A Book Review by Rob Carlson

How the Mighty Fall and Why Some Companies Never Give in

by Jim Collins

Preface

Xiv But the question of how the mighty fall defied the constrictions of an article and evolved into this small book.

Xiv Bear Stearns fell from #156on the fortune 500 to gone, bought out by JPMorgan Chase in a desperation deal engineered over a weekend. Lehman Brothers collapsed into bankruptcy after 158 years of growth and success. Fannie Mae and Freddie Mac, crippled, succumbed to government conservatorship. Merrill Lynch, the symbol of bullish America, capitulated to a takeover bid. Washington Mutual tottered on the edge of becoming the largest commercial bank failure in history. The U.S. Government embarked on the most extensive takeover of private assets in more than seven decades in a frenetic effort to stave off another Great Depression.

Xiv Why some of the greatest companies in history, including some once-great enterprises we'd researched for Built to Last and Good to Great, Had Fallen.

Xiv By understanding the five stages of decline discussed in these pages, leaders can substantially reduce the chances of falling all the way to the bottom, tumbling from iconic to irrelevant. Decline can be avoided. The seeds of decline can be detected early. And as long as you don't fall all the way to fifth stage, decline can be reversed. The mighty can fall, but they can often rise again.

Chapter 1: The Silent Creep of Impending Doom

1 "The Conference Board and the Leader to Leader Institute would like you to come to West Point to lead a discussion with some great students," she said

1 "Twelve U.S. Army generals, twelve CEO's, and twelve social sector leaders," explained Frances.

1 "America"

2 Focus on coming up with good questions. I pondered and puzzled and finally settled upon, Is America renewing its greatness, or is America dangerously on the cusp of falling from great to good?

2 (I believe that America carries a responsibility to continuously renew itself, and it has met that responsibility throughout its history)

2 Half argued that America stood as strong as ever, while the other half contended that America teetered on the edge of decline…The Egyptian Old Kingdom, the Minoans of Crete, the Chou Dynasty, the Hittite Empire, the Mayan Civilization-all Fell. Athens fell. Rome fell. Even Britain…

2 Or will America always find a way to meet Lincoln's challenge to be the last best hope of Earth?

2 "When you are at the top of the world, the most powerful nation on Earth, the most successful company in your industry, the best player in your game, your very power and success might cover up the fact that you're already on the path to decline. So, how would you know?

3 The question-*How would you know?*-captured my imagination and became part of the inspiration for this piece.

3 A project on corporate decline, spurred in part by the fact that some of the great companies we'd profiled in the books *Good to Great* and *Built to Last* had subsequently lost their positions of excellence.

3 How *do* the mighty fall? If some of the greatest companies in history can collapse from iconic to irrelevant, what might we learn by studying their demise, and how can other avoid their fate?

3 West Point…Idle Curiosity…active quest.

3 I began to think of decline as analogous to a disease, perhaps like cancer, that can grow on the inside while you still look strong and healthy on the outside. It's not a perfect analogy; as we'll see later, organizational decline, unlike cancer, is largely self-inflicted. Still, the disease analogy might be helpful.

4 The principals we uncovered in prior research do not depend upon the current strength or struggles of the specific companies we studied. Think of it this way: if we studied healthy people in contrast to unhealthy people, and we derived health-enhancing principles such as wound sleep, balanced diet, and moderate exercise, would it undermine these principles if some of our previously healthy subjects started sleeping badly, eating poorly, and not exercising? Clearly, sleep, diet, and exercise would still hold up as principles of health.

4 Indeed, as this work shows, even the mightiest of companies can self-destruct

5 I realized, in retrospect, that at the very moment she looked like the picture of health pounding her way up Electric Pass, she must have already been carrying the carcinoma. That image of Joanne, looking healthy yet already sick, stuck in my mind and gave me a metaphor.

5 I've come to see institutional decline like a staged disease: harder to detect but easier to cure in the early stages. An institution can look strong on the outside but already be sick on the inside, dangerously on the cusp of a precipitous fall.

5 At 5:12 a.m. on April 18th, 1906, Amadeo Peter Giannini felt…

6 Determined to find out what had happened to his fledgling company, the Band of Italy, Giannini endured a six-hour odyssey…

6 " We are going to rebuild San Francisco," he proclaimed.

Giannini lent to the little guy when the little guy needed it most. In return, the little guy made deposits at Giannini's bank. As San Francisco moved from chaos to order, from order to growth, from growth to prosperity, Giannini lent more to the little guy, and the little guy banked even more with Giannini. The bank gained momentum, little guy by little guy, loan by loan, deposit, branch by branch, across California, renaming itself Bank of America along the way. In October 1945, it became the largest commercial bank in the world, overtaking the venerable Chase National Bank.

7 Over the next three decades, Bank of America gained a reputation as one of the best managed corporations in America.

7 "Bank of America is perhaps best known for its size—it is the world's largest bank, with nearly 1,100 branches, operations in more than 100 countries, and total assets of about $100 billion…quality of management…"

7-8 As one of the most successful companies in the world, but would also post some of the biggest losses in U.S. banking history, rattle the financial markets to the point of briefly depressing the U.S. dollar, watch its cumulative stock performance fall more than 80 percent behind the general stock market, face serious takeover threat from a rival California bank, cut its dividend for the first time in fifty-three years, sell off its corporate headquarters to help meet capital requirements, see the last Giannini family board member resign in outrage, oust its CEO, bring a former CEO out of retirement to save the company, and endure a barrage of critical articles in the business press with titles like "The Incredible Shrinking Bank" and "Better Stewards (Corporate and Otherwise) Went Down on the Titanic"—were anyone to have even suggested this outcome—he or she would have been viewed as a pessimistic outlier. Yet that's exactly what happened to Bank of America.

If a company as powerful and well positioned as Bank of America in the late 1970s can fall so far, so hard, so quickly, then *any* company can fall. …Motorola and Circuit City…Zenith and A&P…

8 Every institution is vulnerable, no matter how great.

9 …Fifty-something gentleman
…Forty-one-year-old
…Samuel Armacost

9 Then he engineered the largest interstate banking acquisition to date in the nation's history, buying Seattle-based Seafirst Corp.

10 "Let others learn from us." Here, finally, Bank of America had a *leader.*

10 "We're trying to drive a wedge between our top performers and our nonperformers,"

10 He hired a high-profile change consultant and shepherded people through a transformation process that *business Week* likened to a religious conversion (describing the bank as "born again") and that the *Wall Street Journal* depicted as "its own version of Mao's Cultural Revolution."
"No other financial institution has had this much change."

11 My point is not malign Armacost, but to show how Bank of America took a spectacular fall *despite* his revolutionary fervor.

11 Bank of America changed a lot, and nearly killed itself in the process. We need a more nuanced understanding of how decline happens, which brings us to the five stages of decline that we uncovered in our research project.

Chapter 2: Five Stages of Decline

13 In one sense, my research colleagues and I have been studying failure and mediocrity for years, as our research methodology relies upon contrast, studying those that became great in contrast to those that did not and asking, "what's different?"

13 After my West Point experience, I wanted to turn the question around, curious to understand the decline and fall of once-great companies. I joked with my colleagues, "We're turning to the dark side."

14 And systematically identified eleven cases that met rigorous rise-and-fall criteria at some point in their history: A&P, Addressograph, Ames Department Stores, Bank of America (before it was acquired by NationsBank), Circuit City, Hewlett-Packard (HP), Merck, Motorola, Rubbermaid, Scott Paper, and Zenith.

14 Our principal effort focused on the two-part question, What happened leading up to the point in which decline became visible and what did the company do once it began to fall?

14 *Companies in Recovery:*

14 This brings me to an important sub-theme of this work to which we will return: just as great companies can topple, some rise again.

15 We study *historical* eras of performance to understand the underlying dynamics that correlate with building greatness (or losing it).

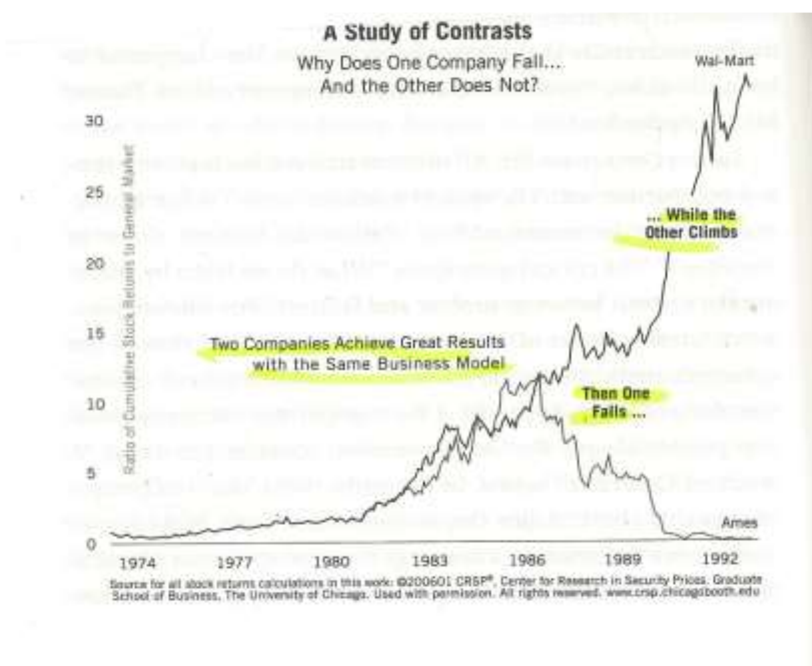
15 *Success Comparison Set:*

15 The critical question is "what do we learn by studying the *contrast* between success and failure?"

15 Ames Department Stores and Wal-Mart

16 Why did one fall, while the other did not? This single contrast illustrates our comparison method.

16



17 We therefore derive our frameworks primarily from evidence *from the actual time of events, before the outcome is known,* and we read through the evidence in chronological order, moving forward through time.

18 This process of looking at historical evidence created at the time, before a company falls, yields one of the most important points to come from this work: it turns out that a company can indeed look like the picture of health on the outside yet already be in decline, dangerously on the cusp of a huge fall, just like Bank of America in 1980. And that's what makes the process of decline so terrifying: I can sneak up on you, and then—seemingly all of a sudden—you're in big trouble.

19 Joanne suggested I look at the first line of Tolstoy's novel *Anna Karenina*. It reads, "All happy families are alike; each unhappy family is unhappy in it's own way."

19 I've concluded that there are more ways to fall than to become great.

19 Even so, a staged framework of how the mighty fall did emerge from the data. It's not the definitive framework of corporate decline—companies clearly can fall without following this framework exactly (from factors like fraud, catastrophic bad luck, scandal, and so forth)—but it is an accurate description of the cases we studied for this effort, with one slight exception(A&P had a different type of Stage 2).

20 Stage 1: HUBRIS BORN OF SUCCESS

21 Stage 1 kicks in when people become arrogant, regarding success virtually as an entitlement, and they lose sight of the true underlying factors that created success in the first place. When the rhetoric of success ("We're successful because we do these specific things") replaces penetrating understanding and insight ("We're successful because we *understand why* we do these specific things and under what conditions they would no longer work"), decline will very likely follow. Luck and chance play a role in many successful outcomes, and those who fail to acknowledge the role luck may have played in their success—and thereby overestimate their own merit and capabilities—have succumbed to hubris.

21 STAGE 2: UNDISCIPLINED PURSUIT OF MORE.

21 Companies in Stage 2 stray from the disciplined creativity that led them to greatness in the first place, making undisciplined leaps into areas where they cannot be great or growing faster than they can achieve with excellence, or both. When an organization grows beyond its ability to fill its key seats with the right people, it has set itself up for a fall.

21 STAGE 3: DENIAL OF RISK AND PERIL.

21 Internal warning signs begin to mount, yet external results remain strong enough to "explain away" disturbing data or to suggest that the difficulties are

"temporary" or "cyclic" or "not that bad" and "nothing is fundamentally wrong."…leaders discount negative data, amplify positive data, and put a positive spin on ambiguous data.

22 STAGE 4: GRASPING FOR SALVATION.
22 By lurching for a quick salvation or getting back to the disciplines that brought about greatness in the first place?

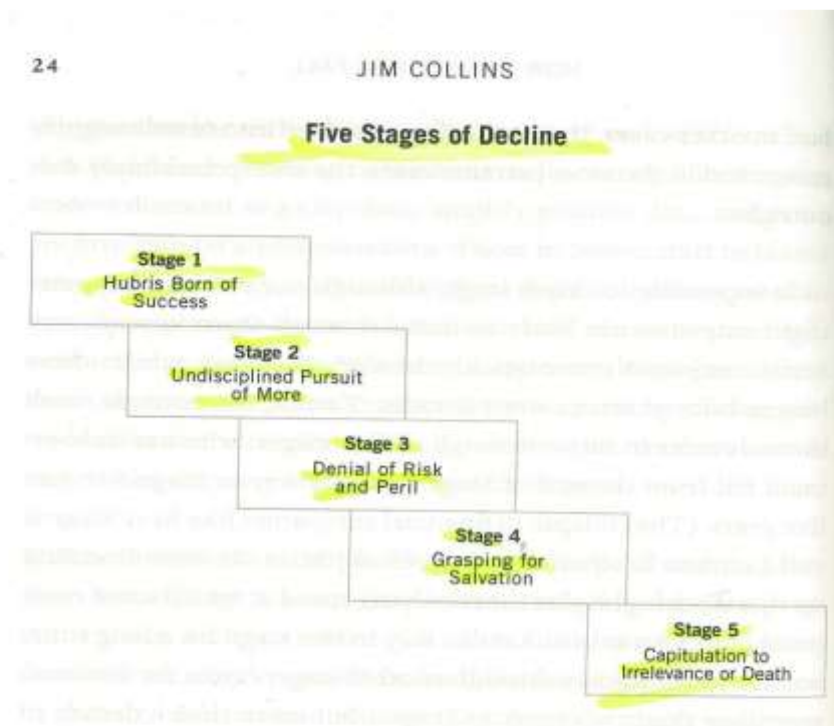
22 Common "saviors" include a charismatic visionary leader, a bold but untested strategy, a radical transformation, a dramatic cultural revolution, a hoped-for blockbuster product, a "game changing" acquisition, or any number of other silver bullet solutions. Initial results from taking dramatic action may appear positive, but they do not last.

22 STAGE 5: CAPITULATION TO IRRELEVANCE OR DEATH.

22 Repeatedly grasping for silver bullets, the more likely it will spiral downward.

22 Leaders abandon all hope of building a great future. In some cases, their leaders just sell out; on other cases, the institution atrophies into utter insignificance; and in the most extreme cases, the enterprise simply dies outright.

24



24 First, we do ourselves a disservice by studying only success. We learn more by examining why a great company fell into mediocrity (or worse) and comparing it

to a company that sustained its success than we do by merely studying a successful enterprise.

25 Second, I ultimately see this as a work of well-founded hope. For one thing, with a roadmap of decline in hand, institutions heading downhill might be able to apply the brakes early and reverse course.

25 Stronger—*after having crashed down into the depths of Stage 4*. Companies like Nucor, Nordstrom, Disney, and IBM fell into the gloom at some point in their histories yet came back.

25 Great companies can stumble, badly, and recover. While you can’t come back from Stage 5, you can tumble into the grim depths of Stage 4 and climb out. Most companies eventually fall, and we cannot deny this fact. Yet our research indicates that organizational decline is largely self-inflicted, and recovery largely within our own control.

25 All companies go through ups and downs, and many show signs of Stage1 or 2, or even Stage 3 or 4, at some point in their histories. Yet Stage 1 does not inevitably lead to Stage 5. The evidence simply does not support the notion that all companies must inevitably succumb to demise and disintegration, at least not within a 100-year time frame.

25 Just because you may have made mistakes and fallen into the stages of decline does not seal your fate. So long as you never fall all the way to Stage 5, you can rebuild a great enterprise worthy of lasting.

Chapter 3: Stage 1: Hubris Born of Success

27 In December 1983, the last U.S. –made Motorola car radio rolled off the manufacturing line and into Chairman Robert Galvin’s hands as a reminder.

28 Galvin Manufacturing Corporation

28 Changed the name of the company to Motorola, and started making profit. But this near-death experience shaped Motorola’s founding culture, instilling a belief that past accomplishment guarantees nothing about future success and an almost obsessive need for self-initiated progress and improvement. When Jerry Porras and I surveyed a representative sample of 165 CEOs in 1989, they selected Motorola as one of the most visionary companies in the world, and we included Motorola in our *Built to Last* research study.

28 Motorola…highest…adherence to core values, willingness to experiment, management continuity, and mechanism of self-improvement.

28 Motorola pioneered Six Sigma quality programs and embraced "technology road maps" to anticipate opportunities ten years into the future.

By the mid-1990s, however, Motorola's magnificent run of success, which culminated in having grown from $5 billion to $27 billion in annual revenues in just a decade, contributed to a cultural shift from humility to arrogance.

28 The StarTAC used analog technology just as wireless carriers began to demand digital.

29 One of Motorola's senior leaders dismissed the digital threat: "forty-three million analog customers can't be wrong."

29 Motorola's arrogance gave competitors an opening, and Motorola fell from being the #1 cell phone maker in the world, at one point garnering nearly 50 percent market share, to having only 17 percent share by 1999. Motorola's fall from greatness began with Stage 1, Hubris Born of Success.

29 Dating back to ancient Greece, the concept of hubris is defined as excessive pride that brings down a hero, or alternatively (to paraphrase classics professor J. Rufus Fears), outrageous arrogance that inflicts suffering upon the innocent. Motorola began 2001 with 147,000 employees; by the end of 2003, the number dropped to 88,000—nearly 60,000 jobs gone.

30 Stock…fell more than 50 percent

30 We will see hubris in undisciplined leaps into areas where a company cannot become the best. We will see hubris in a company's pursuit of growth beyond what it can deliver with excellence. We will see hubris in bold, risky decisions that fly in the face of conflicting or negative evidence. We will see hubris in denying even the possibility that the enterprise could be at risk…insidious forms…arrogance neglect.

30 In October 1995, *Forbes* magazine ran a laudatory story about Circuit City's CEO. Under his leadership, Circuit City had grown more than 20 percent per year, multiplying the size of the company nearly tem times in a decade.

30 And so Circuit City sought The Next Big Thing

30 CarMax…Divx

31 In late 1998, the Wall Street Transcript interviewed Circuit City's CEO.

31 "[Investors] can be fairly relaxed about our ability to run the business well," he replied.

31 I'd refer…[to] our 44 percent earnings growth in the Circuit City business in the first half of the year." He concluded," This is a company that's in great shape."

Yet Circuit City plummeted through all five stages of decline. Profit margins eroded and return on equity atrophied from nearly 20 percent in the mid-1990s to single digits, leading to the company's first loss in more than a quarter of a century. And on November 10, 2008, Circuit City announced that it had filed for bankruptcy.

Circuit City originally made the leap from good to great, a process that began to gain momentum in the early 1970s, under the inspired leadership of Alan Wurtzel. As with most climbs to greatness, it involved sustained, cumulative effort, like turning a giant, heavy flywheel: each push builds upon previous work, compounding the investment of effort—days, weeks, months, and years of work—generating momentum, from one turn to tem, from tem to a hundred, from a hundred to a thousand, from a thousand to a million. Once an organization gets one flywheel going, it might create a second or third flywheel. But to remain successful in any given area of activity, you have to keep pushing with as much intensity as when you first began building that flywheel, exactly what Circuit City did not do.

32 …A cycle of arrogant neglect…

32 1. You build a successful flywheel.
2. You succumb to the notion that new opportunities will sustain your success better than your primary flywheel, either because you face an impending threat or because you find other opportunities more exciting (or perhaps you're just bored).
3. You divert your creative attention to new adventures and fail to improve your primary flywheel as if your life depended on it.
4. The new ventures fail outright, siphon off your best creative energy, or take longer to succeed than expected
5. You turn your creative attention back to your primary flywheel only to find it wobbling and losing momentum.

32 A core business that meets a fundamental human need—and one at which you've become best in the world—rarely becomes obsolete. In this analysis of decline, only one company Zenith…

32 in 60 percent of our matched-pairs, the success-contrast company paid greater attention to improving and evolving its core business than the fallen company during the relevant era of comparison.

33 My point here is not that you should never evolve into new arenas or that Circuit City made a mistake b investing in CarMax or Divx.

33 The real lesson is that Circuit City left itself exposed by not revitalizing its electronics superstores with as much passion and intensity as when it first began building that business two decades earlier. The great irony is that one of its

biggest opportunities for continued growth and success lay in its core business, and the proof rests in two words: Best Buy.
In 1981, a tornado touched down in Roseville, Minnesota, blasting to pieces the showroom of the local Sound of Music store.

33 Richard Schulze realized that he'd stumbled upon a great concept: advertise like crazy have lots of name brand stuff to sell in a no-frills setting (albeit a step up from a parking lot), and offer low prices. Based on his discovery, he invested all his money into creating a consumer electronics superstore that he dubbed Best Buy.

34 Which replaced a commission-driven sales culture with a consultative help-the-customer-find-the-best-answer culture.

34 If Circuit City has invested as much creative energy into making its superstore business a superior alternative to Best Buy…Circuit City would have grown twice the revenue it actually achieved…

35 To disrespect the potential remaining in your primary flywheel—or worse, to neglect that flywheel out of boredom while you turn your attention to The Next Big Thing in the arrogant belief that its success will continue almost automatically—is hubris.

35 Exit definitively or renew obsessively, but do not ever neglect a primary flywheel.

35 Ask yourself two questions:

1. Does your primary flywheel face inevitable demise within the next five to ten years due to forces outside your control—will it become impossible for it to remain best in the world with a robust economic engine?
2. Have you lost passion for your primary flywheel?

If you answer no to both these questions, then continue to push your primary flywheel with as much imagination and fanatical intensity as you did when you first began. (KGSS)

35 This does not mean static, unimaginative replication. Quite the opposite: It means-ever-ending creative renewal…

36 Like an artist who pursues both enduring excellence *and* shocking creativity, great companies foster a productive tension between continuity *and* Change.

36 When institutions fail to distinguish between current practices and the enduring principles of their success, and mistakenly fossilize around their practices, they've set themselves up for decline.

36 "Take care of the organization."

37 A&P's arrogant stance that…we will continue to be successful because—well, we're A&P!" left it vulnerable to new store formats developed by companies…Burger failed to ask the fundamental question, *Why* was A&P successful in the first place?

37 IT retained its aging Depression-generation customers but became utterly irrelevant to a new generation. As one industry observer quipped, "Like the undertaker, A&P could have said every time a hearse went by, "There goes another customer."

38 The point here is not as simple as "they failed because they didn't change." As we'll see in the alter stages of decline, companies that change constantly but without any change constantly but without any consistent rationale will collapse just as surely as those that change not at all. (Think about this)

38 The best leaders we've studied never presume that they've reached ultimate understanding of all the factors that brought them success. For one thing, they retain a somewhat irrational fear that perhaps their success stems in large part from luck or fortuitous circumstance.

39 Like inquisitive scientists, the best corporate leaders we've researched remain students of their work, relentlessly asking questions—why, why, why? —and have an incurable compulsion to vacuum the brains of people they meet. To be a knowing person differs fundamentally from being a learning person.

39 In the late 1950s, a small, unknown company had a Very Big Idea: "to bring discount retailing to rural and small town areas."…its visionary leader created an ethos of partnership with his people…Every dollar invested in its stock at the start of 1970 and held through 1985 grew more than six *thousand* percent….The answer is Ames Department Stores.

40 Ames began in 1958 with the same idea that eventually made Wal—Mart famous…

40 From 1973 to 1986, Ames's and Wal—Mart's stock performances roughly tracked each other…so where is Ames at the time of this writing, in 2008? Dead. Gone.

40 What happened?...A big part of the answer lies in Walton's deep humility and learning orientation.

41 CEOs either declined or neglected to respond, except one: Sam Walton.

41 The founder…sought first and foremost to learn from them, not the other way around.

41 Wal—Mart's success worried Walton. He fretted over how to instill his sense of purpose and humble inquisitiveness into the company beyond his lifetime…

41 He learned from Walton that Wal-Mart does not exist for the aggrandizement of its leaders; it exists for its customers.

42 He kept…adhering to the principles that made Wal-Mart great in the first place.

42 Whereas Walton engineered a smooth transition of power to a homegrown insider…Ames's CEO Herb Gilman brought in an outsider as his successor, a visionary leader who boldly redefined the company.

43 Success entitlement, arrogance.
Neglect of a primary flywheel.
"What" replaces "why".
Decline in learning orientation.
Discounting the role of Luck.

Chapter 4: Stage 2: Undisciplined Pursuit of More

46 Mergers or acquisitions that do not fit with your core values of that undermine your culture or that run counter to that at which you've proven to be best in the world or that defy economic logic—big acquisitions taken out of bravado rather than penetrating insight and understanding—can bring you down.

46 But much of its growth simply did not fit with the strategic insight that produced Ames's greatness in the first place.

46 Meanwhile, Wal-Mart continued its relentless march across the United States…until it reached the North East and killed Ames with the very same business model Ames Pioneered in the first place.

46 We anticipated that most companies fall from greatness because they become complacent…and watch the world pass them by.

47 Only one case showed strong evidence of complacency: A&P. (A&P followed a pattern of Hubris —> Complacency —> Denial —>Grasping for Salvation.)

47 In only three of eleven cases did we find significant evidence that the company failed to innovate during the early stages of decline (A&P, Scott Paper, and Zenith). Motorola…Merck…HP…increased its number of patent productivity.
And then there's the terrifying demise of Rubbermaid.

48 Outlined goals for "leap growth." Growth would come from doing lots of new stuff, all at the same time…choking on nearly one thousand new products introduced in three years, hammered on one side by raw materials costs that nearly doubled in eighteen months, and pressed on the other side by its

ambitious growth targets, Rubbermaid began to fray at the edges, failing at basic mechanics like controlling costs and filling orders on time.

49 Rubbermaid continued to sputter…on October 21, 1998, sold out to Newell Corporation…As Rubbermaid realized too late, innovation can fuel growth, but frenetic innovation— growth that erodes consistent tactical excellence—can just as easily send a company cascading through the stages of decline.(Key)

49 Why do we instinctively point to complacency and lack on innovation as a dominant pattern of decline, despite evidence to the contrary?

50 People went to far—too much risk, too much leverage, too much financial innovation, too much aggressive opportunism, too much growth. (Good—thought to ponder)

52 —$40 billion in market valuation gone in six weeks.

53 My point, rather, is that Merck committed itself to attaining such huge growth that Vioxx had to be a blockbuster, which, in turn, positioned the company for a gigantic fall of Vioxx failed to live up to its promise.

53 Underpromised and overdelivered as a consistent practice

53 Hubris can lead to making brash commitments for more and more and more. And then one day, just when you've elevated expectations too far, you fall.

54 To be clear, the problems of Stage 2 stem not from growth per se, but from the *undisciplined* pursuit of more

Growth Obsession

55 Discontinuous leaps into arenas for which you have no burning passion is undisciplined. Taking action inconsistent with your core values is undisciplined. Investing heavily in new arenas where you cannot attain distinctive capability, better than your competitors, is undisciplined.

55 One of the most damaging manifestations of Stage 2 comes in breaking "Packard's Law" … inspired by his insight that a great company is more likely to die of indigestion from too much opportunity than starvation from too little. …Packard's Law states that no company can consistently grow revenues faster than its ability to get enough of the <u>right people</u> to implement that growth and still become a great company.

56 If a great company consistently grows revenues faster than its ability to get enough of the right people to implement that growth, it will not simply stagnate; it will fall.

Any exceptional enterprise depends first and foremost upon having self-managed and self-motivated people—the #1 ingredient for a culture of discipline. (#1)

56 If you have the right people, who accept responsibility, you don't need to have a lot of senseless rules and mindless bureaucracy in the first place!

56 When bureaucratic rules erode an ethic of freedom and responsibility within a framework of core values and demanding standards, you've become infected with the disease of mediocrity.

57 If I were to pick on marker above all other to use as a warning sign, it would be a declining proportion of key seats filled with the right people.

57 What are the key seats in your organization? What percentage of those seats can you say with confidence are filled with the right people? What are your backup plans in the event that a right person leaves a key seat?

57 Every person in a key sear should be able to respond to the question "What do you do?" *not* with a job title, but with a statement of personal responsibility.

58 Mediocre loan officers could hide behind the bureaucracy, while self-disciplined officers found themselves increasingly frustrated by a system designed to compensate for incompetent colleagues.

58 "One of the great tragedies of this company," commented a Bank of America executive at the time, "is that it lost a lot of good young people because we weren't a meritocracy."

59 …And while the fall of the Roman Empire cannot be explained entirely by problematic successions of power, Augustus failed to create effective mechanisms that would produce and effective of power to generations of outstanding leadership.

61 …The best leaders we've studied had a peculiar genius for seeing themselves as not all that important, recognizing the need to build an executive team and to craft a culture based on core values that do not depend upon a single heroic leader. But in cases of decline, we find a more pronounced role for the powerful individual, and not for the better…

62 While no leader can single-handedly build an enduring great company, the wrong leader vested with power can almost single-handedly bring a company down. Choose well.

63 -Unsustainable quest for growth, confusing big with great -Undisciplined Discontinuous Leaps –Declining proportion of right people in key seats –Easy

cash erodes cost discipline –Bureaucracy subverts discipline –Problems succession of power –Personal interests placed above organizational interests

Chapter 5: Stage 3: Denial of Risk and Peril

68 As companies move into Stage 3, we begin to see the cumulative effects of the previous stages. Stage 1 hubris leads to Stage 2 overreaching, which sets the company up for Stage 3, Denial of Risk and Peril.

70 Audacious goals stimulate progress, but bug bets without empirical validation, or that fly in the face of mounting evidence, can bring companies down, unless they're blessed with unusual luck. And luck is not a reliable strategy.

70 And in fact the greatest danger comes not in ignoring clear and unassailable facts, but in misinterpreting *ambiguous* data in situations when you face severe or catastrophic consequences if the ambiguity resolves itself in the way that's not in your favor.

71 On the afternoon of January 27, 1986, a NASA manager contacted engineers at Morton Thiokol, a subcontractor that provided rocket motors to NASA…The lowest launch temperatures in all twenty-four previous shuttle launches had been 53 degrees, more than twenty degrees above the forecast for the next day's scheduled launch, and the engineers had no conclusive data about what would happen to the O-rings at 25 or 30 degrees.

73 Convince anyone of *what* exactly? That's the crux of the matter. Somehow, in all the dialogue, the decision frame had turned 180 degrees. Instead of framing the question, "Can you prove that it's *safe* to Launch?"…the frame inverted to "Can you prove that it's *unsafe* to launch?"

74 The case for launch should require a preponderance of empirical evidence that it's safe to do so.

74 "waterline" principal…If you blow a hole above the waterline…you can patch the hole, learn from the experience, and sail on. But if you blow a hole below the waterline, you can find yourself facing gushers of water pouring in, pulling you toward the ocean floor.

74 To be clear, great enterprises *do* make big bets, but they avoid big bets that could blow holes below the waterline.

74 1. What's the upside, if events turn out well?
2. What's the downside, if events go very badly?
3. Can you live with the downside? Truly?

76 Of course, not every case of decline involves big launch decisions like Iridium, or lethal decisions like going for the summit on a dangerous rock climb.

76 Customer loyalty and stakeholder engagement also deserve attention…take heed of any decline in the proportion of right people in key seats.

78 Is when those in power blame other people or external factors—or otherwise explain away the data—rather than confront the frightening reality that the enterprise may be in serious trouble.

78 In his historic turnaround of IBM Louis V. Gerstner, Jr. confronted the harsh reality of IBM's short comings head-on, challenging his team early in his tenure,…In this analysis, we found evidence of externalizing blame during the era of decline in seven of eleven cases.

79 A failure to confront head-on the fact that the Japanese had learned how to lower costs *and* increase quality. Shortly thereafter, Zenith fell into Stage 4.

80 Reorganizing and restructuring can create a false sense that you're actually *doing* something productive.

80 Denial. It's a bit like responding to a severe heart condition or a cancer diagnosis by rearranging your living room.

80 Every type of organization has inefficiencies.

81 Markers for Stage 3:

- Amplify the positive, discount the negative.
- Big bets and bold goals without empirical validation.
- Incurring huge downside risk based on ambiguous data.
- Erosion of healthy team dynamics.
- Externalizing blame.
- Obsessive reorganizations.
- Imperious detachment.

Chapter 6: Stage 4: Grasping for Salvation

84 Trying to grow an increasingly large company at an unsustainable rate….If Platt had left some growth on the table, thereby making it easier to maintain a smooth growth trajectory; HP might have soared right through the late 1990s as a success story.

87 Gerstner's self-imposed discipline to get the right people in the first place, then proceed to understand IBM's situation, and only then to settle upon a vision and strategy contrasted with Fiorina's approach.

88 Gerstner steadily increased profitability; Fiorina did not.

88 Fiorina's tenure came to an end on February 7, 2005…That Fiorina's tenure at HP ended in disappointment cannot be blamed entirely on her.

89 The decent into Stage 4 didn't begin with HP's slow response to the dot-com bubble or its falling below Wall Street expectations, but in how the board *reacted* to falling behind.

89 Stage 4 begins when an organization reacts to a downturn by lurching for a silver bullet.

89 The key point is that they go for a quick, big solution or bold stroke to jump-start a recovery, rather than embark on the more pedestrian, arduous process of rebuilding long-term momentum.

91 Every company in this study that fell into the late stages of decline grasped for at least on silver bullet.

92 The signature of mediocrity is chronic inconsistency.

92 Indeed, by succumbing to Stage 4 behavior, they *worsened* their position, increasing the likelihood that they would become a dying company forced into taking desperate action.

92 "Shock Therapy." Motorola bought General instruments Corporation for $17 billion, an amount comparable to Motorola's entire stockholders' equity.

94 Rebuilding greatness requires a series of intelligent, well-executed actions that add up one on top of another.

94 Most "overnight success' stories are about twenty years in the making.

95 Shows a distinct negative correlation between building great companies and going outside for a CEO. Eight of the eleven fallen companies in this analysis went for an outside CEO during their era of decline, whereas only one of the success contrasts went outside during the eras of comparison.

96 By reacting in fear and trying to "save myself," I'd actually increased the danger. Fortunately, my instructor caught me on a backup safety rope, but an important life lesson has stuck with me ever since.

96 When we find ourselves in trouble, when we find ourselves on the cusp of falling, our survival instinct—and our fear—can evoke lurching, reactive behavior absolutely contrary to survival. The very moment when we need to take calm,

deliberate action, we run the risk of doing the exact opposite and bringing about the very outcomes we most fear.

97 If you want to reverse decline, be rigorous about what *not* to do.

97 Breathe. Calm yourself. Think. Focus. Aim. Take *one shot at a time*.

98 Ten months later, in 1981, Addressograph posted single-year losses that wiped out nearly *all* of a half a century's worth of accumulated net worth.

99 Unfortunately, Addressograph lurched about in fearful, frantic reaction while neglecting the offset business and never regained momentum in its core business.

99 Addressograph had plummeted through Stage 4 to enter the final stage, Capitulation to Irrelevance or Death.

100 Markers or Stage 4:

- A Series of Silver Bullets
- Grasping for a Leader-as-Savior
- Panic and Haste
- Radical Change and "Revolution" with Fanfare
- Hype Precedes Results
- Initial Upswing Followed by Disappointments
- Confusion and Cynicism
- Chronic Restructuring and Erosion of Financial Strength

Chapter 7: Stage 5: Capitalization to irrelevance or death

104 *You can be profitable and bankrupt*

104 But organizations do not die from lack of earnings. They die from lack of cash.

105 As institutions hurtle toward Stage 5, they spiral downward, increasingly out of control. Each cycle—grasping followed by disappointment followed by more grasping—erodes resources. Cash tightens. Hope fades. Options narrow.

105 We found two basic versions of Stage 5…those in power come to believe that capitulation offers a better overall outcome than continuing to fight…Second version, those in power continue to struggle, but they run out of options, and the enterprise either dies outright or shrinks…

106 Profits rebounded as cost cutting glowed directly to the bottom line, and Dunlap capitalized on the moment to sell the once-proud Scott Paper to archrival Kimberly-Clark.

106 But Dunlap, for all his pugnacious bravado, was simply the mechanism of Scott Paper's capitalization, not its cause.

106 Dunlap would have never been brought in to burn the village in order to save it.

107 No company we studied was destined to fall all the way to Stage 5, and each company could have made different decisions earlier in the journey to reverse its downward slide. But by the time a company has moved through Stages 1, 2, 3, and 4, those in power can become exhausted and dispirited, and eventually abandon hope, and when you abandon hope, you should begin preparing for the end.

107 But hope alone is not enough; you need enough resources to continue the fight.

110 But through Zenith's story, we see how even some of the smartest and most capable leaders can find themselves unable to control their company's destiny if the accumulated impact of Stages 1 through 4 destroys their cash position.

111 The point of the struggle in not just to survive, but to build an enterprise that makes such a distinctive impact on the world it touches, and does so with such superior performance, that it would leave a gaping hole—a hole that could not be easily filled by any other institution—if it ceased to exist.

Chapter 8: Well Founded Hope

113 When Anne Mulcahy became chief executive of Xerox…She retorted…"*I am* the culture. If I can't figure out how to bring the culture with me, I'm the wrong person for the job."

115 Drawing inspiration from Shackleton, Mulcahy didn't take a weekend off in two years…Xerox faces the very real threat of bankruptcy, yet Mulcahy rebuffed…

116 By 2006, Xerox posted profits in excess of $1 billion and sported a much stronger balance sheet.

116 Xerox. Nucor. IBM. Texas Instruments. Pitney Bowes. Nordstrom. Disney. Boeing. HP. Merck. What do these companies have in common? Every one took at least one tremendous fall at some point in its history and recovered.

116 But in every case, leaders emerged who broke the trajectory of decline and simply refused to give up on the idea of not only survival, but of ultimate triumph despite the most extreme odds.

116 "A crisis is a terrible thing to waste."

117 But that is not our conclusion from this analysis, not if you catch decline in Stages 1, 2, or 3. And in some Cases, you might even be able to reverse course once in Stage 4, as long as you still have enough resources to get out of the cycle of grasping and rebuild one step at a time.

117 Recall the Grestner philosophy: the right leaders feel a sense of urgency in good times and bad, whether facing threat or opportunity, no matter what.

117 The right people will drive improvement, whether standing on a burning platform or not, and they never take well to manipulation.

117 the sooner you break the cycle of grasping for salvation the better. The path to recovery lies first and foremost in returning to sound management practices and rigorous strategic thinking.

118 The point being, however you slice it, lack of management discipline correlates with decline, and passionate adherence to management discipline correlates with recovery and ascent.

119 If you've been practicing the principles of greatness all the way along, *you should get down on your knees and pray for severe turbulence*, for that's when you can pull even further ahead of those who lack your relentless intensity. But beware: if you get caught in the stages of decline during turbulent times—if succumb to hubris, overreaching, denial, and grasping for quick fixes— your fall will be faster and more violent than in stable times.

119 If you've fallen onto decline, get back to solid management disciplines— now!

120 But setting that aside, the main message of our work remains: we are not imprisoned by our circumstances, our setbacks, our history, our mistakes, or even staggering defeats along the way. We are freed by our choices.

121 World War I tragedy at Gallipoli (a botched plan to knock Turkey our of the war, and to attack Germany and Austria from the southeast), which cost 213,980 British casualties for zero gain;

122 Churchill's rivals expected Churchill to see no other alternative than a negotiated peace with Herr Hitler and his Nazi henchmen, and they hoped to capitalize on his taking the political fallout for capitulation

122 "We shall never surrender, and even if, which I do not for a moment believe, this Island or a large part of it were subjugated and starving, then our Empire beyond the seas armed and guarded by the British Fleet, would carry on the struggle, until, in God's good time, the New World, with all its power and might, steps forth to the rescue and the liberation of the old"

123 "This is the lesson: never give in, never give in, never, never, never, never—in nothing great or small, large or petty—never give in except to convictions of honour and good sense. Never yield to force; never yield to the apparently overwhelming might of the enemy."

Never give in. Be willing to change tactics, but never give up your purpose.

123 Failure is not so much a physical state as a state of mind; success is falling down, and getting up one more time, without end.

Appendix

Appendix 5

1. The Right People Fit with the Company's Core Values
2. The Right People Don't Need to be Tightly Managed
3. The Right People Understand That They Do Not Have 'Jobs" They Have Responsibilities
4. The Right People Fulfill Their Commitments
5. The Right People Are Passionate About The Company And Its Work
6. The Right People Display "Window and Mirror" Maturity

Appendix 6.A

- Level 5 Leadership
  - First Who, Then What
  - Confront the Brutal Facts
  - Hedgehog Concept
  - Culture of Discipline
  - Flywheel, Not Doom Loop
  - Clock Building, Not Time Telling
  - Preserves the Core/Stimulate Progress

Appendix 7

- First Who, Then What
  - Stage 2: Disciplined Thought
    - Confront the brutal facts—The Stockdale paradox
    - The Hedge Concept
  - Stage 3:
    - Culture of Discipline
    - The Flywheel
  - Stage 4:
    - The Building, Not Time Telling
    - Preserve the Core/Stimulate Progress

Quote

"Whether you prevail or fail, endure or die, depends more on what you do to yourself than on what the world does to you."