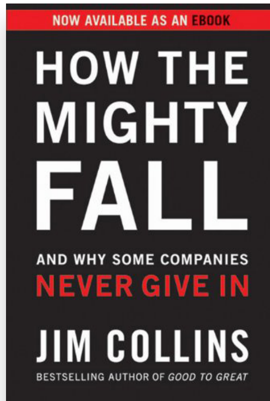

How the Mighty Fall

THE SUMMARY

HarperCollins 2009

ABOUT THE AUTHOR

Jim Collins
Jim Collins wrote Good to Great and Built to Last.

Preface

The origins of this work date back years ago to when I became curious about why some the greatest companies in history, including some once-great enterprises we'd researched for *Built to Last* and *Good to Great* had fallen. The aim of this piece is to offer a research-grounded perspective of how decline can happen, even to those that appear invincible, so that leaders might have a better chance of avoiding their tragic fate.

This work is not about gloating over the demise of once-mighty enterprises that fell, but about seeing what we can learn and apply to our own situation. 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 the fifth stage, decline can be reversed. The mighty can fall, but they can often rise again.

The Silent Creep of Impending Doom

On a cloudless August day in 2002, my wife, Joanne, and I set out to run the long uphill haul to Electric Pass, outside Aspen, Colorado, which starts at an altitude of about 9,800 feet and ends above 13,000 feet. At about 11,000 feet, I capitulated to the thin air and slowed to a walk, but Joanne continued her uphill assault. As I emerged from tree line, I

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spotted her far ahead in a bright-red sweatshirt, running from switchback to switchback toward the summit ridge. Two months later, she received a diagnosis that would lead to two mastectomies. 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.

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

The chief executive of one of America's most successful companies pulled me aside. "We've had tremendous success in recent years, and I worry about that," he said. "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. How would you know?"

The question—*How would you know?*—captured my imagination and became part of the inspiration for this piece. 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 others avoid their fate? Clearly, the solution to decline lies not in the simple bromide "Change or Die." 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.

Five Stages of Decline

In one sense, my research colleagues and I have been studying failure and mediocrity for years. Our research methodology relies upon contrast, studying those that became great in contrast to those that did not and asking, "What's different?" The primary focus of our quest had been on building greatness, an inherently bright and cheery topic. Now 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."

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

All of our research studies involve a control comparison set. The critical question is *not*, "What do successes share in common?" or "What do failures share in common?" The critical question is "What do we learn by studying the *contrast* between success and failure?"

The variables we identify in our research are *correlated* with the performance patterns we study, but we cannot claim a definitive *causal* relationship. If we could conduct double-blind, prospective,

randomized, placebo-controlled trials, we would be able to create a predictive model of corporate performance. But such experiments simply do not exist in the real world of management, and therefore it's impossible to claim cause and effect with 100-percent certainty. That said, our contrast method does give us a greater confidence in our findings than if we studied only success, or only failure.

The 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. That's what makes the process of decline so terrifying. It can sneak up on you, and then—seemingly all of a sudden—you're in big trouble.

This raises a fascinating set of questions. Are there clearly distinguishable stages of decline? Can you spot decline early? Are there telltale markers? Can you reverse decline, and if so, how? Is there a point of no return?

Having studied both sides of the coin, how companies become great *and* how companies fall, I've concluded that there are more ways to fall than to become great. Assembling a data-driven framework of decline proved harder than constructing a data-driven framework of ascent. 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 (with one slight exception for one company in Stage 2).

I believe this framework is helpful for understanding, at least in part, how great companies can fall. Equally important, I believe it can be useful to leaders who seek to prevent, detect, or reverse decline. This model consists of five stages that proceed in sequence.

STAGE 1: Hubris Born of Success

Tolstoy begins his novel *Anna Karenina* with these words: "All happy families are alike; each unhappy family is unhappy in its own way." Having studied how companies become great *and* how companies fail, I've concluded that there are more ways to fall than to become great.

As with most companies that climb from good to great, the process begins with 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 ten, from ten to a hundred, from a hundred to a thousand, from a thousand to a million.

How the Mighty Fall

Once an organization gets one flywheel going, it might create a second or third flywheel. 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.

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. (Dating back to ancient Greece, the concept of hubris is defined as excessive pride that brings down a hero, or alternatively, an outrageous arrogance that inflicts suffering upon the innocent.)

Even if you face the impending demise of a core business, that's still no excuse to let it just run on autopilot. Exit definitively or renew obsessively, but do not ever neglect a primary flywheel. Continue to push your primary flywheel with as much imagination and fanatical intensity as you did when you first began. (Of course, you *also* need to continually experiment with new ideas, both as a mechanism to stimulate progress and as a hedge against an uncertain future.)

Great enterprises can become insulated by success as accumulated momentum can carry an enterprise forward, for a while, even if its leaders make poor decisions or lose discipline. Stage 1 kicks in when people succumb to hubris as they lose sight of the true underlying factors that created success in the first place.

Success entitlement, arrogance: Success is viewed as "deserved," rather than fortuitous, fleeting, or even hard earned in the face of daunting odds. People begin to believe that success will continue almost no matter what the organization decides to do, or not to do.

Neglect of a primary flywheel: Distracted by extraneous threats, adventures, and opportunities, leaders neglect a primary flywheel, failing to renew it with the same creative intensity that made it great in the first place.

"What" replaces "Why": The rhetoric of success ("We're successful because we do these specific things") replaces understanding and insight ("We're successful because we understand *why* do these specific things and under what conditions they would no longer work").

Decline in learning orientation: Leaders lose the inquisitiveness and learning orientation that mark those truly great individuals who, no matter how successful they become, maintain a learning curve as steep as when they first began their careers.

Discounting the role of luck: Instead of acknowledging that luck and fortuitous events might have played a helpful role, people begin to presume that success is due entirely to the superior qualities of the enterprise and its leadership.

How the Mighty Fall

Not every one of these markers shows up in every case of decline, and the presence of a marker does not necessarily mean that you have a disease, but it does indicate an increased possibility that you're in a stage of decline.

STAGE 2: Undisciplined Pursuit of More

We anticipated that most companies fall from greatness because they become complacent, meaning they fail to stimulate innovation, they fail to initiate bold action, and they fail to ignite change. They just become lazy and watch the world pass them by. Although complacency and resistance to change remain dangers to any successful enterprise, *overreaching* better captures how the mighty fall.

Why do leaders instinctively point to complacency and lack of innovation as a dominant pattern of decline, despite evidence to the contrary? Yes, innovation fuels growth, but frenetic innovation or growth that erodes consistent tactical excellence can just as easily send a company cascading through the stages of decline.

The problems of Stage 2 stem not from growth per se, but from the *undisciplined* pursuit of more. 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. Launching headlong into activities that do not fit with your economic or resource engine is undisciplined. Addiction to scale is undisciplined. To neglect your core business while you leap into exciting new adventures is undisciplined. To use the organization primarily as a vehicle to increase your own personal success—more wealth, more fame, more power—at the expense of its long-term success is undisciplined. To compromise your values or lose sight of your core purpose in pursuit of growth and expansion is undisciplined.

Stage 2 follows the hubris from Stage 1 ("We're so great, we can do *anything*!), leading companies to leap into areas where they cannot be great or growing faster than they can achieve with excellence:

Unsustainable quest for growth, confusing big with great: Success creates pressure for more growth, setting up a vicious cycle of expectations; this strains people, the culture, and systems to the breaking point. Unable to deliver consistent tactical excellence, the institution frays at the edges.

Undisciplined discontinuous leaps: The enterprise makes dramatic moves that fail at least one of the following three tests. 1. Do they ignite passion and fit with the company's core values? 2. Can the organization be the best in the world at these activities in these arenas? 3. Will these activities help drive the organization's economic or resource engine?

Declining proportion of right people in key seats: This means losing the right people and/or growing beyond the organization's ability to get enough people to execute on that growth with excellence (e.g., breaking Packard's Law—"a great company is more likely to die of indigestion from too much opportunity than starvation from too little").

Easy cash erodes cost discipline: The organization responds to increasing costs by increasing prices and revenues rather than increasing discipline.

Bureaucracy subverts discipline: A system of bureaucratic rules subverts the ethic of freedom and responsibility that marks a culture of discipline. People increasingly think in terms of "jobs" rather than *responsibilities.*

Problematic succession of power: The organization experiences leadership-transition difficulties, be they in the form of poor succession planning, failure to groom excellent leaders from within, political turmoil, bad luck, or unwise selection of successors.

Personal interests placed above organizational interests: People in power allocate more for themselves or their constituents—more money, more privileges, more fame, more of the spoils of success—seeking to capitalize as much as possible in the short term, rather than investing primarily in building for greatness decades into the future.

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.

STAGE 3: Denial of Risk and Peril

Great enterprises do make big bets, but they avoid big bets that could blow holes below the waterline. Think of being on a ship, and imagine that any decision gone badly will blow a hole in the side of the ship. If you blow a hole above the waterline (where the ship won't take on water and possibly sink), you can patch the hole, learn from experience, and sail on. If you blow a hole below the water line, you can find yourself facing gushers of water pouring in, pulling you to the ocean floor. If it's a big enough hole, you might go down really fast.

When making risky bets and decisions in the face of ambiguous or conflicting data, ask three questions. 1. What's the upside, if events turn out well? 2. What's the downside, if events go very badly? 3. Can you truly live with the downside?

When those in power begin taking outsized risks and acting in ways that deny the consequences of those risks, they imperil the enterprise. Stage 3 arrives as internal warning signs begin to mount, yet external results remain strong enough to "explain away" disturbing data:

How the Mighty Fall

Amplify the positive, discount the negative: There is a tendency to discount or explain away negative data rather than presume that something is wrong with the company; leaders highlight and amplify external praise and publicity.

Big bets and bold goals without empirical validation: Leaders set audacious goals and/or make big bets that aren't based on accumulated experience, or worse, that fly in the face of the facts.

Incurring huge downside risk based on ambiguous data: When faced with ambiguous data and decisions that have a potentially severe or catastrophic downside, leaders take a positive view of the data and run the risk of blowing a hole "below the waterline."

Erosion of healthy team dynamics: There is a marked decline in the quality and amount of dialogue and debate. There is also a shift toward either consensus or dictatorial management rather than a process of argument and disagreement followed by unified commitment to execute decisions.

Externalizing blame: Rather than accept full responsibility for setbacks and failures, leaders point to external factors or other people to affix blame.

Obsessive reorganizations: Rather than confront the brutal realities, the enterprise chronically reorganizes; people are increasingly preoccupied with internal politics rather than external conditions.

Imperious detachment: Those in power become more imperious and detached. Symbols and perks of executive-class status amplify detachment and plush new office buildings may disconnect executives from daily life.

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

STAGE 4: Grasping for Salvation

When I was fourteen years old, I found myself utterly terrified looking down a 100-foot sheer overhanging rock face while learning to rappel as part of a rock-climbing course. The anchor gear unexpectedly shifted, and I instinctively lurched to grab the lip of the overhang and let go of my rappel brake hand (the hand you keep on the rope to control your descent). 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.

How the Mighty Fall

As the cumulative peril and/or risks-gone-bad of Stage 3 assert themselves, the enterprise goes into a sharp decline visible to all. The critical question is, how does its leadership respond? By lurching for a quick salvation or by getting back into the disciplines that brought about greatness in the first place? Initial results from taking dramatic action may appear positive, but they do not last.

The descent into stage 4 begins when leadership reacts to trouble by going for a quick solution or a bold stroke to jump-start a recovery, rather than embark on the more pedestrian, arduous process of rebuilding long-term momentum. Those who "grasp for salvation" have fallen into Stage 4.

A series of silver bullets: There is a tendency to make dramatic, big moves, such as a "game-changing" acquisition or a discontinuous leap into a new strategy or an exciting innovation, in an attempt to quickly catalyze a breakthrough—and then do it again and again, lurching about from program to program, goal to goal, strategy to strategy, in a pattern of chronic inconsistency.

Grasping for a leader-as-savior: The board responds to threats and setbacks by searching for a charismatic leader and/or outside savior.

Panic and haste: Instead of being calm, deliberate, and disciplined, people exhibit hasty, reactive behavior, bordering on panic.

Radical change and "revolution" with fanfare: The language of "revolution" and "radical" change characterizes the new era: New programs! New cultures! New strategies! Leaders engage in hoopla, spending a lot of energy trying to align and "motivate" people, engaging in buzzwords and taglines.

Hype precedes results: Instead of setting expectations low—underscoring the duration and difficulty of the turn-around—leaders hype their visions. They "sell the future" to compensate for the lack of current results, initiating a pattern of overpromising and under delivering.

Initial upswing followed by disappointments: There is an initial burst of positive results, but they do not last. Dashed hope follows dashed hope so the organization achieves no buildup, no cumulative momentum.

Confusion and cynicism: People cannot easily articulate what the organization stands for as core values have eroded to the point of irrelevance. The organization has become "just another place to work," a place to get a paycheck and people lose faith in their ability to triumph and prevail. Instead of passionately believing in the organization's core values and purpose, people become distrustful, regarding visions and values as little more than PR and rhetoric.

Chronic restructuring and erosion of financial strength: Each failed initiative drains resources so cash flow and financial liquidity begin to decline. The organization undergoes multiple restructurings. Options narrow and strategic decisions are increasingly dictated by circumstance.

How the Mighty Fall

You might be thinking, "Perhaps grasping for salvation is the rational answer for companies in trouble; dying companies must do desperate things because they're dying." But companies don't generally find themselves on the verge of death at the start of Stage 4. The companies we studied had taken a tumble at the start of Stage 4, to be sure, but not a lethal one. 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.

STAGE 5: Capitulation to Irrelevance or Death

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.

We found two basic versions of Stage 5. In the first version, those in power come to believe that capitulation offers a better overall outcome than continuing the fight. In the second version, those in power continue the struggle, but they run out of options, and the enterprise either dies outright or shrinks into utter irrelevance compared to its previous grandeur.

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. 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. When you abandon hope, you should begin preparing for the end.

Hope alone is not enough because you need the resources to continue the fight. You might think that companies fall all the way to the bottom because their leaders make just-plain-stupid decisions. But 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.

A company pays its bills with cash. It's possible to be profitable and bankrupt. Once leaders lose the ability to make strategic choices and are forced into short-term survival decisions that cripple the enterprise, then the odds of a full recovery become increasingly remote.

Not all companies deserve to last. Perhaps society is better off getting rid of organizations that have fallen from great to terrible rather than continuing to let them inflict their massive inadequacies on their stakeholders. Institutional self-perpetuation holds no legitimate place in a world of scarce resources. Institutional mediocrity should be terminated, or transformed into excellence.

When should a company continue to fight, and when does refusal to capitulate become just another form of denial? Ask the questions, "What would be lost, and would the world be worse off, if we ceased to exist?" If you cannot formulate a compelling answer then perhaps capitulation is the wise path. On the other hand, if you have a clear and inspired purpose built upon solid core values, then the noble course may be to fight on, to reverse decline, and to try to rekindle greatness.

How the Mighty Fall

The point of the struggle is not just to survive, but to build an enterprise that makes a distinctive impact on the world it touches, and does so with such superior performance, that there would be a gaping hole not easily filled by any other institution if it ceased to exist. To accomplish this requires leaders who retain faith that they can find a way to prevail in pursuit of a cause larger than mere survival (and larger than themselves), while also maintaining the stoic will needed to take whatever actions must be taken, however excruciating, for the sake of that cause. This is the very type of leader who finds a path out of the darkness and gives us well-founded hope.

Well-Founded Hope

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. Sometimes the tumble came early, when they were small and vulnerable, and sometimes the tumble came when they were large, established enterprises. 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. These leaders used decline as a catalyst.

If we discovered that organizational decline is a function first and foremost of forces out of our control, and if we discovered that those who fall will inevitably keep falling to their doom, we could rightly indulge in despair. That is not our conclusion from this analysis, not if you catch decline in Stages 1, 2, or 3. 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.

If you have not yet fallen, beware the temptation to proclaim a crisis when none exists. To manufacture a crisis when none exists, to shriek that we're all standing on a "burning platform" soon to collapse in a spectacular conflagration, creates cynicism. The right people will drive improvement, whether on a burning platform or not, and they never take well to manipulation.

If you've already taken a fall, and you do face a genuine crisis, 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. If you need a refresher course on management discipline, it never hurts to review the classics, including Drucker, Porter, Deming, and Peters/Waterman. Of course, you have to stop the bleeding first and make sure you don't run out of cash, but that's simply emergency surgery, not full recovery. 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.

Our research shows that it is possible to build a great institution that sustains exceptional performance for multiple decades, perhaps even longer, even in the face of chaos, disruption, uncertainty, and violent change. If you've fallen into decline, get back to solid management

disciplines now! If you're still strong, be vigilant for early markers of decline. Above all, do not ever capitulate to the idea that an era of success must inevitably be followed by decline and demise brought on by forces outside your control.

Circumstances alone do not determine outcomes. Of course, there always remains the chance of a random catastrophe as life offers no 100-percent guarantees. After all, you can be the healthiest, most relentless athlete of all time and still be stricken with a crippling disease or career-ending accident. 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. As long as you never get entirely knocked out of the game, hope remains.

It's one thing to suffer a staggering defeat, as will likely happen to every enduring business and social enterprise at some point in its history, and entirely another to give up on the values and aspirations that make the protracted struggle worthwhile. 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.