Corporate catastrophes teach us not only about companies and their leaders but about ourselves.

ACROSS THE BOARD
Interview

James Leynse

Understanding Failure

Why do smart people do stupid things? In particular, why do smart CEOs and other executives make stupid decisions? It could be, of course, that maybe they're not so smart in the first place. But not even their harshest critics accuse them of being stupid—merely of acting stupidly. So there must be other reasons why these top dogs, who have so many things going for them, make what look like, in retrospect, appallingly dumb decisions. Two new books strive to pin down those reasons:

Why Smart Executives Fail and What You Can Learn From Their Mistakes (Portfolio) by Sydney Finkelstein, professor of strategy and leadership at Dartmouth's Tuck School of Business. Based on interviews with 200 executives, Finkelstein's book explores the core causes for failure and finds, surprisingly, that "neither ineptitude nor greed are among them."

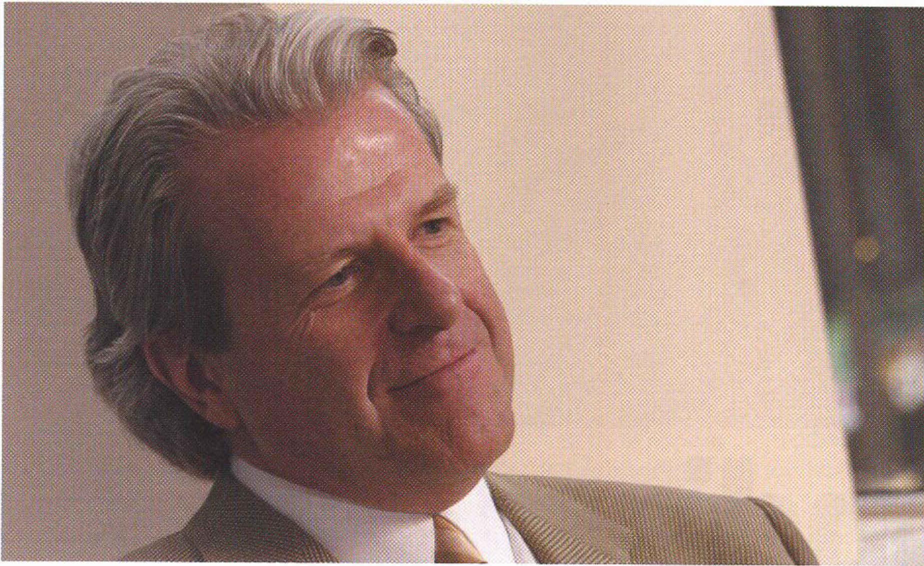
Why CEOs Fail: The 11 Behaviors That Can Derail Your Climb to the Top—and How to Manage Them (Jossey-Bass) by David L. Dotlich and Peter C. Cairo. Their book concentrates on identifying the personality traits that cause CEOs and other leaders to misstep. Dotlich, a former executive VP at Honeywell and Groupe Bull, is now a business adviser and coach to senior executives. Cairo, a consultant in leadership development, is an organizational psychologist.

Across the Board editor A.J. Vogl talked with Dotlich and Finkelstein at the magazine's offices in New York.

Robert Hogan of the Center for Creative Leadership, in his introduction to *Why CEOs Fail*, says that "two-thirds of the people currently in leadership positions in the Western world will fail; they will then be fired, demoted, or kicked upstairs." Were the wrong people picked in the first place, or did these leaders begin to sour and lose what made them successful?

Dotlich: Certainly, for people in visible positions in big jobs—CEOs and executives immediately below that level—I would say their tenure is getting increasingly shorter. There's also a cloning factor at the top of big companies: People clone what they have, which is perfect for the present, but then the world shifts and they find themselves with a cadre of leaders who aren't prepared to deal with change—with pricing pressures, for instance, or globalization. The world changes so fast, and they don't adapt.

Finkelstein: I think "two-thirds" may be drawn out of a hat, though it's a neat number. Did they pick the wrong people? you ask. It's very hard to pick who's going to be the next successful leader in an organization. You may bring in executive search firms, you may search long and thoroughly, and you may pick someone who you think is exactly what you need today—but that person may not be who you need tomorrow. Jill Barad, the former CEO of Mattel, is a perfect example. She is the person who built Barbie into a $2 billion brand. She clearly had the best track record in that company when she was promoted. She's a woman, which is an advantage when you're selling Barbie dolls as your number-one product. But then she had Mattel acquire The Learning Company. That was a major mistake: There was a lot of data on that company that was ignored. By itself, that wouldn't have been enough to lead to her eventual resignation, but the way she handled herself in the executive office was also an issue. Every quarter, she had a wonderful story of how Mattel's failure to make its numbers was just a temporary thing, and that everything was going to change *next* quarter. This went on for four quarters in a row, and it didn't play too well on Wall Street.



Dotlich: I don't know her, but by reputation she was volatile and melodramatic—great at attracting attention to herself as a leader. That worked very well as long as the company was successful. But particularly when she got into trouble, she had difficulty getting feedback, she wouldn't listen, she only knew how to push ahead, and that did her in.

Finkelstein: Another thing that really hurt her was a revolving door at the top. For whatever reason, she found it very difficult to have strong seconds and thirds in command, and there were a number of senior people who left. I look at that as a very critical early-warning sign.

Talking about bad decisions, let's look at two that are too recent to make it into your books. The first deals with Donald Carty of American Airlines, who demanded—and got—concessions from his company's unions while keeping secret from them the fact that he was paying large retention bonuses and pension protection to a select group of top executives. When this became public, Carty, by repute an able, honorable, and—to use your word, gentlemen—smart man, was forced to resign. How do you account for such a dumb decision?

Dotlich: I would account for it in terms of what I call *passive resistance*—a tendency to do one thing and say something different. Carty is a classic passive-resistant leader who says to everyone else, "Here's what I want and need from you," but privately cuts a deal.

Do you think he was aware that he was cutting a deal—working the margins, so to speak?

Dotlich: He probably believed that these were two separate things, so it was OK for him to do this for his group of senior executives and not important to acknowledge it to the union. I think that's the logic he went through.

Finkelstein: I think he knew exactly what he was doing. I don't think it was premeditated in a legalistic sense, but he knew what he was doing, just as many of the other leaders that we studied knew exactly what was going on but chose not to do anything about it. Whether or not it's passive resistance, there's clearly a psychodynamic element here.

Dotlich: It's quite possible that he was out of touch with how people would respond so didn't realize how things would play out. Looking at the decision retrospectively, it seems inconceivable, but when you're in the middle—particularly when you're surrounded by people who agree with you and don't give you information you need—it's easy for it to happen.

"She had difficulty getting feedback, she wouldn't listen, and that did her in."

Speaking of "out of touch," that leads me to my second example: New York Stock Exchange chairman Richard Grasso, who nominated Citigroup chairman and CEO Sanford Weill to be a director of the exchange. Weill was forced to withdraw his nomination

shortly before Citigroup agreed to pay $400 million to settle civil-fraud allegations by regulators, one of which was the exchange itself. Why didn't Grasso foresee that the nomination would produce an uproar?

Dotlich: I think it's arrogance. It's him saying, "I want this person because I think he's the best for the job, and I have made this decision and am going to make it stick."

"Again and again, people at these companies knew exactly what was going on."

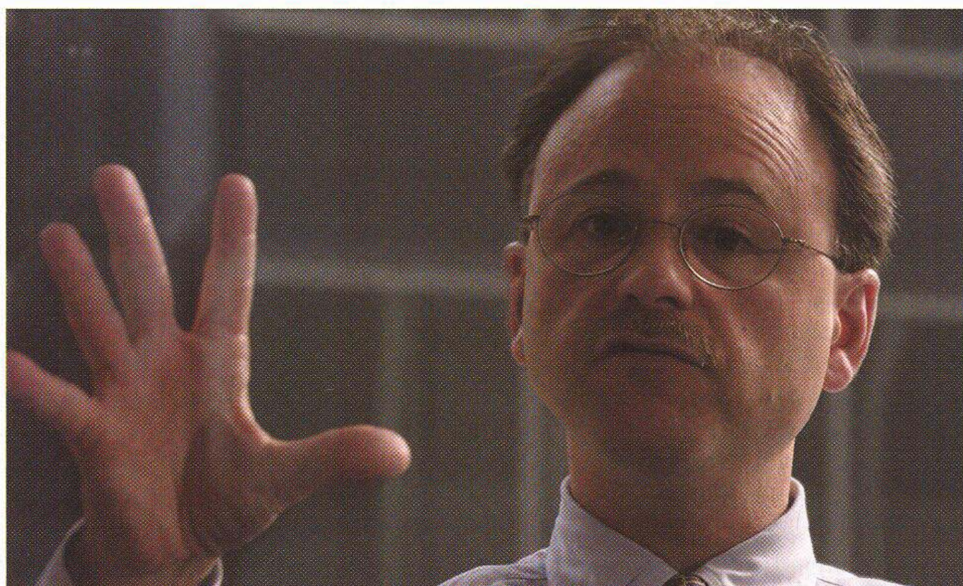
Finkelstein: I see it as a model that comes up in a number of instances, where a CEO or other leader or manager adopts the standard operating procedures that he has always used. Actually, Carty is the same kind of story: Incentives are par for the course in business, so of course you're going to provide bonuses for your senior managers; and for Grasso, of course you're going to bring in top-of-the-line people like Sandy Weill. You wouldn't think of any reason not to. You don't see the disconnect.

Let's talk about some leaders whom you discuss in your books—Christopher Galvin of Motorola, for instance.

Dotlich: That's a fast-moving business. I can't imagine a better case of where a leader needs to be quick and decisive, to make decisions and implement them even if they're only 80 percent right. The rap on Galvin is that he's slow, and the way we would explain it is that he's cautious; he really looks at all the things that could go wrong before he makes the decision. Not to say he's not a wonderful man—I know that he is—but in the industry he's in, the need to do something is important, and he didn't.

Finkelstein: Of the companies I studied, I spent the most time on Motorola. I ended up interviewing his dad, Robert Galvin, and two CEO predecessors to Chris Galvin—Gary Tooker and George Fisher. In going through the process, I got a historical perspective, and Robert Galvin mentioned something really interesting: "We lost what my father said what the core of what the company was all about: a healthy spirit of discontent." They got too comfortable.

Motorola's cell-phone business has been a disaster. There was a disconnect between the corporate level, where Chris is, and the business level, where the people running the phone business were. The guys running the cell-phone business were walk-on-water people: They built the analog business into a mega-success. No one—not Chris, nor Tooker, nor Fisher, for that matter—was willing to challenge them, even though there was a lot of data that said the market



was shifting from analog to digital. They chose to turn a blind eye to that. One of the remarkable sidelights that came out of my interview with Robert Galvin was that Motorola owned several of the key digital patents for cell phones. In the early days, the company licensed them to Nokia and Ericsson. That means that every time Nokia manufactured a phone they wrote a check, so Motorola had perfect data on the market trend going from analog to digital—yet they decided to stick with analog. It wasn't just Chris's mistake—there were cultural issues as well. The company relied on an internal forecasting algorithm: computer-driven, ultra-complicated, sophisticated, high-tech. Classic Motorola.

Dotlich: But don't you think the cultural issues take a big signal from who Chris is and his behavior—how people see his expectations?

Finkelstein: No doubt the CEO plays a role, but here we have three CEOs who expressed regret, mostly by saying that they don't understand how this happened, that this is not the Motorola they knew. It's a deeper thing than just Chris.

Their comment—that they don't understand how this happened—could be applied to many of the examples of failure in your book, Syd. Quaker's disastrous experience with Snapple, for instance. The signs were apparent, but they were misread.

Finkelstein: That's one of the biggest themes that came out of my research. Again and again, people at these companies knew exactly what was going on. In 51 out of the 51 companies I looked at, they chose

not to act on the facts and information they had. In the book, I describe the reasons why that happens, one of which is the cultural dimension, but there's also a strategic dimension, leadership issues, and organizational breakdowns. I refer to it as business-school logic gone bad.

You talk about a cultural dimension, Dave, but your book emphasizes the personal dimension. You write that "failure often has more to do with who people are than with what they know or how bright they are."

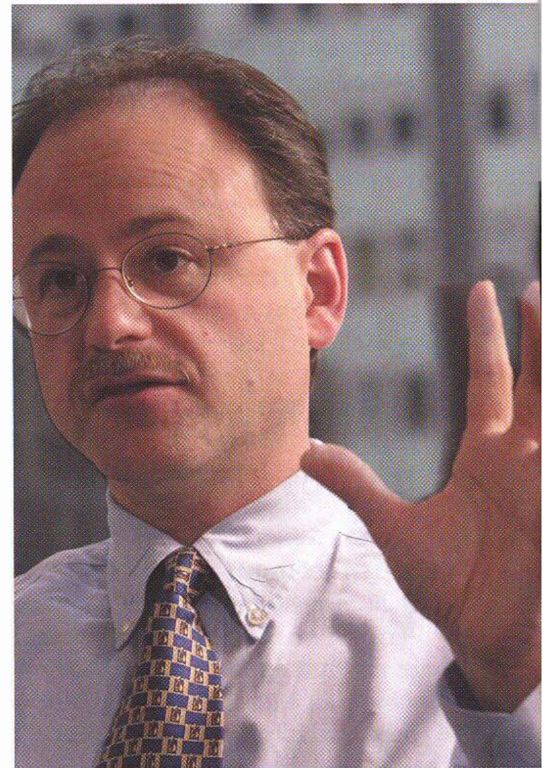
Dotlich: I think that's true. All leaders who fail do so for one of two reasons: what they do, including the decisions they make, and who they are—how they handle the leadership role: whether they listen, how they treat people. I think character is destiny. The higher you go, the more significant that factor is in the destiny of an organization. The higher you go, I tell CEOs, the funnier your jokes get, the brighter your insights, the smarter your strategy. But at that level, people don't tell you things. Good CEOs surround themselves with people who tell the truth; they have a learning orientation. But we have created an environment where we have made CEOs into heroes and princes. In many cases, it's almost impossible to tell them the truth.

In your research into companies, Syd, did you find that CEOs told you this—that they weren't told the truth about their company's situation?

Finkelstein: There's one CEO—who refused to be quoted, so I can't tell you his name—whose company suffered a disaster that cost hundreds of millions. My interview with him was one question long. I asked him what went wrong, and he said there were seven reasons. A good start, I thought—he's very analytical. But every one of those reasons was to blame somebody else. *Every single one.* It was my CFO, it was the consultants that were brought in, it was the board of directors, it was the customers, it was the distributors, it was the regulators, and so on. Every one of them was an excuse.

Remarkable about some of the interviews was that there was a fair amount of honesty. For instance, Quaker CEO William Smithburg, with respect to Quaker and Snapple, admitted, "We should have had another team looking at the *no* side of the Quaker deal. We were so gung-ho that we thought that this was another Gatorade." But they didn't, and it wasn't.

Some of the failures you talk about in your book, Syd, go beyond overlooking or misconstruing data—they violate elementary principles of modern marketing. I'm thinking of Johnson & Johnson's experience with the cardiovascular stent used in angioplasty. Hailed as one of the smartest companies around, J&J in this case refused to listen to its doctor-customers. How do you account for that?



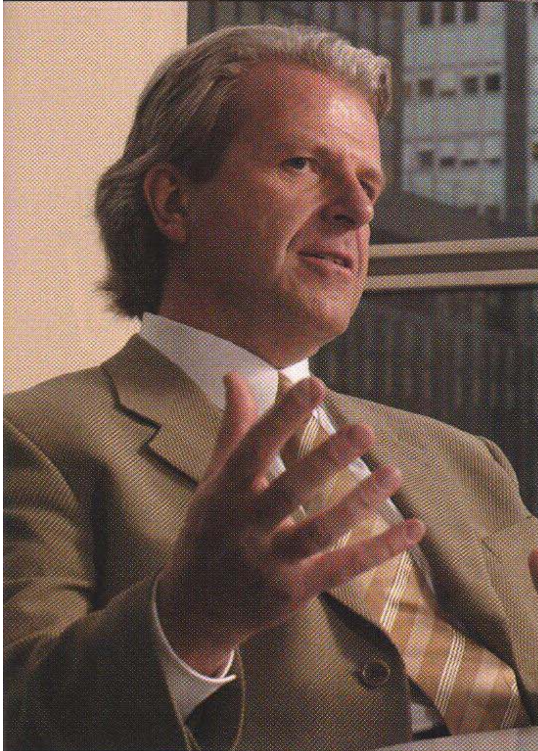
"If J&J can have a major failure, then anybody can."

Finkelstein: What you're asking drove me six years doing this research: How can you explain smart people doing things that just don't make any sense? One of the lessons here is that if J&J can have a major failure, then anybody can.

You talk about violating elementary principles. How many marketing books have been written about paying attention to your customers, being close to them? Every MBA student walking in the first day knows that inside out. In the J&J case, it's not that they didn't know—they just let other things happen. J&J had over 90 percent market share and gross margins of about 80 percent—they *created* that stent market—and they treated it as a classic monopolist would. They ignored customer feedback, they set a maximum price that was high enough for some cardiologists to accuse the company of price gouging, and they didn't worry about the intense pressure on hospitals—their other customers—to control costs. And there was arrogance; the people at J&J thought they were just skating through the world.

There was also a strategic story that was a little more subtle but very important. J&J has grown by acquiring other smaller companies that had great products or devices, and that's how they developed their stent business. But when you do that, the challenge becomes developing the second generation, because in the medical-device business, customers are expecting state-of-the-art all the time. They're not satisfied with last year's model. What happens to your innovative capability internally if you rely on mergers and acquisitions to acquire that innovation in the first place? What happens when the synergy you expect from the company you acquired never develops? What happens when a competitor comes

"American Airlines was on the edge of bankruptcy—what could be more stressful?"



along with a new and improved stent? What happened in this case was that J&J's stent share dropped to 8 percent. In interviews, J&J acknowledged that they should have introduced a second-generation stent but just didn't have the innovative capability in place, which left the way open for a competitor, called Guidant Corp. When I interviewed Ron Dollens, the CEO of Guidant, he said of J&J, "Where were the horses to regenerate the product?", and he was smiling when he said it. But J&J may well mount a comeback: Earlier this year, J&J introduced a new stent of its own, and already analysts are predicting that the company will recoup much of its lost business. [On June 13, Guidant pleaded guilty to 10 felonies for failing to report problems with its stents.]

In your book, David, you list 11 personality characteristics—what you call *derailers*—that lead executives to make major blunders. And in your book, Syd, you list "Seven Habits of Spectacularly Unsuccessful People." Is there a correlation between the 11 and the seven?

Dotlich: I thought Syd's book was wonderful because it looks at the organizational dimension. Ours deals much more with the psychological component of leadership, because we believe that leadership is the most important factor in success and failure. I've seen amazing turnarounds with the right leadership and spectacular failures with ineffective leadership. These derailers that we write about—arrogance, perfectionism, aloofness, volatility, and so on—are characteristics of everyone's personalities. Not just CEOs but all of us are flawed at some level; there's a shadow side that we're trying to keep under control. Most people are able to manage those derailers and behave rationally, but not always, especially under stress. Carty is a classic example: American Airlines was on the edge of bankruptcy—what could be more stressful? At that point, a leader's derailers are likely to emerge.

Was this also true of some of the failures you write about in your book, Syd?

Finkelstein: I have a categorization that I call *desperation management.* Take Coca-Cola and its disastrous introduction of a reformulated Coke. Pepsi was winning all the taste tests, so Coke felt they had to do something. Certainly Carty facing the bankruptcy of his airline, Barad at Mattel, and, today, Peter Dolan at Bristol-Myers Squibb are a bunch of people in desperate strategic conditions. They've got to come up with some answers, and that desperation can lead to major miscalculations.

Let's look beyond specific failures and dumb decisions to talk about what can be done to prevent them. If it follows that better leaders make better decisions, then we should attempt to make our leaders better, and, as you know, there's a whole industry—books, tapes, conferences, seminars—built around leadership. If this industry were to disappear tomorrow, would our failure rate get worse, remain the same, or even improve?

Finkelstein: To believe that you can't improve leadership or creativity is kind of a disappointing viewpoint—it means that you select the right person and then walk away and hope everything works out. I think that's rolling the dice a little bit too much. I can tell you from my experience that there's a deep resonance among CEOs as they read about the mistakes of a Jill Barad or a Chris Galvin. As they assess the underlying reasons for the failures, they quickly come to think, "I've got some of those signs." Sometimes you're so into your work that you don't have the time to step back and think. Leadership

training or development can play a major role in having people catch their breath, and then you can provide some ideas on how to get them back on course.

Dotlich: Well, you know, I'm a participant in the leadership-development industry, so I'm biased. I think we've gotten smart about growing and developing leaders, and one of the foundations of making leaders more effective is first having them understand themselves, their impulses, their strengths, their weaknesses. A lot of leadership development is a combination of the cognitive—great ideas, case studies, classroom work—combined with self-insight: who am I, my values, experiences that are important to me. Finally, there's application—how you put all that together on the job.

We run a lot of what we call action-learning programs, where the CEO has a question and wants an answer, so he puts 10 smart people on a problem and they come back and tell him what they think. What makes that special is that they tell the CEO things they would not normally tell him in his office. A new environment inspires new behaviors, new ways for people to deal with each other.

Finkelstein: When you look at the problems that CEOs have, right near the top of the list is that they have no one to talk to. When there's no one you can reveal yourself to, it's especially hard to find somebody willing to say that the emperor has no clothes. The whistleblowing business is a rough one. And CEOs can't show weakness to the board; they might lose their job.

Dotlich: I really agree with Syd. One of the most difficult things, particularly at the top of large companies, is to express any vulnerability whatsoever. It's very hard for a CEO to say at a meeting, "I'm not sure." We want our leaders to be very confident and sure of themselves. We have the media saying that successful leadership is nothing less than absolute certainty. Yet the reality is that if leaders can't say, "I don't know," they can't create an environment for others to learn. Very few leaders are at that level of self-assurance.

Finkelstein: When CEOs are asked what they really want to know about—and I've seen a lot of these surveys—leadership and change always top the list. Part of the reason is that there's no silver bullet. You can come up with A-B-C in accounting, or with some new idea in marketing, but there's no one principle in leadership that's always going to work.

Dotlich: Leadership is a very faddish, trendy industry. There's a feeling in this country that there's an answer that's going to save us: If we just read the right book, it will change our lives, make us lose weight, become better leaders, all those things—

Finkelstein: *My* book does all of that.

Dotlich: —but changing leadership behavior is one of the hardest things to do. It's harder than any diet or exercise program.

When a CEO is responsible for his company losing billions, would you characterize him as a poor leader or as a good leader who made a bad judgment?

Dotlich: That's the $64,000 question. You know what Peter Drucker says: Whom the gods want to destroy, they send 30 years of success. In the midst of your success, the seeds of failure are sown, and the signals are often very subtle. One of the most difficult things I see with CEOs is that at the peak of success, they must destroy their existing business model or radically change it in order to get on the next growth curve. A classic case is John Akers and IBM. People say he was not really a good leader, but put yourself in his shoes back then—he had a huge mainframe business in the early '80s, just as PCs were coming in. He would have had to go to his board and say, "I'm going to write down this very successful business, and we're going to invest in an entirely different business—the PC business—and grow it."

Finkelstein: Keep in mind that failures are not usually caused by one thing. In doing historical analysis of failures, you need to give the CEO the benefit of the doubt to a certain point. The example of the Schwinn Bicycle Co. is instructive. When Schwinn saw the earliest mountain bikes being imported, how could they know that this would be the next big trend? They couldn't, but they should have tracked this development very closely and adapted when the evidence piled up. But they didn't, and that might be called a leadership failure. There's an interesting story about Ed Schwinn, Schwinn's former CEO. At an off-site meeting with Ed and about 15 of the company's senior managers, they got into a critical discussion of their strategy. And Ed actually said at that time, "This conversation is not going the way I wanted it to be going. I think we'll take a break." And a week later, the person leading that discussion was fired. If you're looking for a perfect model of leadership destruction, that's it. ♦