

SOUNDVIEW Executive Book Summaries®

FILE: STRATEGIC MANAGEMENT



By Jim Collins

Why Some Companies Make the Leap ... And Others Don't

GOOD TO GREAT

THE SUMMARY IN BRIEF

In his previous bestseller, Built to Last, Jim Collins explored what made great companies great and how they sustained that greatness over time. One point kept nagging him, though — great companies have, for the most part, always been great, while a vast majority of good companies remain just that: good, but not great. What could merely good companies do to become great, to turn long-term weakness into long-term supremacy?

Collins and his team of researchers used strict benchmarks to identify a group of eleven elite companies that made the leap from good to great and sustained that greatness for at least fifteen years. The companies that made the list might surprise you as much as those left off (the likes of Intel, GE and Coca Cola are nowhere to be found).

The real surprise of Good to Great isn't so much what good companies do to propel themselves to greatness — it's why more companies haven't done the same things more often.

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What You'll Learn In This Summary

- ✓ **Celebrity executives almost never lead good companies to greatness.** Good-to-great leaders embody a paradoxical mix of personal humility and professional will.
- ✓ **You can't achieve great things without great people.** Many companies create strategy, then try to rally people around it; good-to-great companies start with great people and build great results from their efforts.
- ✓ **Simplicity rules.** To go from good to great requires leaders to know what their organizations are passionate about, what drives their economic engine, and at what they can (and cannot) be the best in the world.
- ✓ **Enterprise-wide discipline is essential.** When you combine a culture of discipline with an ethic of entrepreneurship, you are more likely to achieve great results.
- ✓ **Technology is an accelerator.** Good-to-great companies do not jump on technological bandwagons or chase after fads. They determine what technology makes the most sense for them, then pioneer its application.

GOOD TO GREAT

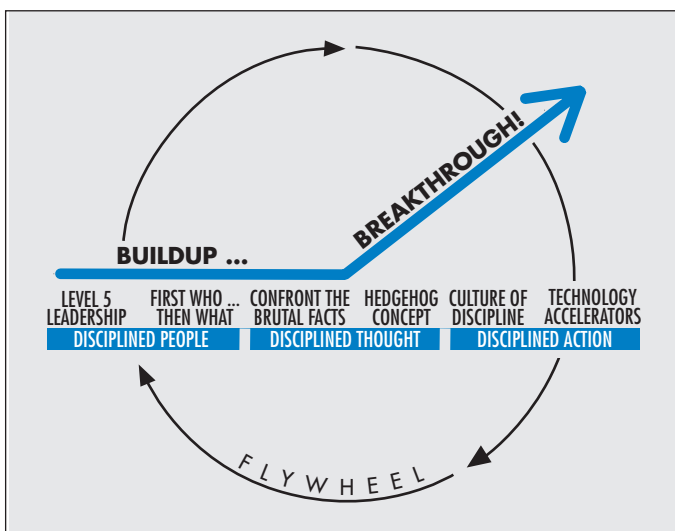
by Jim Collins

— THE COMPLETE SUMMARY

How Did They Do It?

The author and his team of researchers established the good-to-great benchmark as follows:

- The companies had to have experienced 15-year cumulative stock returns that were at or below the general stock market, punctuated by a transition point, then cumulative returns at least three times the market over the next fifteen years.
- Each company had to demonstrate the good-to-



The Eleven Good-to-Great Companies

- ✓ Abbott
- ✓ Fannie Mae
- ✓ Kimberly-Clark
- ✓ Nucor
- ✓ Pitney Bowes
- ✓ Wells Fargo
- ✓ Circuit City
- ✓ Gillette
- ✓ Kroger
- ✓ Philip Morris
- ✓ Walgreens

great pattern independent of its industry.

- Each company had to demonstrate a pattern of results.
- Each company was compared to other similar companies that either never made the good-to-great leap (or made it but did not sustain it), in order to determine what distinguished the good-to-great company from all others.

When the dust cleared and the good-to-great companies were identified, the author and his researchers found distinct patterns of behavior in those who led each company and the people who followed them — patterns that concerned disciplined people, thought and action. ■

DISCIPLINED PEOPLE

Level 5 Leadership

One of the most surprising results of the research of good-to-great companies was in the discovery of the type of leadership required to turn a good company into a great one. One might think that such companies are led by high-profile leaders with big personalities, those who make headlines and become celebrities.

Yet, those leaders who seek and thrive in the spotlight do not exude what can be termed “Level 5 Leadership” behaviors (the term Level 5 refers to the highest level in a hierarchy of executive capabilities as shown in the chart on the following page). Leaders of this type — those who combine extreme personal humility with intense professional will — shun the attention of celebrity, channeling their ambition toward the goal of

building a great company. Those leaders might run different companies in different markets, but they exemplify the same basic set of qualities:

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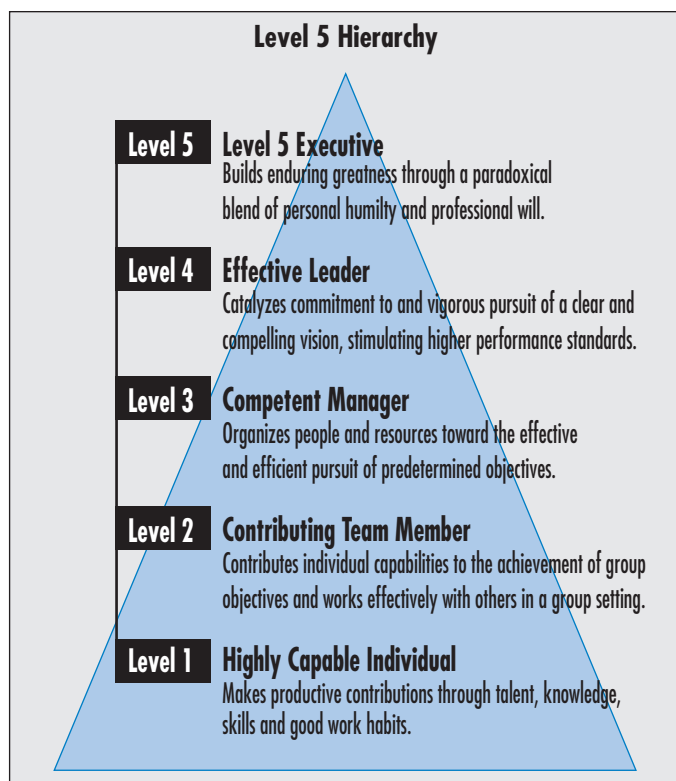
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Level 5 Leadership

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- **They set up successors for success.** Many leaders fail to set their companies up for success when they depart, or pick a weak leader to replace them at the helm — after all, what better testament to your own personal greatness than that the place falls apart after you leave?

Level 5 leaders like Fannie Mae's former CEO, David Maxwell, make sure those who follow them are poised to continue a successful path, or to exceed the expectations that arise as a result of that success. Maxwell came under fire from Congress for the perceived excessiveness of his \$20 million retirement package (Fannie Mae operates under a government charter). Instead of serving his own self-interest and taking the money, he instructed his successor to withhold the remaining balance of \$5.5 million, saving the company from a potentially bad (not to mention threatening) relationship with Washington.

- **They are compellingly modest.** In contrast to the very I-centric style of some other leaders, Level 5 leaders do not typically talk about themselves, preferring to direct attention to other individuals, or to the results of the company as a whole. They don't aspire to be larger-than-life heroes, or to be placed on a pedestal. They are seemingly ordinary people quietly producing extraordinary results.

- **They have unwavering resolve.** Level 5 leaders do not simply exude modesty or humility; they also have a ferocious resolve, an almost stoic determination to do whatever needs to be done to make the company great.

When George Cain became CEO of Abbott Laboratories, the company occupied a lowly space in the pharmaceutical industry. Cain didn't have an inspiring personality to galvanize the company, but he did have a steadfast intolerance for mediocrity; good was simply not good enough. He destroyed the company's most glaring causes of its mediocrity — nepotism — by rebuilding the board and executive teams with the best people available, not just those who had family connections or had been with the company longest.

Want to find out if one of your managers has the potential for Level 5 leadership? Look for situations where extraordinary results exist, but where no individual steps forth to claim excess credit. Want to be a Level 5 leader? Read on; now that you know what a Level 5 leader is, you are ready to discover what a Level 5 leader does. ■

First Who ... Then What

One of the things most people assume they will find when studying good-to-great companies is a compelling, new vision, strategy, or direction, around which management will gain people's commitment.

The truth is quite the opposite. Executives who ignited transformations from good to great did not first figure out where to drive the bus, then get the people to take it there. Instead, they first got the right people on the bus (and the wrong people off) and then figured out where to drive it. "Who" questions must come before

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Wells Fargo's Rigorous People Decision

Wells Fargo began its fifteen-year stint of spectacular performance in 1983, but the foundation of the shift began in the early 1970s, when then-CEO Dick Cooley first foresaw that the banking industry would eventually undergo wrenching change. Because he could not envision the breadth or form of that change, he focused on "injecting an endless stream of talent" into the veins of the company, building a talent-stocked team that could handle any exigency.

Under Cooley's direction, Wells Fargo hired outstanding people whenever and wherever they could find them, often without a specific job in mind. Some of these people would go on to become executives; all of them were responsible for the company's high performance, even in the face of extreme industry change. At a time when its sector of the banking industry fell 59 percent behind the general stock market, Wells Fargo outperformed the market by a 3-to-1 margin.

First Who ... Then What

(continued from page 3)

“what” decisions — before vision, before strategy, before organization structure, before tactics.

Simple Truths

Good-to-great leaders understand three simple truths:

● **If you begin with the “who,” rather than the “what,” you can more easily adapt to a changing world.**

● **If you have the right people on the bus, the problem of how to motivate and manage people largely goes away.**

● **If you have the wrong people, it doesn't matter whether you discover the right direction—you still won't have a great company.** Great vision without great people is irrelevant.

Good-to-great companies tend to have rigorous cultures — cultures in which leadership consistently applies exacting standards at all times and at all levels, especially upper management. To be rigorous means that the best people need not worry about their positions, leaving them to concentrate fully on doing their best work. It can also mean being up front about the need to let people go, if that is warranted.

To be rigorous in people decisions means first becoming

rigorous about top management people decisions, and to following three practical disciplines:

● **When in doubt, don't hire — keep looking.** No company can grow revenues consistently faster than its ability to get enough of the right people to implement that growth and still become a great company. If your growth rate in revenues consistently outpaces your growth rate in people, you cannot build a great company.

● **When you know you need to make a people change, act.** The moment you feel the need to tightly manage someone, you've made a hiring mistake. The best people don't need to be managed — guided, taught, led, yes, but not tightly managed. Don't delay, try different alternatives, give third or fourth chances, or build systems to compensate for shortcomings. Letting the wrong people hang around is unfair to all the right people, who often find themselves compensating for the wrong people's inadequacies. Get the wrong people off the bus.

● **Put your best people on your biggest opportunities, not your biggest problems.** Many companies think that putting their best people in bad situations will help turn the bad situation around. While this sometimes works to everyone's advantage, managers who do so fail to grasp the fact that managing your problems can only make you good. Building opportunities is the only way to become great. ■

DISCIPLINED THOUGHTS

Confront the Brutal Facts

All good-to-great companies began the process of finding a path to greatness by confronting the brutal facts of their current reality. When a company starts with an honest and diligent effort to determine the truth of its situation, the right decisions often become self-evident. Good decisions are impossible without an honest confrontation of the brutal facts.

Why Kroger Beat A&P

The Great Atlantic and Pacific Tea Company (also known as A&P) had the perfect business model for the first half of the twentieth century, when two world wars and an economic depression imposed frugality upon Americans: cheap, plentiful groceries sold in utilitarian stores. However, in the more affluent second half of the century, Americans began demanding bigger stores, more choices, fresh baked goods, fresh flowers, banking services and so forth. They wanted superstores that offered almost everything under one roof.

To face the brutal facts about the mismatch between its past model and the changing world, A&P opened a new store called Golden Key, where it could experiment with new methods and models and learn what customers

wanted. It sold no A&P-branded products, experimented with new departments, and began to evolve toward the

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When “I Don't Know” Is the Right Answer

When Alan Wurtzel assumed the CEO post of Wards (the hi-fi and appliance seller that would one day become Circuit City), the company stood at the brink of bankruptcy, its stores a hodgepodge of loosely connected units with no unifying concept. When asked where he was going to take the company, Wurtzel answered honestly: “I don't know.”

Rather than claiming he had the right answers, Wurtzel got the right people on the bus and began asking questions, sparking debates in the company boardroom and on the executive team. At each step along the way on the company's turnaround path, Wurtzel would keep asking questions until he had a clear picture of reality and its implications.

By asking questions, leaders at good-to-great companies create a forum where current realities bubble to the surface and can be addressed honestly.

Confront the Brutal Facts

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more modern superstore. A&P began to discover the answer to the questions of why it was losing market share and what it could do about it. But A&P executives didn't like the answers they got, so they closed the store, rather than diverge from their ages-old business ideas.

Meanwhile, the Kroger grocery chain also conducted experiments and, by 1970, discovered the inescapable truth that the old-model grocery store was going to become extinct. Rather than ignore the brutal truth, as A&P did, the company acted on it, eliminating, changing, or replacing every single store that did not fit the new realities. It went block-by-block, city-by-city, state-by-state, until it had rebuilt its entire system. By 1999, it was the number one grocery chain in America.

Let the Truth Be Heard

One of the primary tasks in taking a company from good to great is to create a culture wherein people have a tremendous opportunity to be heard and, ultimately, for the truth to be likewise heard.

To accomplish this, you must engage in four basic practices:

- **Lead with questions, not answers.** Leading from good to great does not mean coming up with the answers and motivating everyone to follow your messianic vision. It means having the humility to grasp the fact that you do not yet understand enough to have the answers, and then to ask questions that will lead to the best possible insights.

- **Engage in dialogue and debate, not coercion.** All good-to-great companies have a penchant for intense debates, discussions and healthy conflict. Dialogue is not used as a sham process to let people "have their say" so they can buy into a predetermined decision; rather, it is used to engage people in the search for the best answers.

- **Conduct autopsies, without blame.** Good-to-great leaders must take an honest look at decisions his or her company makes, rather than simply assigning blame for the outcomes of those decisions. These "autopsies" go a long way toward establishing understanding and learning, creating a climate where the truth is heard.

- **Build red flag mechanisms that turn information into information that cannot be ignored.** Good-to-great companies have no better access to information than any other company; they simply give their people and customers ample opportunities to provide unfiltered information and insight that can act as an early warning for potentially deeper problems. ■

For more information on the root causes of A&P's troubles, go to: <http://my.summary.com>

The Hedgehog Concept

In his famous essay "The Hedgehog and the Fox," Isaiah Berlin divided the world into two groups, based on an ancient Greek proverb, which pitted the two natural enemies against each other. Foxes pursue many ends at the same time and see the world in all its complexity; they are scattered or diffused, moving on many levels, never integrating their thinking into one overall concept or unifying vision. Hedgehogs, on the other hand, simplify a complex world into a single idea or principle that unifies and guides everything. Regardless of the world's complexity, the hedgehog reduces all challenges and dilemmas to simple ideas — anything that does not somehow relate to the hedgehog idea holds no relevance. When foxes and hedgehogs are pitted against one another, the hedgehog always wins.

Three Key Dimensions

Those who built the good-to-great companies were, to one degree or another, hedgehogs. They used their hedgehog nature to drive toward a Hedgehog Concept, a simple, crystalline concept that flows from deep understand-

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The "Best in the World" Understanding

The following are among the good-to-great companies that attained an understanding of what they could be best in the world at, and what they did with that understanding:

- ✓ Abbott Laboratories understood it could become the best at creating a product portfolio that would lower the cost of health care. The company confronted the reality that it could not become the best pharmaceutical company in the world, despite the fact that 99 percent of its revenue at one time came from pharmaceuticals. It shifted its focus to creating that lower-cost product portfolio, principally hospital nutritionals, diagnostics and hospital supplies.

- ✓ Nucor understood it could become the best at harnessing culture and technology to produce low-cost steel. The company came to see that it had tremendous skill in two activities—creating a performance culture and making farsighted bets on new technologies. By combining these two, it was able to become the lowest-cost steel producer in the United States.

- ✓ Kimberly-Clark understood it could become the best in the world at paper-based consumer products. The company realized it had a latent skill at creating "category-killer" brands (brands that were synonymous with their products, like Kleenex) in paper-based products.

The Hedgehog Concept

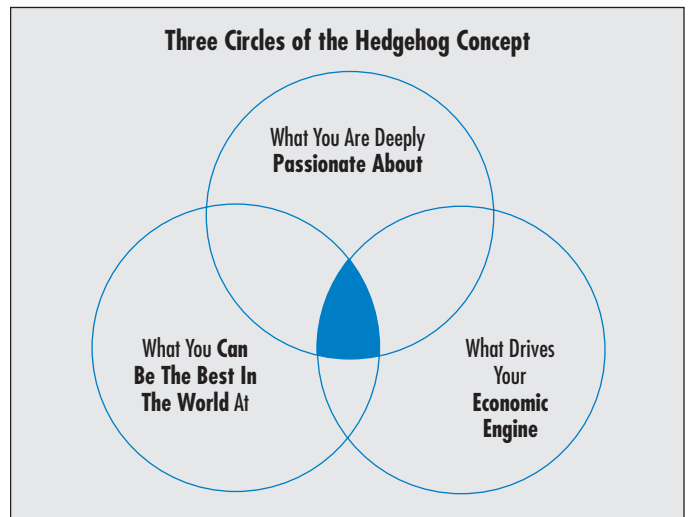
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ing about the intersection of the three key dimensions:

- **At what you can be best in the world.** This standard goes far beyond core competence — just because you possess a core competence doesn't necessarily mean you are the best in the world at that competence. Conversely, what you can be best in the world at might not even be something in which you are currently engaged. The Hedgehog Concept is not a goal or strategy to be the best at something; it is an understanding of what you can be the best at and, almost equally important, what you cannot be the best at.

- **What drives your economic engine.** To get insight into the drivers of your economic engine, search for the one denominator (profit per x, for example, or cash flow per x) that has the single greatest impact. If you could pick one and only one ratio to systematically increase over time to make a greater impact, what would that ratio be? This denominator can be subtle, sometimes even unobvious. The key is to use the denominator to gain understanding and insight into your economic model.

- **What you are deeply passionate about.** Good-to-great companies did not pick a course of action, then



encourage their people to become passionate about their direction. Rather, those companies decided to do only those things that they could get passionate about. They recognized that passion cannot be manufactured, nor can it be the end result of a motivation effort. You can only discover what ignites your passion and the passions of those around you. ■

For the complete parable of "The Hedgehog and the Fox," go to: <http://my.summary.com>

DISCIPLINED ACTION

A Culture of Discipline

Sustained great results depend upon building a culture full of self-disciplined people who take disciplined action fanatically consistent with the three circles of the Hedgehog Concept.

This is in contrast to the typical ways in which many companies (particularly start-ups) conduct themselves when responding to growth and success. As these companies grow, they tend to sacrifice the creativity, energy and vision that made them successful in favor of hierarchical, bureaucratic structures and strictures — thus killing the entrepreneurial spirit as they create order. Exciting companies thus transform themselves into ordinary companies, and mediocrity begins to grow in earnest.

Indeed, bureaucratic cultures arise to compensate for incompetence and lack of discipline, which arise from having the wrong people on the bus in the first place. Most companies build their bureaucratic rules to manage a small percentage of the wrong people, which in turn drives away the right people.

This self-perpetuating problem can be avoided by creating a culture of discipline.

Action Steps

To create a culture of discipline, you must:

- **Build a culture around the idea of freedom and responsibility, within a framework.** Good-to-great companies built a consistent system with clear constraints, but they also gave people freedom and responsibility within the framework of that system. They hired self-disciplined people who didn't need to be managed, and then managed the system, not the people. They also had the discipline of thought, to confront the brutal facts of reality and still maintain faith that they were on the track to greatness. Finally, they took disciplined actions that kept them on that track.

- **Fill your culture with self-disciplined people who are willing to go to extreme lengths to fulfill their responsibilities.** People in good-to-great companies tend to be almost fanatical in the pursuit of greatness; they possess the discipline to do whatever it takes to become the best within carefully selected arenas, and then seek continual improvement from there. While everyone would like to be the best, most organizations lack the discipline to figure out with egoless clarity what they can be the best at, and the will to do whatever

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A Culture of Discipline

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it takes to turn that potential into reality.

● **Don't confuse a culture of discipline with a tyrannical disciplinarian.** Many companies that could not sustain their success had leaders who personally disciplined the organization through sheer force. Good-to-great companies had Level 5 leaders who built an enduring culture of discipline, powered by self-disciplined people who acted in the company's best interests without strict dictums from leadership.

These disciplined companies could and did thrive even after their leaders had departed the organization; those companies that practiced discipline only by tyrannical rule could not sustain themselves once their leaders departed.

● **Adhere with great consistency to the Hedgehog Concept, exercising an almost religious focus on the intersection of the three circles.** The good-to-great companies at their best followed a simple mantra — “Anything that does not fit with our Hedgehog Concept, we will not do.” They did not launch unrelated businesses or joint ventures in an effort to diversify. They did not panic if the competitive landscape shifted. If a course of action did not fit into their disciplined approach, they did not perform that action. It takes discipline to say “No” to such opportunities. ■

For more information on one athlete's fanatical discipline, go to: <http://my.summary.com>

Technology Acceleration

Good-to-great organizations think differently than mediocre organizations about technology and technological change. They avoid the fads and bandwagons that typically arise from new technology, instead becoming pioneers in the application of carefully selected technologies. When used correctly, technology becomes an accelerator of momentum, not a creator of it.

Find the Right Technologies

Good-to-great companies never began their transitions with pioneering technology, for the simple reason that you cannot make good use of technology until you know which technologies are relevant — the ones that link directly to the three intersecting circles of the Hedgehog Concept. Examples of this approach abound in the list of good-to-great companies:

● Circuit City pioneered the application of sophisticated point-of-sale and inventory-tracking technologies, both of which were linked to the concept of being the “McDonald's” of big-ticket retailing, able to operate a

Walgreens and Technology

Walgreens pioneered the use of satellite communications and computer network technology, linked to its concept of convenient corner drugstores, tailored to the unique needs of specific demographics and locations. Walgreens also approached the Internet with great care, even in the face of new, technology-driven competition.

geographically dispersed system with great consistency.

● Gillette pioneered the application of sophisticated manufacturing technology for making billions of high-tolerance products at low cost with fantastic consistency. The company protects its manufacturing technology secrets with the same fanaticism that Coca-Cola protects its cola formula.

● Philip Morris pioneered the application of both packaging and manufacturing technology, including the technology to make flip-top boxes — the first tobacco industry packaging innovation in twenty years. The company also was the first to use computer-based manufacturing, making an enormous investment in a manufacturing center to experiment with, test and refine advanced manufacturing and quality techniques.

Don't Overreact to New Technology

How a company reacts to technological change is a good indicator of its inner drive for greatness versus mediocrity. Leaders of good-to-great companies respond with thoughtfulness and creativity, driven by a compulsion to turn unrealized potential into results. They do not take reactionary measures, defining strategy in response to what others are doing. They act in terms of what they want to create, and how to improve their companies, relative to an absolute standard of excellence.

Mediocre companies, on the other hand, react and lurch about, motivated chiefly by the fear of what they don't understand — a fear of watching others hit it big while they're left behind. Never was there a better example of this difference than during the technology bubble of the late 1990s, when mediocre companies moved from one technological scheme to the next, always reacting, never pioneering. The great companies acted with calm equanimity, taking quiet, deliberate steps forward, with great discipline.

Those organizations that stay true to their fundamentals and maintain their balance will accumulate the momentum required to break through; those that do not will spiral downward or remain mediocre. ■

For more information on Walgreens Internet battles, go to: <http://my.summary.com>

BUILDUP AND BREAKTHROUGH

The Flywheel and The Doom Loop

Good-to-great transformations often look like dramatic, revolutionary events to those observing from the outside, but they feel like organic, cumulative processes to people on the inside. The confusion of end outcomes (dramatic results) with process (organic and cumulative) skews our perception of what really works over the long haul. Those companies had no name for their transformations; there was no launch event, no tag line, no programmatic feel whatsoever.

There was, in other words, no miracle moment in the transformation of each company from good to great. Each went through a quiet, deliberate process of figuring out what needed to be done to create the best future results, then they simply took those steps, one by one over time, until they hit their breakthrough moments.

The Flywheel Effect

Their successes can be seen in the following illustration: Imagine an enormous, heavy flywheel — a massive disc mounted horizontally on an axle, measuring 30 feet in diameter, two feet in thickness and 5,000 pounds in weight. In order to get the flywheel moving, you must push it. Its progress is slow; your consistent efforts may only move it a few inches at first. Over time, however, it becomes easier to move the flywheel, and it rotates with increasing ease, carried along by its momentum. The breakthrough comes when the wheel's own heavy weight does the bulk of the work for you, with an almost unstoppable force.

Each of the good-to-great companies experienced the flywheel effect in their transformations. The first efforts in each transformation were almost imperceptible. Yet, over time, with consistent, disciplined actions propelling it forward, each company was able to build on its momentum and make the transformation — a buildup that led to a breakthrough. The momentum they built was then able to sustain their success over time.

These companies understood a simple truth: Tremendous power exists in the fact of continued improvement and the delivery of results. Point to tangible accomplishments — however incremental at first — and show how those steps fit into the context of an overall concept that will work. When this is done in such a way that people see and feel the buildup of momentum, they will line up with enthusiasm. This is the real flywheel effect.

When a leader lets the flywheel do the talking, he or she does not need to fervently communicate the organization's goals — people can just extrapolate from the momentum of the flywheel for themselves. As people

decide among themselves to turn the fact of potential into the fact of results, the goal almost sets itself. People want to be part of a winning team, producing visible, tangible results.

The Doom Loop

Other companies exhibited very different patterns. Instead of a quiet, deliberate process of figuring out what needed to be done, then doing it, these companies frequently launched new programs — often loudly, with the aim of “motivating the troops” — only to see those programs fail to produce sustained results. They pushed the flywheel in one direction, stopped, changed course and pushed it in a new direction, a process they repeated continually. After years of lurching back and forth, these companies failed to build sustained momentum and fell into what could be termed the doom loop.

Are You on the Flywheel or in the Doom Loop?

How can you tell if your organization is on the flywheel, or in the doom loop? Consider the following:

You're on the flywheel if you—

- Follow a pattern of buildup, leading to breakthrough.
- Confront the brutal facts to see what steps must be taken to build momentum.
- Attain consistency with a clear Hedgehog Concept, staying within the three circles.
- Follow the pattern of disciplined people, thought and action.
- Harness appropriate technologies to your Hedgehog Concept, to accelerate momentum.
- Spend little energy trying to motivate or align people; the momentum of the flywheel is infectious.

You're in the doom loop if you—

- Skip buildup and jump right into breakthrough.
- Implement big programs, radical change efforts, dramatic revolutions and chronic restructuring.
- Embrace fads and engage in management hoopla, rather than confront the brutal facts.
- Demonstrate chronic inconsistency, lurching back and forth and straying outside the three circles.
- Jump right into action, without disciplined thought, or first getting the right people on the bus.
- Spend a lot of energy trying to align and motivate people, rallying them around new visions.
- Sell the future to compensate for lack of results in the present. ■

For more information on one company's flywheel discovery, go to: <http://my.summary.com>