merger and acquisition activity in recent decades. However, most of this activity is due to distress selling rather than strategic buying because so many companies are in trouble.

Let me say at once that I have no intention of discounting the need to learn the underlying causes of success—the "good habits" of good companies. Nor will I second-guess de Geus or Peters and Waterman or others, like Jim Collins. For very good reasons, they singled out certain companies as models of success—companies that, for very different reasons, have since fallen on hard times. My purpose is not to reexamine why these companies were considered "excellent" or "visionary" in the first place. I am interested in what happened to them afterward—why they fell, why they failed, why they lost the magic touch. What happened?

In my view, when companies rise to excellence, they often unwittingly develop self-destructive habits that eventually undermine their success. As with people, these self-destructive habits are learned, not innate, and we can watch as companies adopt patterns of behavior that are self-destructive. Sometimes these habits get worse over time and become, in effect, addictions. But self-destructive habits can also be broken and overcome, and companies can be put back on the road to improved health.

Often the turnaround is precipitated by a crisis. Our self-destructive habits creep up on us, if you will. We overeat, fail to exercise, maybe even smoke, but we think we're still doing okay—until we have that minor heart attack, that potent reminder of mortality. Suddenly our self-destructive habits are gone, and we're eating salads and walking five miles a day. In the case of corporations, the

crisis might take the form of an emerging competitor, a sudden erosion of market share, or a technological advance that threatens to leave the company behind. Such developments can spell doom, or they can serve to shake companies out of their destructive behavior patterns.

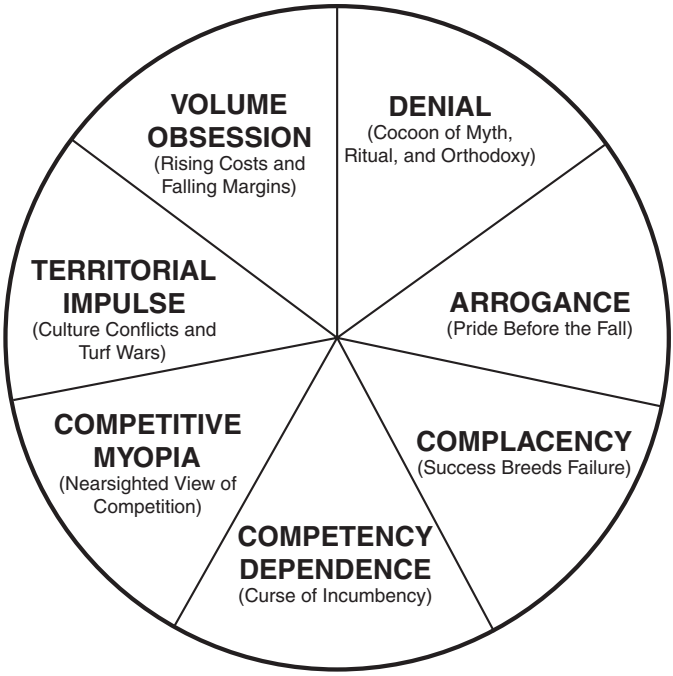

Figure 1-1 Self-destructive habits of good companies

We'll see plenty of examples of companies that are actively working to curb their self-destructive habits, to change their behavior, as well as companies that have already done so and are "in recovery." Our message is positive: if you're willing to examine yourself honestly enough to discover your weaknesses, you can ultimately transform yourself.

So what are these self-destructive habits? We'll enumerate them one by one in the following chapters (and they're summarized in Figure 1-1). But first, let's see them in action by examining three companies in the technology sector.

DIGITAL

It's one of the great success stories in the annals of American business. In 1957 Kenneth Olsen, a 31-year-old engineer at MIT's Lincoln Laboratory, asked for $70,000 from American Research & Development to start a new firm he wanted to call Digital Computer Corp. He got the money, but the venture capitalists made him change the name. They pointed out that too many big companies, like RCA and General Electric, were losing money in the computer business.

So Digital Equipment Corp. set up shop in an old wool mill in Maynard, Massachusetts, and Ken Olsen set about to pursue his dream: to revolutionize the computer industry with the introduction of the "minicomputer"—a smaller, simpler, more useful, and far cheaper device than the bulky mainframes that were the industry standard.

In its first year, Digital had sales of $94,000. Five years later that number reached $6.5 million. In 1977, the company hit the $1 billion mark. Digital found itself leading an industry boom rippling from the Boston area that created so many high-paying jobs it came to be called the Massachusetts Miracle. At the same time, the reputation of its founder grew. He was brilliant and eccentric. He protected his innovative engineers. He instituted a no-layoff policy. Digital was known as "a fun place to work."

No wonder that when Tom Peters and Bob Waterman went "in search of excellence" for what became their 1982 bestseller, Digital not only made the list of excellent companies but was also considered one of the 15 "exemplars" that basically did everything right. It was one of the companies that represented "especially well both sound performance and the eight traits [of excellence]" the authors identified. Such high accolades appeared to be borne out when *Fortune* magazine, in 1986, declared Olsen "arguably the most successful entrepreneur in the history of American business."

Let's jump ahead to the end of that decade. In January 1989, Digital announced it would introduce a range of personal computers, along with their more powerful cousins, workstations. The question was, had Olsen already waited too long? One thing was certain: the stock was trading at $98, down from $199 just a year

and a half earlier. Another certainty was that the minicomputer, the radical innovation on which Olsen had staked his company, was rapidly becoming a high-tech dinosaur. Today it's clear that the writing was on the wall. But Olsen had erased it and scrawled his own message: "The personal computer will fall flat on its face in business." Now his company appeared to be acknowledging its failure to see the future.[1]

Despite the eleventh-hour about-face, the hemorrhaging at Digital continued through 1991. Top executives were fleeing, and the company that abhorred layoffs was in the process of cutting 10,000 employees from the payroll. By then, Olsen had been in charge for 34 years and still entertained no thoughts of retirement. Instead, he used the annual shareholders' meeting that year to introduce the company's next-generation "Alpha" computer chip, which Olsen claimed was four times faster than the top-of-the-line chip from Intel. But the shareholders probably weren't heartened because the stock was now trading at $59 a share.

In the spring of 1992, the company flabbergasted Wall Street with the news that it had lost $294 million in the quarter that had just ended, only the second time in its history that Digital had reported a loss. Olsen responded with a massive restructuring of top-level management. It didn't help. By the end of April, the stock had fallen to $46, its lowest price since 1985, and takeover rumors were circulating.

That same spring, the *Wall Street Journal* seemed to be working on its first draft of Olsen's obituary. The *Journal* noted that a secret meeting between Olsen and Apple's John Sculley—a meeting that might have produced an alliance with much potential for Digital—had come to nothing. Instead, Apple had shocked the industry by inking a broad technology-sharing agreement with archenemy IBM.

The *Journal* described this as another opportunity apparently lost to Digital and Olsen. His persistent doubts about the PC—"he used to call it a 'toy'"—had crippled the nation's second-largest computer maker when the market turned to PCs. The *Journal* also noted that Olsen's resistance to another major trend of the last decade—so-called "open" systems that use standard operating software—had similarly impeded the company's performance.

Digital was now faced with the danger of being left behind by the industry it was instrumental in creating. As it struggled with huge losses on declining sales, repeated restructurings, and the exodus of key executives who questioned Olsen's decisions, the company watched its value plummet, with shares trading at one-fourth of their 1987 high.

At the same time, Olsen's autocratic style was drawing widespread criticism. John Rose, who a month earlier had resigned as manager of Digital's PC unit, told the *Journal* that the company "has everything it needs to turn around—good people, good products and great service—but it won't happen while he's still in charge." And one of Digital's former computer designers described Olsen as the Fidel Castro of the computer industry, adding that he's "out of touch, and anyone who disagrees with him is sent into exile."

One who had fallen into disfavor amid the recent turmoil was Digital's chief engineer William Strecker, who had opposed a mainframe project that Olsen backed, despite the fact that it was proving a costly failure. The disbanding of Strecker's group was viewed as an especially strong signal of disarray in the executive suite. A former Digital manager told the *Journal* that it was a "criminal shame," because Strecker was the only member of the inner circle who could develop a coherent product strategy.

The *Journal* suggested that Olsen's support of the ill-fated VAX 9000 mainframe, which cost $1 billion to bring to market but attracted few buyers, was partly responsible for Olsen's failure to work out a deal with Apple. Roger Heinen, an Apple senior vice president who was privy to the meeting, blamed the stalemate on Olsen's disinterest and lack of understanding of the importance of the personal computer industry. The *Journal* concluded that Olsen's vision of the computer industry was lacking and that his choices were leaving the company at a disadvantage in a market that was rapidly transforming.[2]

Just two months later, in July 1992, Digital announced that Olsen would retire as president and CEO, effective October 1. Olsen quickly followed with his own announcement that he would also vacate his seat on the board at that time, thus severing all formal

ties to the company he had led since its inception. His resignation would also give a free hand to his successor, Robert Palmer, who faced the unenviable task of rescuing a company that had reported a loss of $2.79 billion in fiscal 1992.

Would the seven-year Digital veteran prove up to the challenge? He certainly seemed to be giving it his best shot. After six months on the job, Palmer had reorganized, slashed costs as well as jobs, recruited a new management team from outside, changed the color of the Digital logo, and, most radically, sold the old mill, the company's first and only home base. Palmer also announced a fundamental change in philosophy: a 19 percent spending cut on product development and engineering. No longer would Digital put competing teams to work on the same or similar problems (a practice highly praised in *In Search of Excellence*). "We have to rationalize our spending, have less redundancy in hardware and software design," Palmer told the business press.[3]

Early results were promising. In July 1993, the company announced quarterly earnings of $113 million. The stock price was rising back into the mid-40s. Even more important in many analysts' minds, wrote the *Washington Post*, was that "under Palmer the company is no longer in denial."[4]

Too little, too late. Ultimately, Palmer couldn't stop the bleeding. In January 1998, the crippled giant was acquired by Compaq—ironically, the world's largest maker of PCs—for $9.15 billion. The great Digital was dead.

All the postmortems agreed that, in the last analysis, the visionary's vision had failed: the company blinked and missed the PC revolution; blinked again and missed the change to open, rather than proprietary, systems; and, in classic denial, continued through the early '90s to pour money into developing a new mainframe.

As C. Gordon Bell, one of the chief engineers in Digital's early days, told the *Boston Globe*, the company's success bred its failure. "The VAX [minicomputer] took over the company, and what it allowed them to do was not think. No one had to think from 1981 until 1987 or '88 because the VAX was so dominant."[5]

IBM

Digital was not the only giant computer company that found itself struggling in the early 1990s. Big Blue, IBM itself, was also on the ropes. What happened there makes for an interesting contrast. But first let's back up.

IBM's roots go back to 1911, when two small companies specializing in measuring scales, time clocks, and tabulating machines for clerks and accountants merged to form the Computing, Tabulating, and Recording Company. The new company floundered for three years, and its board seriously discussed liquidation. Instead, they hired Tom Watson Sr. away from National Cash Register in 1914. Under Watson's leadership, the company's health gradually improved, and by 1930 it had become the market leader in tabulating machines. Watson's far-reaching vision for the company was in evidence when in 1925 he changed the company's name to International Business Machines.

Watson Sr.'s success, and that of his company, is often attributed to his fierce adherence to what he called his "three basic beliefs": give full consideration to the individual employee, spend a lot of time making customers happy, and go the last mile to do things right and seek superiority in all that we undertake. Watson Sr. also consciously created a culture to embody and promulgate these beliefs—"an organization of dedicated zealots," as Jim Collins and Jerry Porras called it in *Built to Last*. IBM's process of institutionalization and indoctrination encompassed appearance (dark suits), behavior (no drinking), and attitudes (high and mighty). In the words of Watson Sr., "You cannot be a success in any business without believing that it is the greatest business in the world."[6]

Guided by its core beliefs and proud of its unique culture, IBM evolved from the leader in tabulating machines to the dominant player in the computer industry, a position it has held for decades. Not surprisingly, IBM was not only hailed as one of the 15 "exemplars" in *In Search of Excellence*; it was also one of the 18 "visionary" companies profiled in Collins and Porras's influential study, published in 1994.

To attain "visionary" status, say Collins and Porras, a company must be willing to take the big risk (much as Digital did by developing the

minicomputer). A company must be willing to pursue what the authors call a "Big Hairy Ambitious Goal." In IBM's case, the BHAG was to reshape the computer industry in the early 1960s with an all-or-nothing investment in a new computer—the IBM 360. According to the authors, when IBM rolled the dice on the 360, it was the largest privately financed commercial project ever attempted, and it used more resources than the United States did to develop the first atomic bomb. Tom Watson Jr., who succeeded his father as CEO, described it as the biggest and riskiest decision he had ever made.[7]

The gamble paid off, to say the least. The company soared on the success of the 360, and its position of industry leader was further solidified—that is, until the company began to slip in the late 1980s and early 1990s. In 1992 IBM suffered its worst year in history, posting a nearly $5 billion net loss. Its stock was down 70 percent from its all-time high, wiping out more than $70 billion in shareholder value. What had happened?

In the case of Digital, Ken Olsen was in denial; he refused to change. In contrast, IBM knew it needed to change but simply couldn't. Presiding CEO John Akers was no Ken Olsen, and he lamented his inability to bring about the necessary transformation. He couldn't make the ocean liner change direction. IBM's culture was too ingrained, and its DNA seemed inalterable. The company was trapped by its own competency, victimized by what I call the "expertise paradox." Plus, it had been doing so well for so long that it had become complacent. Ironically, IBM had originated the concept of the home computer in the early 1980s. But its position in mainframes was so dominant and so secure that it continued to set the company's direction while the PC market was inundated by less-expensive IBM clones. Lou Gerstner, former CEO at IBM, hit on an appropriate metaphor in the title of his autobiography: *Who Says Elephants Can't Dance?*

Collins and Porras say that IBM began to lose its stature as a visionary company in the late '80s and early '90s because it lost sight of Watson Sr.'s core beliefs. There was too much emphasis on the *trappings* of its vaunted culture—blue suits, white shirts, and even computers—and not enough on real core values. "IBM should have much more vigorously changed *everything* about itself *except* its core values," write the authors. "Instead, it stuck too

long to strategic and operating practices and cultural manifestations of the core values."[8]

Collins and Porras go on to say that visionary companies have an extraordinary resiliency and the ability to rebound from adversity. But, interestingly, they looked with disapproval at IBM's overtures toward Lou Gerstner, who was being offered IBM's top post even as they were writing. "What should one make of IBM's 1993 decision to replace its internally grown CEO with Gerstner—an outsider from R.J. Reynolds with no industry experience? How does this massive anomaly fit with what we've seen in our other visionary companies? It doesn't fit. IBM's decision simply doesn't make any sense to us—at least not in the context of the seventeen hundred cumulative years of history we examined in the visionary companies."

If the IBM board was looking for drastic change, the authors write, "With Mr. Gerstner, they'll probably get it. But the real question for IBM—indeed, the pivotal issue over the next decade—is: Can Gerstner preserve the core ideals of IBM while simultaneously bringing about this momentous change?"[9]

They were not the only ones asking such questions in 1993. Before Gerstner's ascension, IBM had had only six chief executives in its long history—all career Big Blue men. The new chief would not only have to master a new industry, he would somehow have to transform an entrenched corporate culture. At the same time, he had to tackle the fundamental task of rebuilding shareholder value and reenergizing IBM's huge workforce. Frankly, there weren't many believers. As soon as word of Gerstner's selection got out, the company's stock fell more than three dollars.

But within just a few months, the doomsayers were recanting. Gerstner was being widely praised for listening to and acting on the recommendations of his 200 top customers, rather than on the advice of his internal management team. It seemed he had stifled the turf wars among competing functions and product lines by going straight to customers and finding out what *their* needs were. Collins and Porras, no doubt, would have also applauded because in so doing Gerstner was surely getting back to Watson Sr.'s basic beliefs—particularly number 2: "Spend a lot of time making customers happy."

In two short years, the Gerstner turnaround was well under way. He had cut the workforce; sold assets, including real estate and a 300-piece art collection; and cut the dividend on the company's common stock. Costs were down, and profit margins were rising. The company was already back in the black by 1994; then it reported record profits in the first quarter of 1995, far exceeding analyst forecasts. Shares were back up to $90, more than double their 1993 low. The company even began to act like its old "imperial" self again—moving to acquire Lotus Corp. for $3.5 billion.

By 1998, Gerstner's work was complete. As the *San Francisco Chronicle* rhapsodized, "Given up for dead by many people just five years ago, Big Blue has enjoyed under Lou Gerstner one of the great turnarounds in the annals of U.S. business." IBM's record sales and profits in 1997 and soaring stock price were signs that IBM had regained its throne atop the computing world.

But it's not enough to say that IBM had returned to its old self; more accurately, the company, under Gerstner, had managed to reinvent itself. The *Chronicle* noted that what had really driven IBM's prosperity was its ability to help businesses enter the Internet age by working with them to develop, implement, and maintain their computer systems. This included their networks, intranets, and electronic commerce Web sites. IBM not only supplied the equipment—whether its own or other companies'—it also serviced the systems. Such services now account for more than 50 percent of IBM's sales.

The transformation has been quite remarkable. Golf fans watching the 2005 Masters Tournament, for example, saw dozens of commercials touting "IBM Global Services," which basically continues the "Solutions for a Small Planet" and "e-business" campaigns that began back in 1997 and 1998. With the help of those ads, IBM was trying to acquire a reputation as the company that others turn to for their technology needs. It was much more successful in promoting that image than its nearest competitor, Hewlett-Packard (HP).[10]

In the last analysis, Gerstner not only changed the fortunes of IBM; he changed its image. The focus on services and the advertising supporting it gave the company a new personality. "Five years ago, people would say that IBM has an incredible brain, but not a heart," says Ogilvy Mather's Shelly Lazarus, whose company

created the "Solutions" campaign. "Today, it...also has a heart and a soul and a sense of humor."[11]

INTEL

In 1968, Andy Grove and Gordon Moore built a factory to manufacture chips for video game makers such as Atari. It was a good idea, and their company, Intel Corp., had promise—until the video game industry was overwhelmed by Nintendo, which preferred to buy chips made in Japan. Suddenly Intel had more chips than buyers. About that time, though, IBM began to develop the PC, for which it would need just the sort of microchips that Intel was producing in abundance. It was a match made in high-tech heaven. Intel quickly became the world's number-one chip maker, a position it has maintained ever since.

But technology, as we have seen, continues to develop. What happened to the mainframe, and what subsequently happened to the minicomputer, is now happening to the PC. Cell phones, handheld computers, and other gadgets are eroding the demand for PCs. Now it is Intel's turn to adjust to a changing marketplace. Let's take a quick look at how the company has been doing.

At the end of 2000, Intel announced that its two-year partnership with Analog Devices was about to yield fruit. The company was ready to bring to market a new chip—the high-performance digital signal processor (DSP) for use in "third-generation" wireless devices such as advanced cell phones and palm-size computers. The problem, though, as we saw with Digital, was that Intel was following, not leading, the market. Indispensable components of electronic gadgets like modems, CD players, and cell phones, DSPs had for some time been the fastest-growing segment of the microchip market.

Intel's job, then, was not only to produce the DSP, but also to oust the market leader, Texas Instruments. (It's worth noting that TI showed considerable prescience in making the leap to DSP. It could have continued to make PC chips, but, realizing that Intel had already won that battle, it looked over the horizon. There it saw the future in "best-access" gadgets like the then-emerging cell

phone, and it concluded that the DSP was the direction to take.) For its part, Intel realized, correctly, that its PC chip business was tied to slowing growth in PC sales, but the realization came later rather than sooner. TI had already tied up a 60 percent share of the digital wireless phone business, and Mike McMahan, the company's head of R&D, told the *Boston Globe* that he was confident of their position in the market.[12]

Like Digital and IBM, Intel's story illustrates that when you're totally dominant in your chosen arena, it's hard to pay much attention to what's happening outside that arena. It's too easy, also, to ignore competition. If that was the case with the DSP in 2000, it happened to Intel again in 2003, when Advanced Micro Devices (AMD) beat Intel to the market with a product it called Opteron—a chip that offered advanced 64-bit computing power while retaining the ability to run thousands of 32-bit Windows-compatible programs. According to one account, Intel and others inside the industry scoffed at the new chip from AMD, but within a year its customer list included IBM, Sun Microsystems, and HP. Then Intel had to play catch-up again. In early 2004, the company announced that it would add 64-bit capacity to its 32-bit Xeon server chips.

The story's amusing twist is that, a decade earlier, Intel's then-CEO Andy Grove had derided AMD as "the Milli Vanilli of semiconductors," taunting the smaller company for mimicking Intel chip designs rather than creating its own processors from scratch. Fred Weber, AMD's chief technology officer, admitted to feeling "some emotional satisfaction" from seeing the tables turned. He credited AMD's success not to chance but to a five-to-seven-year strategy of "innovating in places where they were not."

Has Intel's dominant position also allowed it to take its customers for granted? An executive at Boxx Technologies, an AMD customer, points out that AMD keeps Intel honest and that competition is critical. "If you took AMD out of the picture," he says, "Intel would really slow down to maximize its return on investment." AMD's Weber puts it more forcefully: "Intel has an arrogance out of being a near monopolist.... Its respect for the customer is created by customers yelling at it."[13]

Whether Intel will be able to shed its perceived arrogance and complacency, stay abreast of its competitors, and respond to the evolving demands of the marketplace is a question now facing its newly appointed CEO, Paul Otellini, a company veteran who ascended through the marketing, rather than engineering, ranks. Will Otellini be able to reinvent Intel as Gerstner reinvented IBM and find a new direction for the company in the face of a largely saturated PC market? Based on his advocacy of the "right-hand turn"—a sharp break from the "cherished belief" that nothing matters more than ever-faster, more powerful computer chips—Otellini may be the right man for the job. He appears to be pushing the company toward the realization that, in addition to speed, customers now want things like built-in security features, wireless connectivity to the Internet, and better graphics and audio. With his marketing background, maybe he'll be able to shake up the company's elitist, high-tech engineering culture.

IT'S ALL ABOUT LEADERSHIP

So what "self-destructive habits" do you find in the interconnected stories of these three companies? Denial? Arrogance? Complacency? Check. Check. Check. How about "competency dependence" and "competitive myopia"? Check, check. Given a slightly different slant, these stories could also illustrate our final two self-destructive habits, "territoriality" (internal turf wars) and "volume obsession" (too-high cost structures). But I have lots more stories to tell. The following chapters spell out, define, and illustrate all seven of the self-destructive habits, examine other companies that have exhibited them, and look at how they corrected them—or failed to. The discussion, I hope, will show you ways to identify such behavior in your own business and ultimately point the way back toward health and longevity.

First, though, let's define our terms a little further. For our purposes, let's consider two aspects, or connotations, of "bad." The first is the more obvious and direct: bad means unhealthy, not good for you, contrary to your self-interest, or destructive. Behavior that makes your customers or suppliers resent you, that makes them seek out other business partners, seems clearly "bad"

in this sense. Arrogance or abuse of stakeholders would seem to be good examples. But "bad" in the business arena can also suggest "lost opportunity." Here, perhaps complacency, or underestimation of the competition, causes you to fail to maximize your potential. Your behavior may not be "actively" bad, nor are you reviled by others in your community. But your vision has failed, and you have lost, or are about to lose, your chance.

Finally, a word about leadership. Sometimes CEOs are directly responsible for the self-destructive habits their companies develop. This is most likely to be the case with founding CEOs, or CEOs who refuse to retire, or who "clone" their successor, or whose directors have been handpicked. Family-run businesses, where the "genetic influence" is strong, are similarly likely to fall into self-destructive habits.

However, whether or not the CEO is responsible for the company's self-destructive habits, it is definitely his or her job to break them. When proactive intervention is necessary, it can only come from the top. Sometimes, especially when the crisis is severe, when the habits have become addictions, a new leader must be brought in. We saw this in the case of IBM, and you will see other examples in the chapters to come.

Consider the performance of GE under Jack Welch. When Welch became CEO in the early '80s, analysts regarded the company as a solid but staid performer, growing at the same rate as the gross national product. Welch disagreed, and he soon threw GE into turmoil by declaring it had to radically transform itself. He launched a major restructuring under a strategy called "No. 1, No. 2," which mandated "fixing, closing, or selling" every business that was not first or second in worldwide market share and that did not offer major global growth opportunities. In implementing this strategy, GE eventually sold 400 businesses and product lines—including housewares and mining operations—worth $15 billion and acquired 600 others worth $26 billion. By 1988, GE was organized into 14 major high-tech or service businesses that Welch believed had tremendous global growth potential.

GE is a prime practitioner of anticipatory management, a proactive approach to controlling one's destiny in a changing market.

Anticipatory management is most needed and works best when the external environment is undergoing rapid and discontinuous change. Anticipatory management gives organizations a major competitive advantage. Trends that are anticipated can be planned for, and competitive advantage accrues for firms that do so better and earlier than their competitors.

As shown in the following figure, when a company continues to practice "status quo" management and look inside-out rather than outside-in when the environment is changing, it begins a slippery downward spiral. These companies die a slow death, as if inflicted with a chronic disease.

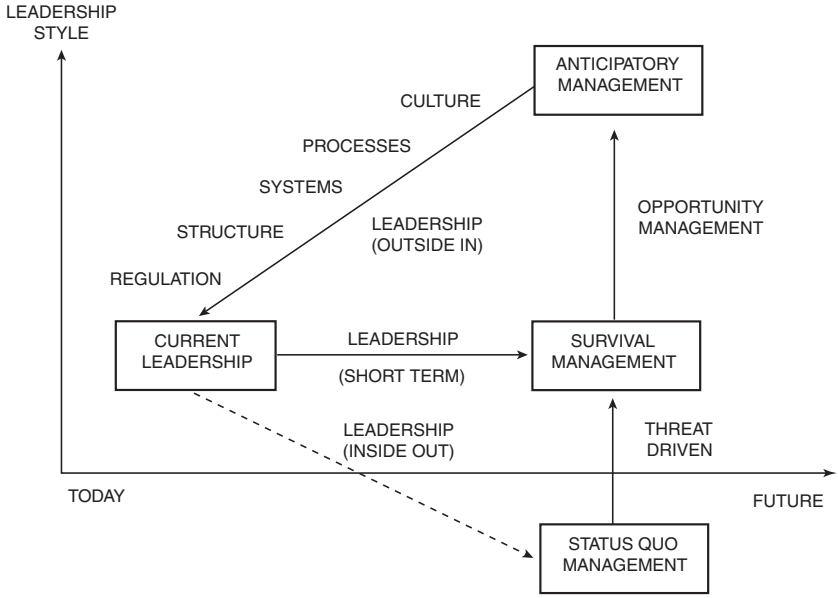

Figure 1-2 Leadership styles

If the company confronts a sudden threat, it goes into crisis management as a survival necessity. For example, if an investment bank suddenly loses important customers because it has taken them for granted, it can immediately undertake a campaign to assess how its remaining customers view the company and focus more attention on relationship management. Such threat-driven

changes can prolong survival, but they don't ensure growth or prosperity in the long run.

Leaders must anticipate environmental changes and proactively position their companies to be even more successful than they were under the status quo. They must intervene and transform the company's culture, processes, structure, and systems internally. They also must alter the regulation externally to safely position the company's future in a changing world of technology, competition, capital markets, regulation, globalization, and market needs.[14]

Leadership is about shaping expectations; management is about delivering expectations. Management is perfectly capable of sustaining habits, whether good or bad. Real change is likely to come only from an executive with the power to initiate it.

Now, let's look at those self-destructive habits.

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