Verbatim

Why Bad Things Happen To Good Executives

The coroner of failed businesses has some potentially lifesaving advice for boards.

Sydney Finkelstein is the coroner of the business world: He examines the wreckage of dead or dying companies to find out what happened. The professor at the Tuck School of Business at Dartmouth is less interested in what executives do right, than in what they do wrong. Clearly, he thinks we can learn more from our blunders than from our triumphs. Finkelstein authored a book on the topic titled *Why Smart Executives Fail*. He sat down with *Directorship* to talk about how his studies can be applied to the current financial crisis and what we can learn from other people's disasters.

So what are the main reasons that otherwise brilliant executives mess up?

One of the main drivers of failure that I found in my research is related to strategy, the assumptions that leaders make, and whether those assumptions are accurate or not. The reason I think it's important to look at assumptions is that they are certainly something that boards can pay attention to and ask questions about. But also assumptions are, in some ways, the first principles of strategy.

Do executives tend to be overly optimistic in their assumptions? Do they fall in love with their own strategies?

There's a natural tendency for all people to like to keep doing what they've been doing before if there's been any degree of success in it. And sometimes if it hasn't gone as well, they tend not to focus on some of those signals.

The world is changing and changing very quickly. My experience has been that not that many companies and senior executives are taking the time to say, "Well, are these assumptions that we put in place and are driving our strategy still relevant? They've been around for six months or a year or whatever their time frame might be. Are they still operative or has the world changed so much that we need to adjust?" These are exactly the questions a board member can ask: "What are the assumptions?" and "How do you know they're still accurate?"

We hear all the time that the pace of change is speeding up. How true is that?

I think the best evidence that the pace of change is increasing, really accelerating, is to just look at the example of the companies in the *Fortune* 100. From 1955, when the list was started, to 1965, 80 of the 100 were still on the list. By 2005, there were only 18 of the top 100 still on that list. And from 1995 to 2005, 30 companies dropped off. That's a huge attrition rate, and it has continued.

Are some of these companies blinded by their own success?

That's another reason for failure that I call "the delusions around a dream company." It refers to a successful organization, one that's been hitting the numbers, but suddenly goes into decline. Because of its success, management begins to believe that it doesn't have to pay as much attention to what's going on around it. Executives begin to believe that they are the cause of success because they are so good. And what happens in those situations is really a lack of debate and discussion. This is absolutely what was going on at Enron. It was hitting the numbers, blowing past the numbers, and growing into one of the largest companies around—just a powerhouse. In part, because of the tremendous success of what was going on, the board got complacent. We have learned subsequently that, yes, there were a lot of things that the board was kept in the dark about, but the board also had all sorts of clues and signals about what was happening and didn't pay attention to those because they really fell into this delusionary attitude that this was a superior company.

What are some of the red flags that something might be amiss?

I call it "keeping track of the lost signals" that exist all around. One of the questions I ask boards is: "Tell me about your early-warning system?" And I do not get very good answers. The most common answer that I get is, "Well, we look at our quarterly numbers and we see the trends and what's happening." And my response is, that's kind of late in the game. If the problems are already playing out to the extent that they've hit the P&L and the balance sheet, you're playing catch-up at that point. What are you doing to identify the problems that exist or potential problems that may exist ahead of time?

One of the biggest warning signs that companies need to be tracking is the extent to which key people in the organization are leaving. Yahoo is a good example: There's been a steady flow of people out of Yahoo for a long time. Just the other day, some senior engineering/entrepreneurial types who had been acquired at an earlier time jumped ship. It's a very powerful signal that something's gone wrong.

Are there some things you just can't plan for, that you just can't know?

I certainly say that no board, no management team, can predict everything that's going on around them. From the 51 companies that I studied and write about in *Why Smart Executives Fail*, there were commonalities. In virtually every instance, senior decision makers, and sometimes even board members, had the data, they knew what was going on around them, and they ignored it.

Motorola's decline started in the mid-1990s when cell-phone technology shifted from analog to digital, and it knew exactly what was going on. In fact, it actually owned several key patents for digital technology of mobile phones. So the company knew how to do it. And that turns out to be a very common pattern that surprised me. The companies I studied that failed, went bankrupt, or lost hundreds of millions—even billions—of dollars in shareholder value had all sorts of clues and data, much more than you would think.

When people start to say that this time is different, that usually means it's not.

People begin to forget unbelievably quickly what happened. Subprime is unique in a way, but it's not that much different from the collapse of the savings and loan industry 15 or 20 years ago. It's also not that different in some ways from the Internet bubble. People get caught up in a system or a way of making a ton of money, everything is going well, and they keep doubling down on the same bets. They ignore all the warning signs and potential problems that are coming up.

How does a board recognize good decision-making on the part of the company's management?

I think boards should be asking the question: How do we know that something might go wrong? We put ourselves in a position to have a reasonable chance to identify what our true risks are. And when you talk about risk, which is probably top-of-mind for board members, the problem is that most of the time that gets translated into Sarbanes-Oxley, accounting issues, and financial metrics.

I'm not going to say you don't need to look at those things because of course you have to, but the risks that I found to be the ones that really led to disaster are the ones that are about people, about leaders, about strategies. I just don't see a really good attempt to identify those types of things in companies, and that's what the early system diagnostics can do. That's where board members need to make big bets.

Sydney Finkelstein