"How do you participate in market disruptions which threaten your current leadership status? In this book, Adam Hartung shows the kind of thinking needed to deal with the creative destruction that underlies global capitalism today."

—Geoffrey Moore, Author, *Dealing with Darwin: How Great Companies Innovate in Every Phase of Their Evolution* and Managing Director, TCG Advisors

CREATE MARKETPLACE DISRUPTION

HOW TO STAY AHEAD OF THE COMPETITION

Adam Hartung

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Foreword

A hundred years ago, no smart businessperson would have produced bath products—only one in five houses had bathtubs, and women washed their hair once a month. No shrewd financier would have invested in the telephone, which cost more for a three-minute call than the average person made in a week. No prudent distributor would have considered the California market because of its physical remoteness and tiny population. A manufacturer was more likely to release version 3.0 of the horse carriage than to retool for the new automobile or aero-plane, both new and dangerously unsafe.

In retrospect, the foolish short-sightedness of such mindsets is obvious. We don't stop to think of how many companies of that era *did* go out of business because they could not see the *new*. They were locked in by historical thinking, by defending and extending what had worked before, by perceiving their market as relatively stable, static, and safe. Any number of businesses missed the shift from the Agrarian Age to the Industrial Age. Even more have missed, or have been slow to join, the shift to the Information Age, as Adam Hartung describes in *Create Marketplace Disruption*.

Today's business leaders, managers, consultants, and educators have the same blinders (to continue the horse-and-buggy conceit) as our forebears. We think our technology is "advanced," yet the internal combustion engine has not fundamentally changed for a hundred years, the Internet Age is no further along than automobiles were in 1920, and our major medical treatments continue to be slicing people open with knives, bombarding them with deadly radiation, and infusing them with poisonous chemicals. A hundred years from today, carbon-consuming engines will run only in museums, the Internet will be seen as we now

see the telegraph, and our barbaric medical practices will be an ancient, sorry chapter in human biology. Historically, we are as primitive and short-sighted as anyone before us.

How can we step outside ourselves to perceive such shortcomings in our business thinking today, rather than wait until history books are written—or our company's obituary? Hartung offers both a change in mindset and a change in behavior, with a "Phoenix Principle" that is both academically sound and pragmatically do-able. He doesn't just wave his arms and talk about the importance of change. He explains how every company can make it happen every day.

Of course, we all believe that we are "change ready." From some perspectives, we are. It seems natural that we went from Kitty Hawk to the moon in 66 years—less than the lifetime of an average person—and use a lot of the derived technology in everyday life. We appreciate our ability to travel to any major city in the world in hours instead of days, to make, buy, sell, and service products globally, to communicate instantly. We are grateful that modern medicine has eliminated most childhood diseases and is gaining on cancer. During the working life of any senior businessperson, digital technology has transformed business and given rise to multiple new industries. In a historical instant, we have seen the rise and fall of the mainframe, the rise and fall of the minicomputer, the rise of the PC, and the rise of connectivity and an array of digital gadgets that will destroy as many technology companies as it will give birth to.

Change is great when it benefits us as consumers or happens to somebody else at work.

We are curiously resistant to change within the confines of our business lives. It's as if the physical walls of our cubicles and offices create mental walls impervious to market signals. Or maybe we're too busy to think because we're responding to email, talking on our cell phones, or texting friends and colleagues (all technology that will appear quaint to our grandchildren). The simple fact is, business teaching, business thinking, and business execution is locked in to the past, to what has worked before—or in many cases, has *not* worked before, but we fail to see the truth. As avant garde as we think we are, we're as much in our own cocoons as our predecessors were when they missed the shift from hard labor to cotton gins, automated looms, and mechanical threshers.

How did Kodak and Polaroid miss the shift to digital film? How did Sony miss the shift to digital music? How did existing makers of small aircraft miss the shift to composite materials so that most of them went bankrupt? How did IBM miss the shift to smaller computers—twice? How do airlines *continue* to miss the real reasons they struggle—the fact that they overcharge their best customers and provide the worst service of any business that ever existed?

Create Marketplace Disruption takes on this profound problem in which businesses lock in to the practices that gave them their initial successes and seek to defend and extend their current products and markets against all comers—including their own employees with new ideas—all the way to their demise. The problem begins in academia. We continue to teach the same business mindset, disregarding the statistics showing that Fortune 500 companies have no more than a 50-50 chance of staying at the top of their game for even ten years. Hartung points out that once companies fall into the "Defend and Extend" mindset, only seven percent will ever grow consistently again, and fifty-five percent will remain in permanent decline. Yet academia keeps teaching the "basics" that will repeat this formula for failure.

Businesspeople, who ought to be more practical than academia, are just as blind. Hartung gives many examples in which companies sabotage new thinking and approaches through management indifference or hostility, by organizing new projects for failure, by hamstringing resources, and by outright "cooking" of financial analysis to reconfirm that it is more sensible to continue a weak or failing strategy than to take a risk on something new.

Fortunately, Hartung does more than critique the status quo (or describe the many subtle techniques of the Status Quo Police). He also provides many examples of companies from multiple fields that have broken away from locked-in thinking. There's the router maker that obsoletes itself as fast as possible. The workstation manufacturer that got into film. The PC maker and coffee shop that got into music. The music maker that got into airlines. And many, many others. This book is replete with examples of companies that not only disrupted their own business but redefined entire markets. He takes the added, and usually overlooked step, of describing how companies can bring along their customers, who are also locked in to the old way of doing things and prevent vendors from moving ahead.

More than the interesting case studies (which are valuable enough), Hartung describes specific steps that every business can take to create disruptions in thought and action. He shows how businesses can build in strategies and techniques for disruption and constant rethinking, reevaluation, and new action, rather than relying on rehash and re-action (the latter usually an effort to cut costs rather than raise revenue). He gives numerous specifics about the future that companies should be acting on now. How has your business disrupted itself to take advantage of universal connectivity, biotechnology, nanotechnology, green business, the demographic changes in the United States, or the burgeoning economies of China and India? These are things *we know* will create the markets of tomorrow. Hartung covers them all.

If you want to teach or conduct the business equivalent of the flat-earth theory, look elsewhere. If you want to keep doing the "same old, same old" because it's easier, if less productive, than disrupting your product development, look elsewhere. You can be like Hartung's farmer, who beats on the hen house to improve the laying of his hens. Not because it works but because he always has. Or you can be like the vendor who showed farmers how new products would reduce fuel and water consumption and improve profitability. The vendor disrupted its own business to develop new products and sales approaches and disrupted customers by changing how they understood and responded to costs. Everybody won.

Create Marketplace Disruption shows businesspeople how to create results rather than complete processes. It shows practical ways to use short-term disruptions to generate long-term profits. It's a valuable tool for any businessperson who wants to go where the market will be tomorrow instead of remaining where it is today.

Collins Hemingway
Business author, marketing consultant, executive coach
Coauthor, *Business at the Speed of Thought*, with Bill Gates

Preface

The Phoenix Principle: Those actions which allow any organization, group, or individual to overcome obstacles to achieve perpetual growth.

Those who understand and follow The Phoenix Principle overcome Lock-in to past practices and behaviors by utilizing internal Disruptions and White Space to keep their Success Formulas evergreen.

The Phoenix Principle gives businesses a clear vision of their future problems and the tools to address these problems—or avoid them altogether in today's highly dynamic marketplace. The Phoenix Principle overcomes previously static business planning approaches so businesses can compete more effectively—growing revenue and profits that create and sustain success.

PART I INTRODUCTION

Overcoming Schumpeter

Is there no overcoming Schumpeter's argument that businesses are unable to achieve long-term success?

Who Is Schumpeter, and What Did He Say?

Joseph Schumpeter was an economist born in Austria in 1883. Atypical for economists, he was first educated as a lawyer. A very good student, at age 36 he became the Finance Minister of Austria and at age 38, President of the privately-owned Biederman Bank. It was in this latter role that he learned firsthand the concepts of competition and business risk, given that the bank failed in 1924, leaving him impoverished. Schumpeter spent the rest of his career in academia, most notably as an Economics professor at Harvard from 1932 until his death in 1950.

Professor Schumpeter was a maverick. Rather than believing Adam Smith was the premier historical economist, he revered one of Smith's teachers—the far less well-known French economist Jacques Turgot, who professed (among other things) that societies pass through cycles of growth followed by cycles of conservatism that lead to ruin. Turgot wrote that human progress sows the seeds of its own demise.

Schumpeter expanded Turgot's thinking and is best known for the popular text *Capitalism*, *Socialism*, and *Democracy* in which he introduced the concept of "Creative Destruction." An avid fan of capitalism and free markets, Schumpeter adored entrepreneurs and wrote that they were the most important element of a vital capitalistic economy. He expanded on the long-wave cycles introduced by Russian economist Kondratiev, in which over periods of 50 to 75 years innovation drives waves of economic growth. According to Schumpeter, innovation that is brought to market by entrepreneurs creates economic vitality. Then over a long period of time, economies falter as innovation grows stale and entrepreneurship dwindles. To Schumpeter, entrepreneurs were the kings of innovation, and thus they drove all economic benefit.

But Schumpeter saw this process of innovation and renewal as extremely destructive as well, hence the term, Creative Destruction. Innovation unleashed by entrepreneurs often causes a vast amount of inventory, equipment, and skills to become obsolete, causing existing businesses to flounder and fail, while new businesses drive a resurgent economy. Entrepreneurs in their creative drive unleash a torrent of destruction upon existing competitors and generate a wake of destroyed business in their aftermath—thus companies cannot expect to have a long life. Creative Destruction wipes out historical competitors as new innovations come to market.

Schumpeter is considered the father of "Evolutionary Economics." Businesses are born into an environment, grow, mature, and die. As players in a larger environment, they have a particular, and not easily adapted, role. This concept of business evolution is so far-reaching that we no longer even recognize how embedded it has become in our thinking and our lexicon. While business leaders frequently refer to Darwin, it was Schumpeter who started managers talking about companies as if they were an animal species that emerges from competition, grows in strength, and then matures and eventually dies. This sort of thinking has become widespread, even though there is nothing evolutionary about companies or business organizations.

Businesses are abstractions created by people to serve a purpose, and they have no inherent evolutionary cycle. A business is not born; it is a legal and organizational construction. There is no maturity timeline. There is no requirement that it "age" or that it even "die." Yet it is from Schumpeter and his notions of Creative Destruction that we developed these concepts upon which many business assumptions are built.

What Is Business Success, and What Creates It?

For most business people, success is achieving planned goals. Business leaders plan to grow revenue and profits, and by meeting those plans, they are considered successful by themselves, their investors, their employees, their suppliers, and usually their customers.

How to achieve future projections is the fodder of hundreds of management books, countless business gurus, and the content of almost all MBA classes.

A common set of themes emerge from reviewing this enormous volume of business education.

- *Hard work*. Those who put in considerable hours and build organizations that are highly industrious are considered more competitive and therefore more successful.
- *Diligence*. Constantly paying attention to key barometers and working to improve performance is considered a hallmark trait for success. Like the tortoise racing the hare, the diligent performer is considered to have the greater likelihood of success.
- *Persistence*. Never giving up is part of demonstrating the ability to compete. By having employees who work hard and long, businesses can expect to find themselves partnered with success.
- *Setting goals*. Jim Collins, in his best-selling book *Built to Last*, talked about creating a BHAG—Big Hairy Audacious Goal—around which the organization can rally to tremendous success. Variations of this thinking abound, all oriented toward the notion that goals provide motivation for success.
- *Planning and execution*. Volumes have been written on the importance of creating a plan to achieve goals and then executing those plans. Management literature is filled with doctrine about planning your way to success and then merely being disciplined to execute the plan.

Few business leaders would take exception to this list as a set of core elements for business success. Yet, the press is filled with stories of companies that simply do not succeed. Every quarter there is a long list of publicly traded companies that fail to achieve their forecasted goals. Some of these companies miss goals for several quarters.

Over the last few years General Motors, one of America's largest employers and a member of the Dow Jones Industrial Average, has shown a complete inability to maintain market share or improve margin. GM management has made decisions and taken actions, but results indicate these behaviors have been directed at something other than long-term success, given company long-term performance.

In the early 1980s, AT&T was launched into the deregulated telecommunications marketplace with a near-monopoly of long distance phone service. AT&T had enormous resources and deep industry knowledge unavailable to any other competitor. No competitor had the people, assets, or money AT&T had and none knew anywhere near as much as AT&T about long distance. Yet management ran the business for 25 years with declining sales and margin erosion and eventually sold out completely to one of the companies they had previously spun-off, SBC.

We could add to these stories those of Polaroid, Xerox, Ford, Montgomery Ward, PanAm, Sears, Fannie Mae, KMart, Kodak and many others. While each story might have unique particulars as to why sales and profits waned, are we to believe that these companies were simply being led by management that did not understand the critical elements of success?

Or could the answer be that the definition of success is more complex than we previously assumed? On the surface, achieving results seems like the most natural definition of success. And that definition certainly fits with economists' notions that we all behave rationally within a competitive market. Each player must achieve results, or he will be eliminated in favor of a better performing competitor. But if management has demonstrated repeatedly that decision-making by educated and trained leaders often does not achieve goals, and yet those decisions and behaviors are repeated, then perhaps a new definition of "success" is necessary. One is needed that explains why businesses do what they do, even when their decisions and actions have shown little likelihood of achieving desired results.

The Sad Tale of AM

Addressograph-Multigraph (AM) was a very successful company. An early pioneer in printing equipment, the company grew quickly in the early twentieth century. As the industrial revolution dawned, AM had

the right printing equipment and supplies to help businesses with their emerging printing needs. Through acquisitions, international product sourcing, and new product development, AM became the global leader in printing solutions for in-house print shops and a standard-bearer for quality in small, offset printing equipment.

In the 1950s AM grew by opening offices globally. The company hired its managers from top business and law schools, as well as the ranks of leading management consultancies, such as McKinsey and later The Boston Consulting Group. In the 1960s, AM was compared with IBM by analysts and considered likely to have a more illustrious future than the younger and smaller office products company. After all, AM had a global sales force reaching into practically every substantial company, a global manufacturing and distribution organization keeping costs low and inventories well supplied, and a global service organization well trained and capable of keeping customer equipment running around the clock.

Company return on sales, return on assets, and return on capital were all above average, giving AM an above-average stock price to earnings multiple. Product development had been robust, generating an excellent growth rate for over a decade, and the company showed no signs of slowing its market leadership.

It was in the early 1970s that AM missed its first revenue and profit forecast. The stock price declined as investor confidence declined. So the company hired external consultants. No stone went unturned in the effort to put the company back on track. Immediate actions to cut costs and focus on core customers and markets included the following

- Manufacturing was streamlined; some plants were closed, and management consolidated work into others. Some manufacturing was outsourced to new partners in Japan and Europe.
- Distribution was overhauled, slashing inventories and freeing cash.
- Sales was reorganized, and several reps were laid-off.
- Equipment service was reorganized, and enhanced dispatching technology was added, allowing for service technician lay-offs.
- Accounting and procurement personnel at AM's headquarter's were cut, lowering overhead.
- New product development costs were slashed as the company turned to outside vendors for new products in what was perceived as a slower-growth environment.

- Marketing costs were almost eliminated as the company relied on its brand name and market share.
- Forecasts were lowered, given new expectations about underlying industry demand.
- Customers were classified into groups, and sales resources were targeted at larger customers.

As a result, within a year AM was back on track to making forecasts. The company had weathered a storm, management had taken significant action, and leadership was hopeful to regain the previous P/E (price/earnings) multiple. In discussions with investment analysts and the press, AM brimmed with confidence that management had righted the ship. Future results would soon resemble those of the past.

At the same time, a leading consulting firm prepared a strategic report for AM management that said that its market was under attack by Xerox. The consultants predicted that printing equipment sales would decline as users switched to copiers. Although there were a range of cost and quality issues complicating the economics of which equipment was optimal, there was no doubt that copiers were far easier to operate and Xerox was making rapid inroads into the AM customer base.

AM quickly developed a series of competitive maneuvers. New pricing schemes lowered initial equipment cost, similar to the per-page pricing Xerox initiated. AM harped on its ability to print in color and published technical documents demonstrating lithography's superior quality. And AM produced charts showing traditional printing's cost advantages.

But by the 1980s it was clear to management that the ease of use of the copier made it preferable for most customers. So AM reacted by sourcing copiers from IBM to resell under the AM brand. These IBM machines were comparable to current Xerox machines, and AM took them to customers with aggressive marketing and pricing programs intended to meet the competition head-on. AM used its best managers and hired premier consultants to advise them on strategies and plans.

Unfortunately, AM's copiers never took off—sales achieved less than 10 percent of forecast. With sales weakening, their traditional products and their failure to succeed with copiers, AM horribly missed revenue and profit forecasts and management announced they would make a "strategic" decision to file for bankruptcy. Given protection from

creditors, leadership was convinced AM could regain competitive strength.

After a year, the company reemerged from bankruptcy. The company was smaller and had lower costs. AM announced it was again focusing on its core corporate printing market. Additionally, AM intended to utilize cash flow from traditional markets to aggressively develop new opportunities.

But, AM did not return to meeting forecasts. Inconsistently, AM met and at times missed both its revenue and profit results. Leadership repeatedly pointed out that its traditional market was being overtaken by copiers, and thus investors should not expect substantial growth. Profit misses were brushed off as pricing problems, which AM hoped would resolve themselves when competitors disappeared and the company's consolidated position improved pricing power. New markets proved fleeting in their technology solutions, never allowing AM time to establish a firm position or profitably grow market share.

By the late 1980s, AM again filed for bankruptcy. The executive ranks were completely overhauled. A new Chairman and CEO were installed, as were new in-house legal counsel and, CFO. New division presidents were hired, and new management teams populated the divisions. New personnel were again recruited from top business schools, management consultancies, and the ranks of successful Fortune 50 companies. Promises of substantial bonuses were tied to turning around the company, linking compensation to performance. And another round of employment cuts and operational reorganizations across the company were intended to improve performance.

Equity investors were wiped out. Bank loans were reorganized, and a Mike Milken junk bond was issued to provide the cash for implementing a turnaround. Nearly half the equity was placed into an Employee Stock Ownership Plan (ESOP), financed via an investment of all the old employees' pension plans, tying employees' retirement to company performance.

A new Board of Directors was installed, including the famous Harvard Business School marketing guru Arthur Levitt, as well as CEOs from famous and high-growth companies such as Avery Label.

By the early 1990s AM was again a new company. One division president, a West Point graduate, Stanford MBA, and McKinsey alumnus, who regularly arrived for work at 6:00 a.m. and started meetings by 7:00, typified leadership. Managers, many young and

banking their careers on company success, worked long hours. Expenses were slashed—gone was free coffee. Travel and sales expenses were kept to a minimum. When employees had lunch meetings, everyone paid for his own.

Employees were part of the planning, with all-employee meetings happening monthly. Quarterly meetings with field sales personnel provided the pulse of customers. Team efforts were pushed, and everyone was encouraged that reaching goals required individual success as well as company success. A new Total Quality Management (TQM) program was implemented by an experienced quality guru to improve product and service quality, as well as quality in all areas of overhead (marketing, accounting, procurement, and so on).

Goals were set for every part of the organization. The company had ambitions to be #1 in not only equipment but also printing supplies. AM also intended to leverage its sales and distribution skills to become a leader in new markets for emerging digital printing technology. A vision was set to leapfrog xerography and be the leader in a range of new products and technologies just coming to market via start-ups with digital printing and reproduction expertise.

But by the late 1990s, AM was gone. The company turnaround never happened. Management filed again for bankruptcy protection in the mid 1990s, and eventually the assets were acquired first by a competitor and later by a private equity firm. Most top managers of the company never again held substantial positions in any large organization. For most of them, this was the painful end of their careers. Most equity investors, including the ESOP (and pension) were wiped out. And bondholders received a fraction of their investments.

AM Is Not Alone

On the surface, Creative Destruction reared its head, and Schumpeter would have predicted AM was doomed. While AM was wiped out, Xerox, Sharp, and other competitors benefited greatly during the AM downfall. Copier growth was high, creating a raft of new jobs in companies bringing to market new innovations. Copiers quickly led to innovations in desktop printing—such as laser printers—and other digital printing solutions created yet more revenue and more jobs. While AM was faltering, the number of printed pages was certainly not

declining. In fact, they were growing at a rapid pace! Total printing equipment sales exploded as traditional press and platemaker sales declined.

The AM story is all too familiar. Good, often "great," companies fail. AT&T, Bethlehem Steel, Polaroid, Digital Equipment Corporation (DEC), Compaq, White Hen Pantry, Brach's Candy, PanAm, Eastern Airlines, Montgomery Ward, and KMart are just a short list of companies that have been unable to effectively compete despite incredibly successful histories. And the list of companies that have had enormous setbacks but haven't faltered to the point of bankruptcy or market elimination, includes names such as Xerox, Kodak, Sun Microsystems, Sears, and Tribune Company—who were big winners just a few years ago.

Foster and Kaplan, in their book *Creative Destruction*, provide substantial statistical evidence of the fact that companies "built to last" regularly and systematically underperform in the market. Looking at just over 1,000 of America's largest companies, they discovered that from 1962 to 1998 only 16 percent remained in the top 1,000. Of the Forbes 100 in 1917, America's best resourced and most capably managed organizations, only 39 survived into 1987, and only 18 remained in the top 100. And only 2, yes only 2, earned above average rates of return. And since 1987, one of those has declined horribly.

Of the S&P 500 in 1957 (the peak year for babies in the Baby Boom), only 74 remained in 1994. Only 12 had gained in position on the list. Less than one-third of these companies survived a mere 25 years. Had you been so prescient as to invest in the "winners," your returns would have been less than an index fund. And probably more concerning, almost no one can expect to have his employer survive the length of his working career.

But relying upon Schumpeter's Creative Destruction would indicate that business managers have no say in the future of their organizations. Schumpeter's thesis implies managers are mere automatons doing day to day what they previously had done without thinking about how to adjust to changing requirements. Are these executives and managers simply incompetent? Are they simply arrogant and unwilling to listen to their marketplace? Do they lack diligence and persistence? Do they fail to set goals—or ignore the need for detailed plans? To accept these answers would be illogical, for in almost all cases the leadership held most of the traits described earlier as important for achieving success. And we know

that the best minds from the best business schools and advisory firms are plotting strategies and tactics to help these companies succeed.

When market changes are obvious to outsiders, and simple, important actions seem clear, we find it inexplicable that management does not take what we see as necessary actions. But this simplistic outsider's view is naïve and self-serving because we presume none of us would ever find ourselves in such a difficult situation. Almost all managers *will* find themselves in exactly the problematic situation as described at AM once, if not more than once, in their careers. And few will behave much differently than the management at AM.

Something more is afoot—something that allows, possibly even promotes, decision making and behavior which *appears* to be the right thing and yet results in unsatisfactory results. If we can accept that there is a rational explanation for management's misbegotten behavior, then possibly we can determine how to overcome the circumstances that seem to support Schumpeter's view that capitalism depends upon Creative Destruction—causing so much pain to investors, employees, customers, and suppliers.

A New Explanation for What Goes Wrong and How to Fix It

A considerable amount of business education, and the activities undertaken by managers as they advance their careers, is dramatically removed from implementing, or even understanding, innovation. The history of business education largely began as industrial engineering post-WWII and focused on how to operate manufacturing plants more effectively and efficiently. Over the years, finance, marketing, and eventually information technology all came to greater prominence in business education. Yet the focus still remains largely on how to do better what was previously done.

Business education is steeped in optimizing execution as opposed to managing innovation. This focus fit the business world's needs from 1940 into the 1980s well, but times have changed. Markets are now global, and they have become increasingly dynamic via lower trade barriers and enhanced technology for communication and transportation. Market leadership via consolidation and domination is increasingly giving way to increased flexibility and access to resources. What produced good results in 1970 or 1980 does not create the same results today. What's needed is a new approach for managing that produces positive results.

Very few executives make their way to the CEO position or any other senior position by following the route of entrepreneurship or innovation management. By and large, most advance by managing a group as good or better than their predecessors. Consistent performance is praised, and small incremental benefits are valued. Managers advance by better optimizing the performance of their teams.

This leads to *Defend & Extend Management*. D&E places, as the manager's first priority, understanding the existing business and working to defend and extend what has previously been done. By *focusing* on core capabilities, core customers, core services, core assets, core functionality—whatever is considered *core*—and first defending that core while seeking incremental opportunities to extend it, followers of this doctrine believe the future will successfully take care of itself. Avoiding mistakes is absolutely critical. Those who don't screw up are more likely to succeed than those who take chances.

One result of Defend & Extend Management is that practitioners are always late to new innovations. They are late to market challenges. Innovations are threats to *core*, and it is most important to defend against these potential attacks. Further, it is costly to adopt and implement innovation—much more costly than extending what is already considered core by adding new, but similar products, similar new services, new functionality to existing products, or by entering an adjacent and similar market segment or taking the business without change into a new geography. These actions are simple and straightforward and relatively low-cost. If they don't produce desired results, not much is lost, and it is reasonably easy to retrench.

But businesses that adopt Defend & Extend Management doctrine early in their life cycles quickly fizzle. Early breakthroughs do not develop into robust solutions with significant markets when management stays intent on optimizing existing technology or current business model. That is why pioneers often fail. They attempt to Defend & Extend into a large business what worked in very early stage implementations. And competitors find it easy to out-innovate the early innovator.

Businesses that adopt the Defend & Extend Management doctrine later in their lifecycles find themselves incapable of addressing market challenges, whether they result from technology or business process innovations. For these companies, Defend & Extend is like a bomb fuse. Protective behavior slowly burns toward detonation from a competitive failure they cannot overcome.

AM fell into the trap of Defend & Extend Management. While it recognized a market challenge was developing in the form of xerography, the company primarily acted to

- defend its existing market position in traditional products,
- defend its business hierarchy and structure,
- defend its manufacturing and distribution assets,
- defend its sales organization and brand,
- defend its service organization,
- defend its existing large customers from intrusion,
- extend its position into additional geographic regions,
- extend its existing position with new products for the traditional market, and
- extend its existing business model into xerographic equipment.

AM failed as a result. It never really adapted to changing market dynamics, and competitors used innovation to creatively destroy the company.

AM largely followed best management practices while it found itself waging war with Xerox, Sharp, and a slew of upcoming competitors in both analog and digital printing equipment. But those practices were not oriented toward adopting and implementing innovation. They were designed to protect historical assets. And those assets were rapidly dwindling in value as a result of new technology and innovative changes in business processes they provided customers.

Understanding Defend & Extend Management gives us the first insight to "success." For most people and organizations, success is *not* about achieving goals. Success is defending and extending each day, each week, and each month what was done in the past. Operationally, success is not about the result, but rather about the doing. And successfully doing is all about defending what exists and seeking out extensions to prolong what was previously done.

Everyone has heard of a story where a business manager pioneers a breakthrough for his company and is still let go. Despite producing results far beyond expectation, his activity took the business away from what it had previously done. Although this manager exceeded goals, he did not Defend & Extend the business. And the company reacted not

with gratitude and advancement, but with admonishment and concern for breaking cultural norms and structural procedures. Performance was not evaluated upon what he accomplished, but rather how he did it. He did not Defend & Extend, and thus he found himself without a role.

Likewise, everyone is familiar with the manager whose results never greatly exceed expectations. Despite consistent mediocrity, the manager enjoys a stellar career. His ability to Defend & Extend the organization, while supporting its behavioral norms and structural practices, allows him to be perceived as an important contributor. Resulting company performance is not even factored in.

Quite frequently, possibly more often than not, *success is not about the results*. CEOs who do not achieve desired results remain in their jobs, as do their Boards of Directors. The executive team makes little contribution toward improving company return on capital, revenue growth, or cash flow enhancement, yet it remains almost completely intact. There is little punishment for not achieving the defined success target, as various explanations are offered for how the expected results were simply not achievable.

People in senior positions are usually considered successful merely by having the position, not because they can demonstrate superior results achievement. And some companies are considered successful just because they once were—and have not yet failed. The CEO at General Motors commands considerable respect, and so does his executive team, despite the fact that sales, market share, profits, and return on capital have declined precipitously over nearly two decades. This is because what we think of as defining success, the achievement of results, is not the success actually being sought. Instead, most "successful" behavior is that which Defends & Extends the past for one more day—without failure…yet.

Also not well understood are the assumptions about what creates business success. Americans love a Horatio Alger story about hard work and dedication that leads to success, even though Mr. Alger is a fictitious character. As we explore the road to achieving results, it is important we watch for myths that pervade our assumptions.

The flip side of Foster and Kaplan's statistics are those companies that have defied the statistics and been successful long-term. What distinguishes them? Why were they able to avoid or escape Defend & Extend Management? How did they overcome Creative Destruction and survive—even *thrive*? What helped the winners to earn long-term high rates of return? What makes them exceptional?

These better performing companies implement The Phoenix Principle. They utilize Disruptions and White Space to unlock themselves from repetitive Defend & Extend behavior and seek out new Success Formulas that create evergreen performance.

Schumpeter observed patterns of innovation that lead to failure. But Schumpeter does not condemn us to repeat these behaviors with predictable results. It is within our power to understand why we Lock-in to behaviors that create failure or choose to embrace alternative decisions and behaviors which will allow much better future managerial performance.

I

The Myth of Perpetuity and Lifecycle Realities

Does anyone really believe his or her business will last indefinitely? If not, why do we act like it will? What is the reality of business lifecycles, and how do lifecycle myths help us fulfill Schumpeter's predictions?

The "S" Curve Theory of Business Lifecycle

Anyone who has ever read about business growth has read about "S" curves. "S" curves are very popular, in part, because they do a great job of describing many biological systems. Business theories that reflect what we see around us in everyday life are easy to accept and need only have a few good analogies to be wholeheartedly believed. However, businesses are not biological systems, and they are not required to behave like them.

Most of the pioneering work on "S" curves was done by biologists who were describing the behavior of viruses. Even Jonas Salk, inventor of the Salk vaccine for polio, wrote extensively on "S" curves as a descriptor for how viruses compete and mutate to propagate and succeed. This laid the groundwork for business academics and professionals to use "S" curves as tools for describing business behavior. After all, businesses compete and desire to propagate, which is similar to viruses, so shouldn't the analogy hold true?

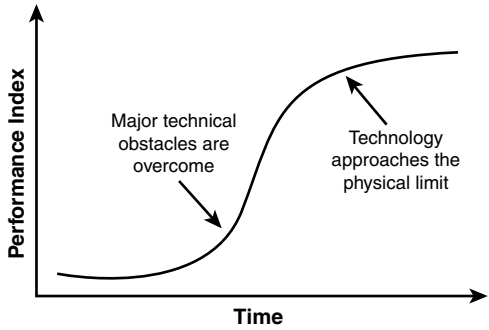

Figure 1.1 Traditional "S" curve

According to the "S" curve theory, businesses start with a very slow growth rate, taking substantial time to demonstrate business efficacy. Early on, growth is challenged by the need to find a customer or two willing to consider the new business. Eventually, growth explodes as customers find the solution more valuable than other solutions. In a relatively short time, revenue begins to exceed expectations. However, this rapid growth does not last forever because new competitors enter, making what once was valuable less so.

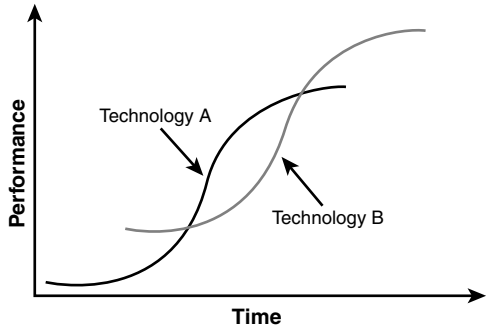

Figure 1.2 Jumping the curve

So what should a business do once the "S" curve starts to become level? Introduce something new, of course! A new product or a new version of an existing product creates a new curve. This new curve, built on the first-generation solution, means revenue doesn't start at zero. Instead it continues to grow.

According to the "S" curve theory, as shown in Figure 1.2, no business need ever decline. By maintaining a constant stream of replacement products, businesses can generate continuous growth. Multiple curves can blend into a nice northeasterly line of increasing revenue. A business could live into perpetuity this way!

Over the last 30 years, there have been many articles and books that offer management guidelines for utilizing "S" curves. They present a number of multiple theories and often include case studies that describe how the researchers applied the "S" curve concept. Each theorist claims that using multiple curves allows for "jumping the curve," which means to jump out of curve A and into curve B before the business starts to observe a revenue decline.

The Myth of Perpetuity

The "S" curve concept for business growth has been around so long that it is now accepted as dogma. It's not whether a business *can* jump the curve, but *how* it is going to happen. The fact that there are few examples of actually building a business this way, especially in the last 20 years, is conveniently ignored. After all, the concept itself has been demonstrated in the physical, biological world. And it does seem to make sense. This logic allows leaders to take the "S" curve concept to its limit and expect their businesses to go on forever.

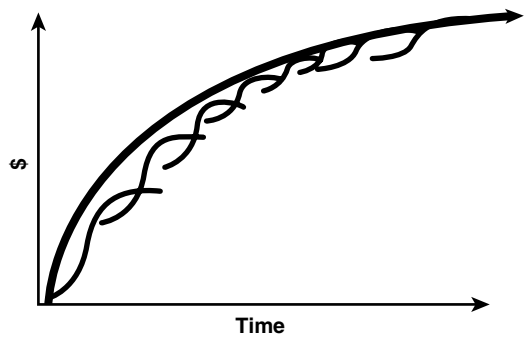

Figure 1.3 The Myth of Perpetuity

According to the "S" curve lifecycle theory, in its early days, a business should introduce new variations, products, and technologies

quickly, resulting in more curves per time period with faster growth. These build upon each other to maintain a high growth rate. Later, the number of variations decline as there is less need for and less capability to produce meaningful enhancements. It is accepted that the technology will start reaching its limits, customers will achieve high levels of satisfaction with fewer products, and the number of competitors will decline. This leads to fewer curves with less growth in each. Eventually a market "shake out" occurs as competition turns from new products to cost management. Scale advantages should lead to fewer, larger competitors that operate at lower cost and offer a lower price yet maintain an acceptable margin.

As the lifecycle curve flattens, however, results do not worsen. According to the theory, fewer competitors, and each of those being larger, grants much more market stability. Competitors learn to protect their positions, and there is less competitive intrusion as competitors protect their market shares and rates of return. It takes much greater investment for a new competitor to enter the marketplace, and this higher investment rate makes it practically impossible for newcomers to achieve an acceptable return. Existing large competitors have so much volume that their costs are far lower than anything achievable by a new entrant.

The "S" curve lifecycle theory then states that as growth slows, investment rates also slow. So return on assets and equity remains acceptable. The market is at this point considered "mature." Employees and executives begin focusing on market share maintenance and cost control. And the business can begin paying out increasing dividends to shareholders or repurchase shares to drive up investor value. Late in the cycle, the big payoff happens. New products are far less necessary, given that the technology is more mature and market shares are more stable and defended by high-volume large investments. It's time to pay back investors for riding the curve. And there is no discernable end to how long this should continue. Thus, very mature companies should be great places to work and to invest in because they have become predictable and produce lots of cash.

There has been a great deal of work done by academics and consultants to support this theory. The Boston Consulting Group became famous for its pioneering work on experience curves where volume from market share leaders created long-lived cost advantages. Experience curves led to

the growth/share matrix, which defined high market share companies in low growth markets as "cash cows."

Great examples of companies that followed this theory to powerful success in the 1940s to the 1970s were General Motors, AT&T, Polaroid, and DuPont, to name just a few. All these companies achieved market domination. When looking at the pattern of the era, it appeared that the largest companies were those that followed this lifecycle plan.

It's too bad that most of these example companies later got into trouble. They took advantage of the unique post-WWII U.S. economy to grow rapidly in an industrial era with huge demand. But once markets shifted to greater competitiveness, more differentiation, and higher information content, these companies found themselves unable to use "S" curves to find perpetual success.

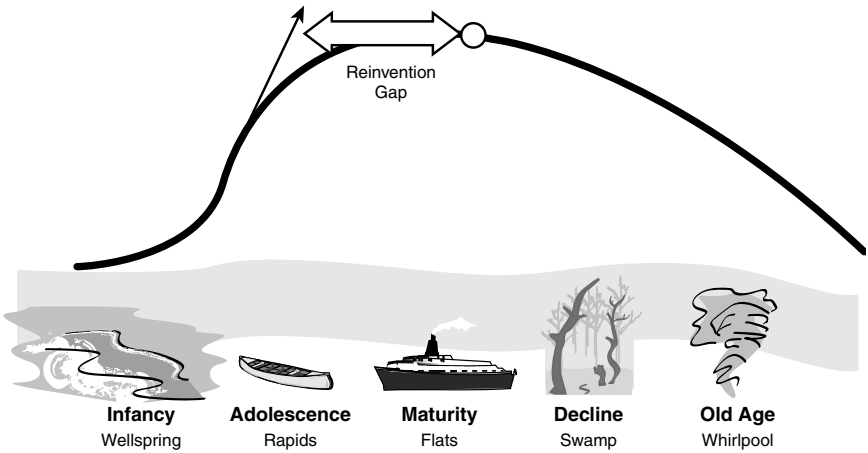

Figure 1.4 Business lifecycle reality

In reality, few businesses "jump the curve." The vast majority of businesses follow the pattern in Figure 1.4. On the lifecycle river, after initial growth, they simply decline and fail. Their time spent in maturity is surprisingly short—and getting shorter in today's competitive environment. Even for the largest companies, much more time is spent in decline and failure than in any other part of the lifecycle.

The Wellspring—Find Something that Floats

Businesses are started in the Wellspring of ideas. For entrepreneurs, the goal is to find initial customers and figure out how to make a profit. Though much has been written on the Wellspring, there is no predictability as to how long a business will spend here, nor whether it will ever emerge into the next phase. Venture capitalists often say that only one in ten businesses ever really break out, and they invest broadly to distribute risk and create more predictable returns.

Wellspring behavior is largely exploratory. The focus is finding a customer. In the Wellspring, discussions are not about developing a marketplace or competing for share. They are about finding one customer who will buy the product and then finding a second. It's about proving the product, service, or business idea is viable and then figuring out how to make a profit at the price initial customers will pay.

The Rapids—Paddle Fast and Stay Afloat

Companies that emerge from the Wellspring enter the Rapids of high growth. The business has found a way to add value to customers, and there are a lot of customers looking for that value. The high growth rate covers a multitude of sins, as revenue expansion either produces great positive cash flow or there are investors more than ready to throw money at the business. The business uses this cash to further define and refine its products and services to continue meeting customer needs.

Most businesses thrive in the Rapids. New products are generated quickly and expedited to market. New services are launched. To keep the growth rate high, lots of customer analysis is undertaken to determine the most critical needs. Simultaneously, the technology and offerings are focused on the customer value proposition. The organization keeps looking for ways to ride the market growth and extend their position. Mostly, amidst the chaos of white water in a fast growing market, it's about staying alive by growing faster than everyone else.

The business press and gurus love to talk about businesses in the Rapids. Ford in the 1920s, Woolworth's in the 1930s, General Motors in the 1940s, Coca Cola in the 1950s and '60s, Polaroid in the 1960s and '70s, KMart in the 1970s, Apple Computer in the early 1980s, Cisco Systems and Dell in the 1990s, and Google today represent companies loved while in the Rapids. AM was in the Rapids during the 1940s through 1960s as businesses exploited the small offset lithographic

printing presses and low-cost printing supplies made and sold by AM. In the Rapids, life is good. Even when things go wrong, such as bad product launches or lousy acquisitions, growth allows the business to prosper.

The Flats—Don't Run Aground

Eventually the Rapids slow, and usually much earlier than management predicts. The market growth rate is *perceived* to slow—frequently significantly. Maturing is a wonderfully pleasant euphemism for what is actually an unpleasant growth slowdown.

In the Flats, it's common for businesses to hire new managers who are more "experienced" and considered more "professional" to replace early management from the Wellspring. The mindset of business leaders changes dramatically, as the focus shifts from high growth to greater predictability and the focus on revenue shifts to costs. P&L management receives a lot more attention as new leaders begin jettisoning activities that are deemed unable to generate sufficient profitability.

By saying that *market* growth has slowed, business leadership is able to deflect the most critical problem in the business—its own slower revenue growth. Because investors and employees are conditioned to view maturation as acceptable, and even desirable, any overwhelming worry about future business viability is swept away. Believing in the Myth of Perpetuity, it is accepted that in maturity costs will decline and the business will turn toward producing more security for investors and employees. All that's needed is a different perspective on the part of management—less focus on revenue and more on profits.

Sheer size is seen as the greatest protection for the business. By being large, leaders believe the business can protect itself from competitors. Even though growth is slowing, competition is intensifying, and results are not as good as before, an enormous amount of faith is placed on size as protection, which is exactly what management is led to believe by the "S" curve lifecycle theory. This is despite the fact that a brief look at history shows many failed businesses were once extremely large. Size, at one time, did offer various protections, but in today's Internet-enabled world, size can be as much a negative as a positive.

Believing maturity is good, or even acceptable, is a deadly assumption that sets the stage for failure. By assuming that lower growth can be compensated for with better cost management, the entire business is

thrown into jeopardy. As leadership turns to cutting costs, the word "focus" takes on much greater importance. The business starts spending much more time on larger customers and dropping smaller ones as it reduces headcount. It is deemed acceptable to lop off entire product lines—sometimes in profitable niches—if they don't meet criteria for size and sales to large customers. To generate a more predictable and consistent profit stream, usually at a lower return on sales, serving existing customers becomes more important than finding new ones. And leveraging existing products becomes more important than new launches. Both of the former activities are much cheaper than the latter, and it is considered better to defend what the company has always done than seek out new opportunities.

For example, in the 1800s there was a thriving market for whale oil to fuel lamps. Returns were high for whalers and their crews. Then crude oil distillation created a competitive product called kerosene. Kerosene was much easier to make and considerably cheaper. The demand for lighting fuel grew exponentially. But not a single whaling company stayed in business, as they determined that the *market* for whale oil rapidly matured and declined. These companies all could have seen themselves as participating in the market for fuel, but instead they accepted the maturation of *their defined* market for whale oil.

Recalling AM, the market for printed pages exploded in the 1970s and continued to grow at double digit rates through the rest of the century—there was no maturing of demand for printing. By stating that the *market for lithography* had slowed and then undertaking a series of cost cutting actions to better manage the P&L, AM management drilled a series of holes in their boat. They were slow to evaluate new printing solutions, such as xerography, and even slower to make changes to market these solutions. Their first reaction was to manage for maturity, the Myth of Perpetuity, and accept lower revenue growth while reducing costs.

When a business enters the Flats, it begins creating a "Reinvention Gap." This is the gap between what the marketplace wants and what the business sells. The market continues to grow, sometimes even faster, but the business does not participate. Rather than quickly admit there is a new technology, a new product/service, or some type of solution that is replacing them in the marketplace, management starts looking for ways to capitalize on history. They stop looking to the future and begin trying to recapture the past. The longer management tries to Defend & Extend its old business, the larger the Reinvention Gap becomes. The larger the gap, the less likely a business will ever cross back over it.

For many business leaders and investors, the Flats are considered good—but this is a myth based on believing in the old lifecycle theory.

In believing the Myth of Perpetuity, leadership views its existing sales force, distribution, brand image, service expertise, manufacturing volumes, tightly knitted supply chain, or other capability as "entry barriers" which protect them from new competitors. Business decisions become oriented toward protecting these "entry barriers."

Entry barriers were an enormously valuable concept when introduced by Harvard's Michael Porter in his groundbreaking 1980 book *Competitive Strategy*. At the time, looking back at the industrial economy, large companies had often successfully created and defended entry barriers. But in the information economy, entry barriers are proving far more difficult to not only erect, but to defend. Using widely available and very cheap computing resources, along with the Internet, entry barriers are increasingly easy to overcome.

OVERCOMING ENTRY BARRIERS

- Today, globally connected financial institutions provide access to large financial resources cheaply and extremely quickly.
- Access to financial resources means that "scale" manufacturing plants can be built in months, often in countries with lower cost labor or fewer regulatory requirements.
- Learning curve effects are captured in knowledge databases, which then become available to everyone almost instantly via the Internet. Competitors achieve learning benefits even at small volumes.
- Large sales and distribution organizations are circumvented by Web sites with volume pricing.
- Service organization knowledge is replaced by online service manuals and training available to small distributors and clients.

The Reinvention Gap is completely ignored by the business as it tries to improve its relative position with *existing* customers against *historical* competitors. Frequently, the most threatening *new* competitor is not even addressed. As the business increasingly talks only with historical,

large customers, it loses any vision about where the market is still growing.

In the 1980s IBM pioneered the personal computer through a small development team in Florida. The PC became a wildly popular product, portrayed on *Time's* cover as the "Man of the Year" in 1982. Yet when IBM interviewed its primary computer customers, data center managers, IBM did not perceive a high demand for PCs. Data center managers were clamoring for better and cheaper hardware and software used on their IBM proprietary mainframe and mid-range computer systems. Many of these customers chastised IBM for bringing PCs to market because PCs disrupted Information Systems Directors' plans. Several of these customers were actively anti-PC. As a result, internally the PC was not seen as a threat to IBM's large and profitable computer business, and IBM downplayed the product. Before the end of the decade, IBM was one of the earliest companies to exit the PC business.

At AM, Xerox's early entry was ignored because AM was busy selling lithographic products to print shop managers in client basements. Copiers were being sold to office managers who controlled typewriters used on the office floor. AM did not even track Xerox sales because Xerox was not seen as a competitor in the print shop where AM dominated.

Because management is making forecasts using financial models from the Rapids, it does not recognize that most of its assumptions are wrong. Rather than having an easy time generating margins at lower growth, the business finds it is chronically struggling to maintain customers, price, and competitive costs. Lower volumes start to drive costs per unit up rather than down (despite focusing on procurement and supply chain expertise), and greater competition intensity among remaining rivals—as well as the new competitors—makes price maintenance impossible as per unit revenues decline. Missing forecasts becomes too common.

Given all the dangers of the Flats and all the problems that develop in this phase, it is startling that business leaders seek to operate here. According to The Conference Board, hitting a revenue stall is deadly. For publicly traded companies, after hitting the Flats, seven out of ten companies will lose more than half their market capitalization. Only 7 percent will ever again consistently grow at a mere 2 percent per year, and nearly 40 percent will have a future with virtually no growth. Even worse, 55 percent will have a *negative* revenue growth rate—a persistent decline!

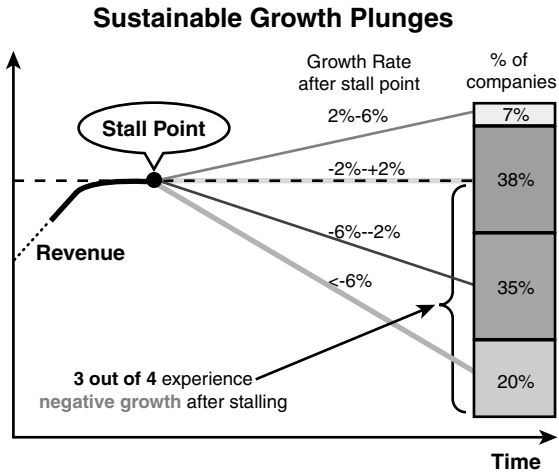

Figure 1.5 Business stalls are deadly

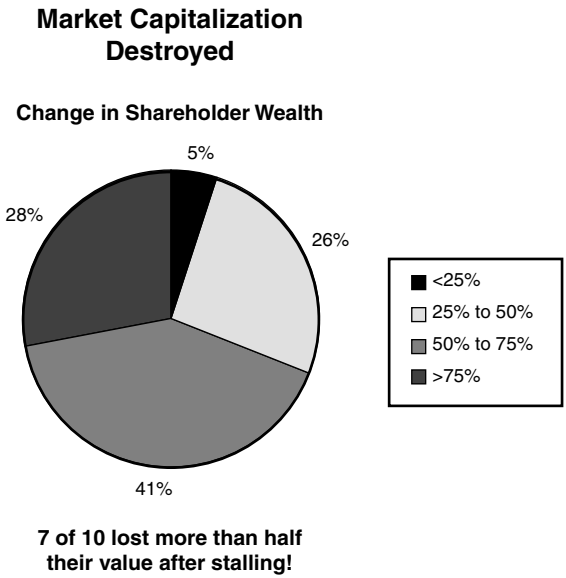

Figure 1.6 Destroying economics value

According to Foster & Kaplan in their book *Creative Destruction*, even for large companies the odds of maintaining a business are not good.

- Of the S&P 500 in 1957 (a big year for baby-boomer births), by 1998 only 74 still existed (15%).
  - Of these, only 12 gained in position (2.5%)
- Since 1962, of the 1,000 companies that were largest by size in the U.S., only 160 (16%) managed to stay in this group.
- Less than one-third of companies in the S&P 500 survive 25 years

The Flats is the riskiest position on the business lifecycle.

The Swamp—Trying to Get Unstuck (While Fighting Alligators and Mosquitoes)

When interviewing business leaders, the vast majority will describe their businesses as being in the Flats. They know they are not in the Rapids, and they don't want to think they are in the Swamp. But, truthfully, most are well into the Swamp.

The Swamp is characterized by limited growth. No growth means no current to the water. Any forward movement has to come from paddling. Unfortunately, the Swamp is full of competitors that behave like alligators, constantly trying to eat you and your boat. At the same time, swarms of new competitors are buzzing around like mosquitoes looking to suck all the blood out of the business.

Modern business has a basket of tools to use for hiding low growth. One of the easiest for a public company is simply to start buying back shares. Management uses cash in the bank or money from issuing bonds (often low grade/junk) or from selling a division or other assets to buy back shares. Management starts focusing on earnings per share (EPS). EPS goes up not because earnings rise, but because the number of shares goes down, and position in the Swamp is hidden.

Another good Swamp-hiding management technique involves acquisitions. Company A agrees to buy some or part of Company B. Prior to acquisition, the revenue of A is $5 million and the revenue of B is $4 million. A year later, Company A announces it has revenue of $7.5 million and declares a 50% revenue increase!

This technique is extremely beneficial for leaders that believe in the Myth of the Perpetuity because it reinforces the assumption that troubled businesses will benefit from competitor consolidation to drive down costs. It's also a nice way to hide declining growth.

There are a myriad of opportunities to use Generally Accepted Accounting Principles (often times referred to as GAAP Accounting) to modify published financial results. In any given year, a company can simply shift the handling of how taxes are booked, changing expenses this year, last, or next. Or by altering accounting for pensions, an extremely complex issue that is handled deep in the footnotes and is not even a line item on the P&L, earnings are adjusted. By simply underfunding the pension plan or even raiding it for resources, a business can look better purely at the expense of the company pension fund.

Other financial machinations used in the Swamp include reclassifying expenses into capital items to improve short-term profitability or changing the focus of management reports to analysts from net profit to a higher margin line in the P&L and then shifting cost problems down into "non-recurring expenses." These are supposedly one-time events but often seem to never let the business return to old net profitability levels. When discussing weakness in current results, management frequently turns to discussing "pro forma" (or future prediction) numbers where they discuss "synergies" intended to improve revenue and lower costs. This is despite the fact that there is no way to track such synergies by outsiders, and most academic literature says these synergies are rarely found.

Of course, all these manipulations must be spelled out in the footnotes of the financial statements. But footnotes are not where emphasis is placed when evaluating management. Analysts and investors, customers, vendors, and employees focus on the P&L itself. Even with pages of footnotes, including supporting schedules, financial machinations get little attention. For people who believe in the Myth of Perpetuity, such actions are often viewed as good management decisions being implemented by smart executives who are utilizing all available tools to increase the apparent strength of the company!

One favorite tool of businesses deep in the Swamp is bankruptcy. Leaders will declare that there is really nothing wrong with the business, but due to some sort of unexpected circumstances (of course they were unexpected—if they were expected, we are to presume management would have dealt with them!), the company is unable to meet its obligations. As a result, the business is in a "technical" default.

For example, after the year 2000, several of America's largest airlines, including United, declared default due to union contracts and particular clauses in their financing instruments. Leaders did not describe their problems as a bad business model, unlikely to ever make money and

unable to deal with almost any competitive shock, nor did management admit it was unable to price its product appropriately to cover its costs or that it had made assumptions when signing labor contracts which proved overly optimistic, running the business utilizing those assumptions until bankruptcy loomed. The problem creating bankruptcy was described as a "technical problem" with union contracts and financial agreements that had to be resolved by the unions and the banks.

And of course bankruptcy was a "strategic" move taken to protect the airline. By characterizing as strategic, this action was positioned as sensible for smart executives. How declaring financial failure is "strategic" is less than clear.

Amazingly, demand for air travel has continued growing year-over-year since deregulation, so it was not insufficient demand that plunged United and its counterparts into bankruptcy court. And somehow Southwest managed to avoid this problem altogether. Both facts imply that the problem causing bankruptcy is not an industry problem, but instead something directly related to the particular companies stuck in the Swamp.

Once bankruptcy is undertaken, management does not portray the action as a failure. The fact that debt holders are forced to take a loss, that suppliers are never repaid in full, or that employees see their pay or benefits reduced is just part of the "strategic" overhaul that management wanted to do for a long time but could not implement due to legal restrictions. Management will often blame investment bankers for loading the company with too much debt or too high an interest rate. Or state that the employees, through their union, simply are unrealistic in their demands for the business. Or claim that regulators made it impossible for the business to succeed.

In reality, bankruptcy is never a tool used by healthy, growing companies. Only companies that are in the Swamp and struggling to understand their growth problems find themselves in bankruptcy court.

TRUE STORIES: YOU KNOW YOU'RE IN THE SWAMP WHEN...

- The CEO sends out an e-mail to all employees chastising them for using color printers in the office, due to the cost, and instructs them to switch all printing to black and white.

- The Division President e-mails the company that the business is having a tough quarter, so all use of overnight shipping is suspended.
- Employees receive a memo from the HR vice president that all business auto rentals are being downsized by one vehicle type.
- The business owner takes time at the all-employee meeting to tell everyone that he is appalled by the wastefulness of people, throwing away paper clips along with used paper. He then demonstrates the proper way to dispose of paper by removing the clip.
- The CEO describes a recent quarterly loss to employees as caused by a downturn in customer business, having nothing to do with company operations.
- Top management asks all management personnel to participate in two weekend days of inventory auditing without pay to complete the task at lower cost.
- A vice president lauds employees for coming into the office over the weekend and painting their offices themselves—the first time these offices had been painted in nearly 20 years, and he recommends all leaders have their employees do the same.
- Company travel is suspended to meet quarterly profit projections.
- The company installs a centralized headquarters system to control the heating and cooling of all facilities.
- The Vice President of Marketing tells analysts that a competitor growing at more than double his rate is unimportant because that company is so much smaller.

No business leader ever says, "Our company has misjudged the direction of the marketplace. We have missed what our customers want. We are in deep trouble, and we're getting so far behind new competitors that we will probably never compete effectively in our markets again." Management never admits they are in the Swamp. But they are.

The Whirlpool—Paddle Like Crazy

Eventually, competition simply becomes too intense. New solutions, born out of Wellsprings or competitive Rapids, overwhelm the company's attempts to stave off disaster. The company's product or service is so costly or competitively ineffective that it becomes impossible to maintain a profit. And the business spins into the Whirlpool from which it never returns.

Some companies simply disappear in a bankruptcy court, such as Polaroid, with all remaining assets sold in liquidation. But this is the rare dramatic case. Instead, businesses are more likely to begin a long but consistent route of selling off assets, such as Eastern Airlines, Montgomery Ward, or Wang. A slow liquidation occurs where each sale brings in a little more cash to keep the company alive a little longer until eventually there is simply nothing left, and the business disappears. Its brands, products, customers, technology, product designs, intellectual capital, and equipment find their way into a myriad of other companies through a series of small sales.

Some businesses are acquired. Another competitor, itself usually stuck in the Swamp, acquires the deeply troubled business in an effort to improve its own lot—such as when Compaq, struggling to compete in the PC market, acquired Digital Equipment. Often, within just a few months, the acquired company simply disappears.

A similar fate befalls some companies acquired by private equity or leveraged buyout firms. Here a private entity takes over the failing business, strips it of all possible costs, and sucks whatever cash it can out of the business to invest elsewhere. This is the direction KMart and Sears have taken the last few years under the control of Chairman and CEO Eddie Lampert.

We Keep Repeating the Same Cycle

The lifecycle river is very familiar to all businesspeople, largely because everyone can think of *so many* examples. Yet management keeps repeating it as if there is no other option to the cycle of breakout, then grow, then *decline and fail*. While management gurus and academics talk about "jumping the curve" from one "S" to another, it simply doesn't happen very often.

While businesses enjoy being in the Rapids, very few return to the Rapids after hitting the Flats. And practically none return to the Rapids from the Swamp. (When these do occur, such as the turnarounds at IBM and Apple Computer, they get an enormous amount of attention.) As a result, we become sanguine about Schumpeter's forecasts of business failure—as if it is simply destined to happen.

Most business leaders have the will to turn their companies around—they are globally savvy, hard working, and smart. They have enormous desire to leave a legacy of success, and they are willing to demonstrate their will and their sacrifice by undertaking painful management actions, such as employee lay-offs, reducing benefits and pay, cutting executive ranks and perquisites, slashing expense budgets, and enforcing draconian vendor cuts and under-funding employee pension plans. They take these actions because they truly believe it is the right thing to do, often telling everyone the businesses are accepting the pain for the long-term good of the enterprise.

Many of these leaders will turn to outsiders for help. They seek experts at law firms, accounting firms, investment banking, and management consultancies in downsizing, outsourcing, and strategy. Yet, the vast bulk never find the Rapids again. When they find themselves in the Flats, they remember the theories surrounding lifecycle management developed 50 years ago and take actions that yield more than a hundred Polaroids for every Apple.

It's time to understand why it is so hard for businesses to undertake a different set of recommendations. It's time to look at how we develop *Success Formulas.*

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