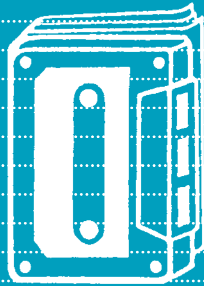

Audio-Tech Business Book Summaries

In this issue:

- ***Discover...*** the critical business practices that winning companies use to achieve lasting business success.
- ***Learn...*** how to devise a clearly stated, focused strategy and to develop flawless operational execution.
- ***Understand...*** how you can create a performance-oriented culture and build a fast, flexible, and flat company structure.
- ***Increase...*** your returns to shareholders by keeping your most talented people and making sure your leaders are committed to the business.
- ***Develop...*** innovations that transform your industry, and stimulate growth with mergers and partnerships.

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What Really Works

The 4 + 2 Formula for Sustained Business Success

by **Nitin Nohria, William F. Joyce, and Bruce Roberson**

A summary of the original text.

All of the challenges confronting managers today can be summed up in one critical question: *What really works?* Why do a few companies thrive in the worst of times, contradicting all the misfortunes that afflict their competitors? Why do great companies stumble even during the best of times?

The truth is that executives have spent more than a century guessing at what really matters in business — and guessing wrong. Managers have embraced fad after fad, all with poor results. The mystery of why some companies win and most lose has never been unraveled.

To find the answers, the authors conducted the world's most systematic, large-scale study of the practices that create business winners. Nitin Nohria is a professor of business administration and the chairman of the Organizational Behavior Department at Harvard Business School. William F. Joyce is Professor of Strategy and Organizational Theory at the Amos Tuck School of Business at Dartmouth College. Bruce Roberson is a former partner with McKinsey & Company who now holds a senior position with a new management firm.

Their study, called the Evergreen Project, was the first statistically rigorous search for the key to "evergreen" business success. It mobilized more than 50 leading academics and consultants, who analyzed dozens of companies over the period from 1986 to 1996. From that examination emerged the "4+2" formula that we will explore throughout this summary.

Essentially, they found eight management practices, four primary and four secondary, that directly correlated with superior performance as measured by total return to shareholders, or TRS. Those companies that remained winners excelled in all four primary practices and at least two of the secondary practices. Losing companies failed to do so.

The researchers compared 160 companies in four narrowly

defined industries. As the results were compiled, they divided companies into winners, losers, climbers, and tumblers. The 10-year study was divided into two five-year periods, and winners outperformed their peers in both periods. Losers underperformed in both. Climbers lagged in the first five years and moved up in the second, while tumblers did well at first and then faltered.

They chose 200 management practices to track, from the general to the specific. They analyzed hundreds of documents, from annual reports to newspaper articles, some 60,000 documents in all. The results were startling: Most of the 200 practices they started with made *no impact* on total return to shareholders.

But they found a clear and compelling correlation between TRS and eight management practices. The four primary practices that stood out were:

1. Devise a clearly stated, focused **strategy.**

2. Develop flawless operational **execution.**

3. Create a performance-oriented **culture.**

4. Build a fast, flexible, flat company **structure.**

The secondary practices were:

1. Hold on to people who show **talent** and find more of them.

2. Keep **leadership** committed to the business.

3. Develop **innovations** that transform your industry.

4. Make growth happen with **mergers and partnerships.**

These are the eight crucial practices that achieve lasting business success.

Companies that excelled in the four primary practices and two of the secondary ones had a better than 90 percent chance of being winners.

The results are impressive. Sales soared by 415 percent, assets rose by 358 percent, and operating income grew by 326 percent. Investors in the average winner saw their money multiply nearly 10-fold, with total returns to shareholders of 945 percent.

By contrast, the average loser produced only 62 percent in total returns to shareholders over the entire 10 years. Loser sales increased by only 83 percent, assets by 97 percent, and operating income by 22 percent over the decade.

Later we'll discuss each of the primary and secondary practices of winners. But first, let's examine one of the winners to understand the importance of these ideas in action.

Meet a Winner

Tennessee merchants J.L. and "Cal" Turner opened the first Dollar General store in 1955. The business proposition was simple: Every item in the store cost one dollar. By the end of the 1960s, with more than 400 stores and $40 million in sales, Dollar General went public. By 2001, the company had more than 5,000 stores and sales had passed the $5 billion mark.

A close analysis of their operations shows exactly how they did it by using the four primary and two of the secondary practices identified in the Evergreen study.

The first primary practice is to ***make sure that your strategy is clear and focused.*** The Turners deliberately targeted households with incomes of less than $20,000 a year. Most businesses ignore that segment, but it's the fastest growing segment of the economy. Some 37 percent of U.S. households earn less than $25,000 a year.

The company's strategic purpose is to help its 9.7 million low-income customers improve their standard of living by selling them high-quality goods at the lowest possible price. To differentiate itself from low-price competitors like Wal-Mart, Dollar General keeps its stores small. Most of them are in communities of less than 25,000 people or in low-income urban neighborhoods.

The second primary practice is to ***execute flawlessly.*** Because its typical customer is a 49-year-old woman in a household of three or four people with a total household income of $17,231, Dollar General's mission is to keep its costs and prices low.

Its buyers squeeze suppliers relentlessly. And managers reduce costs ruthlessly, slashing overhead from 25 percent of sales in 1992 to 15 percent in 2000. At the same time, technology has cut distribution center costs by half in five years, and using scanners sped up checkout lines enough to allow the stores to cut the number of cashiers per store from three to two.

Finally, Dollar General relies on word of mouth instead of advertising, which avoids another major expense. Every savings in costs allows the company to cut prices even

deeper. Such flawless execution involves constant attention to every element of the business.

The third primary practice is to ***make your culture gung-ho for performance.*** The Turners believe in the dignity of hard work. Their deeply felt mission is to improve their customers' lives. Cal Turner once said, "My dad said we don't want to make more money, we want to make more friends." In their inner-city stores, it runs learning-center work programs and promotes programs that teach people to read and write.

The fourth and final primary practice that all winners share is to ***make your organization fast, flat, and flexible.*** Dollar General's corporate structure allows it to respond rapidly to market changes without wasting time or money.

The company has never developed layers of bureaucracy, even as its number of stores climbed into the thousands. This made it possible to convert all 2,700 stores to a new format in just five months in 1997.

Dollar General gives managers stock options to motivate performance. Its corporate design has allowed it to become a modern company while remaining a family operation, excelling at all four primary practices.

It also excels at two of the four secondary practices, including the policy of ***retaining talent while developing more in-house.*** All employees receive profit-sharing bonuses. All levels of management are eligible for stock options. And all rewards are tied to performance. In that way, everyone feels like an owner.

The other secondary practice at which Dollar General excels is to ***make leaders committed to the company's success.*** Like his father, Cal Turner readily accepts suggestions from employees and shares the credit for success with them. And instead of surrounding himself with "yes men," he realized it would be best for the company if he recruited a board of directors who aren't hesitant to tell him when he's wrong.

By employing the four primary practices and two secondary ones, Dollar General is in a perfect position to continue as a winner. Not even the slumping economy can alter its path, because its stores appeal to people who are trying to get more value for less money. As a result, Dollar General promises to remain a winner.

Now let's take a look at a company at the other extreme: A loser.

MEET A LOSER

Harry Cunningham, president of Kresge's dime store, opened the first Kmart in Garden City, Michigan, in 1962. Then another five-and-dime merchant, Sam Walton, inspired by Kmart, opened the first Wal-Mart in Rogers, Arkansas. At around the same time, department store king John Geisse, launched Target in Roseville, Minnesota.

Four decades later, Wal-Mart is the world's biggest retailer and a clear winner. Target had a slow start but has now turned into a climber. But after initial furious growth, Kmart faltered and became a clear loser. How did it squander such a promising empire?

The answer is that it neglected the four primary practices and at least two of the secondary ones as well.

By 1977, Kresge had evolved into Kmart and made retailing history, setting a record by opening 17 million new square feet of retail space in a single year. By the end the 1980s, Kmart had 180 million customers and sales of $32 billion.

But Wal-Mart had newer, brighter stores and was gaining ground. Moreover, Kmart employees had become complacent. Customers were grumbling that it was hard to get help in the stores. Joseph Antonini, the CEO, decided to spend $3 billion remodeling and expanding the stores. He also opened more Super K stores, which were huge and hugely profitable supermarket discount stores.

Determined to compete with Wal-Mart, Antonini lowered prices on 8,000 items, which proved to be a major mistake. Wal-Mart's cost structure was much lower than Kmart's, so it easily won the price war.

Even more devastating was Antonini's decision to take on Sam's Club, Wal-Mart's dominant entry in the warehouse club business. In 1989, he bought the Pace Membership Warehouse chain in Denver. A bitter war of attrition ensued, with the two rivals battling over real estate and slashing prices. Once again, Antonini lost, and he had to sell Pace to the competition in 1993.

Meanwhile, the recession of the early 1990s tore into Kmart's sales, while customers defected to Wal-Mart and Target. In 1995, Kmart lost $230 million, and it was $780 million in debt.

The New York Times wrote that Kmart was bedeviled "by high costs, poor inventory management, too many shabby stores and no strategy to speak of." Target's Floyd Hall replaced Antonini. He pushed Kmart to a profit of $231 million in 1996 and by 1998, things were looking good, at least on the balance sheet.

But merchandise flow was slow. Stores often ran out of sale items. Hundreds of outlets weren't performing, and customers were not happy. Hall introduced the Big K design, and a profit of $403 million in 1999 turned into a loss of $244 million the next year. Hall was eased out, and Chuck Conaway from CVS drugstores took the reins.

Conaway raided Wal-Mart's employee stable and became obsessed with beating them at their own game. Wal-Mart's secret was amazing distribution, leading to low prices on 30,000 items. Kmart's distribution, always its weak point, was no match. Customers fled, and by late 2001, Kmart was losing more than $200 million each quarter. It's no surprise that Kmart filed bankruptcy, while Wal-Mart is the world's largest company.

What went wrong? Kmart's customers were low- and middle-income people. When Wal-Mart began taking the low end away, Kmart tried to move upscale. It not only spent billions on remodeling, but ventured into product development, introducing the Martha Stewart and Kathy Ireland private labels. Kmart's strategy, once clear, became blurry, violating the first primary practice: *It had no clearly stated, focused strategy.*

It began casting about for a magic combination but ended up with a confusing array of brands and stores, including everything from Builders Square to Borders Books. Trying to be all things to all people, it wound up being nothing to anyone.

Kmart also failed at the second primary practice by *lacking flawless execution.* The stores were small, crowded, and dirty. Suppliers were up in arms about Kmart's logistics. Despite a big investment in technology, Kmart's operations remained sporadic. At one point, it had 18 private men's clothing labels and 13 different toasters for sale, two of which produced 85 percent of sales.

In addition, while Dollar General needed only five months to remodel all of its stores, Kmart took three years. By the time the remodeled stores were finished, they were already getting old.

Its record on the third primary practice, *create a performance-oriented culture,* was no better. Hall understood the need for a gung-ho culture, but he couldn't make it happen. For example, while Wal-Mart tied bonuses to performance, Hall sent anonymous managers to secretly shop at stores and then grade them. Bonuses were tied to those visits and were seen as arbitrary raids, not incentives.

The last primary practice at which Kmart failed was to *have a fast, flat, and flexible organization.* Kmart's organization was slow, multi-layered, and rigid. Only the top executives had the power to make decisions. Employees felt that it made little difference what they did. If word came down from headquarters to stock 13 different toasters, then that's what they did, even if they knew that customers were not buying 11 of the models. A succession of CEOs tried to flatten the organization, but the crucial exchange of information and expertise across divisional lines never took place. Kmart had failed at all four primary practices with catastrophic results.

Neither was it any better at any of the four secondary practices:

1. It failed to *keep talent and develop more.*

2. Its leadership was determined to beat Wal-Mart at the low-cost game, rather than being *committed to the success of the business* based on its own strengths.

3. It never *made industry-transforming innovations,* instead following what competitors did first.

4. It entered disastrous *mergers and partnerships,* such as the acquisition of the Pace Membership Warehouse chain.

Because of all of these failures, Kmart squandered its potential and became a loser.

In the following sections, we'll take a more in-depth look at how each of the four primary practices turns companies into winners.

Make Your Strategy Clear and Focused

The first primary practice is to devise a clearly stated, focused strategy. Every winner's successful strategy consists of five elements.

The first is ***a clear, focused, and easily communicated value proposition for customers.*** In the case of Target, John Geisse had the initial

insight that there's more to discounting than cheap merchandise. What if a customer could enjoy the upscale shopping experience in a discount store? That is the essence of Target's value proposition.

Target is bright, spacious, clean, hip, and contemporary. You can get in and out quickly. The prices are low but not super low. The service is polite and efficient. Target creates most of its own goods, and they're by top designers.

The second element of a winning strategy is that it is ***developed from the outside-in.*** The winners in the Evergreen study were guided by the suggestions of customers, partners, and investors.

Target's founders interviewed hundreds of potential customers before they opened their first store. They also observed shoppers' behavior and found that even upper-class women like a bargain. The founders realized that middle-class women who were annoyed by discount stores would patronize one that had a pleasant atmosphere, speedy service, and high-quality merchandise at lower prices. The women also wanted to do all their shopping in one store so they could get on with their busy lives.

By listening, Target was able to create an ad campaign that projected the message that it was fun and fashionable to shop at Target. Target was the only place that people could get certain hip and trendy items, such as household appliances designed by the renowned architect Michael Graves.

The next element of a winning strategy is to ***keep information up-to-date and allow it to fine-tune strategy as the market changes.*** Today, information travels at light speed. A new style in Manhattan will show up in Cleveland the next week. It's essential for a company to have eyes and ears everywhere, sensing the market. Winning companies anticipate change and quickly adapt.

John Geisse was a master trend-spotter when he created Target. He spent a lot of time strolling up and down Park Avenue and wandering through airports to see what people wore. Before many others, he spotted the trend toward more casual clothes among upscale people.

Target now relies on a trend-spotting team. It also has Marshall Field's, where it can study fashions that will trickle down to Target. In addition, Target's upscale designers can provide timely information. All in all, it leads to a winning combination for keeping crucial information flowing.

The fourth element is to ***make strategy a stretch.*** The core business should double even as you develop a new business as big as your core is now — all within five years.

Target stretched its core business by opening SuperTarget in 1995, adding food to its mix. It became the primary grocery store for 40 percent of its customers, while 60 percent of grocery shoppers buy other goods, too. As of 2002, there were 75 SuperTargets in 17 states.

Target also started a new business by moving into financial services. It introduced a store credit card and convinced 20 million people to rack up $4 billion in sales in 2001. It has now introduced a chip-enhanced smart Visa card, which can store huge amounts of information. This move is increasing its loan portfolio, already profitable, by up to $2 billion a year.

The fifth element of an excellent strategy is that it is ***clearly communicated to stakeholders.*** Target again hit the bull's-eye. Its TV spots led to honors from *Advertising Age* as marketer of the year. The ads sent a clear message that Target was fun, cheap, and yet classy.

Target also communicates continuously with suppliers through its Internet-mediated groupware. Vendors are never in the dark, and neither are investors.

In the end, Target developed a value proposition to support its strategy and precisely aimed it at its customers. It built its strategy on the words and deeds of those customers, as well as partners, and investors. It kept up-to-date information on market trends. And it adopted a stretch strategy of growth.

Now let's move on to the second primary practice: Execution.

EXECUTE FLAWLESSLY

Duke Power of Charlotte, North Carolina, is a prime example of superior execution. Such operational excellence requires ingenuity, constant intense effort, and an ability to ignore some traditional management practices.

Duke has a venerable history going back to the 1890s, when James Buchanan Duke got in on the ground floor of electrical power. Today, Duke Energy serves two million customers

and is a leading producer of natural gas.

Like the other winners in the Evergreen study, Duke has achieved its success in part by following three mandates to execute flawlessly.

The first is to ***deliver products and services that consistently meet customers' expectations.*** Executives understood that perfection was not part of its value proposition. They knew that the downside of poor quality is much greater than the upside of great quality. It was delivering flawlessly that mattered.

Management was spurred to make improvements by deregulation. They began to look long and hard at their quality of service. They found, for example, that they completed a job on time only 74 percent of the time. They established a new goal: Finish 96 percent of orders on time.

As tasks were analyzed and target times established, customers could be told exactly how long a given job would take. By 1997, Duke was rated first in its field for customer satisfaction by *Fortune* magazine. At the same time, it was improving productivity and containing costs, leading to a lean, efficient operation prepared to compete.

The second mandate is to ***achieve brand loyalty in real-life interactions with customers.*** This means paying close attention to that defining moment when an employee and a customer interact. Front-line people, in other words, need authority. As Peter Drucker put it, "Each of the individual service people must be the 'boss,' with the rest of the organization taking its direction from him or her."

Duke was a traditional hierarchical organization when Dick Priory took over as its president. Front-line workers had to wait for decisions from on high, frustrating customers with unpredictable service. Priory made sure the front-line people had the authority and information to satisfy customers with predictable, efficient service. After a few growing pains, the customer survey score rose steadily.

Finally, the third mandate for flawless execution is to ***constantly strive to improve productivity and eliminate waste.*** In other words, perfect operational excellence. But it's important to decide which processes are most important.

A perfect illustration of a winning company that follows this mandate is Campbell Soup. When David Johnson became its CEO in 1990, he found an old family business floundering. Sales were flat, profits were declining, and its market share was dwindling. Johnson cut the workforce by 15 percent, shut down 20 plants, and dumped unprofitable products.

He then had his surviving plants bid for the business that had been handled by the operations he had axed. The plant managers were forced to focus as never before on cutting costs and improving productivity to get the extra work — and operating efficiencies soared.

Between 1990 and 1995, profits rose 18 percent a year, and return on sales went from 0.1 percent to 9.6 percent.

Now it's time to take a closer look at the third primary practice: Creating a performance-oriented culture.

Make Your Culture Gung-Ho for Performance

In the Evergreen study, culture was found to be just as important as operations in terms of success. Culture is what ensures that everyone is performing at the highest levels. The shining example of how that's done is Home Depot.

Home Depot, along with other winners, abided by four cultural mandates. We'll discuss them one by one.

First, ***encourage personal initiative and pride within the context of team loyalty.*** At Home Depot, the interaction between customers and associates, as sales people are called, is definitive. The customer must have a pleasant, rewarding experience. The associate must feel proud and be genuinely caring. Part of that pride comes from the fact that associates have the information and power to make decisions and take risks without asking permission or fearing reprisal.

Co-founder Arthur Blank explains that "associates feel that they own the stores, that they own the merchandise, that they have total responsibility for the customers in their aisles, and that they create the value."

No two Home Depot stores are quite the same, because managers can decide what to put up front, and even what to order. The mix of entrepreneurial spirit with tight financial controls and business fundamentals makes the system work.

The company has a gung-ho approach to training, which creates a strong sense of belonging to an elite group set apart from the pack. That

translates to energized employees, happy customers, and bottom line profits.

The second mandate, to ***reward achievement with praise and bonuses,*** is evident at Home Depot, where employees make no more than the industry average. But part of their income comes in company stock, which ties their performance directly with their pay. Every winning company has some compensation tied to overall company performance, making people feel like owners.

At its rallies, Home Depot also honors associates who have initiated new programs or founded new best practices. Company founders frequently visit the stores and praise employees in person.

The third mandate is to ***create a fun, satisfying, and challenging work environment.*** At Home Depot, the word "associate" is used for everyone, because that flattens the organization. Salespeople can feel respected, valued, and know that they have equal access to opportunity. Memos are frowned upon, and executives are addressed by their first names.

This culture is handed down from more experienced to newer employees, and managers are given extensive training in teamwork, trust, communication, and leadership effectiveness.

The fourth mandate is to ***establish clear, stringent values and require everyone to abide by them.*** In the wake of corporate scandals, this is more important than ever. Values should be written down and made an essential part of the culture. Home Depot sets out seven core values, ranging from "excellent customer service" to "creating shareholder value." Employees must also believe in "doing the right thing" and "giving back."

Doing the right thing means understanding the impact of decisions, and taking responsibility for them. Giving back means community service. Teams of volunteers do everything from helping to build affordable housing to teaching at-risk youth, even as the company provides millions of dollars in grants to communities in need. Everyone at Home Depot is involved in the seven core values.

Now, let's turn to the fourth primary practice that winners excel in: Making the organization fast, flat, and flexible.

MAKE YOUR ORGANIZATION FAST, FLAT, AND FLEXIBLE

The fourth practice involves fighting bureaucracy at every turn. The winners in the Evergreen study followed three mandates to keep their structures fast, flat, and flexible.

The first involves ***eliminating redundant organizational layers.***

Nucor Steel is a great example of a lean structure. Its corporate offices embody just 20 people, including secretaries. It built itself on mini-mill technology to rack up more than $2 billion in sales in 1994 with over 6,000 employees.

Nucor has just four layers of management, compared to nine at the major producers. They are: foremen, department heads, plant managers, and president or chief executive.

To make that lean structure work, CEO Ken Iverson pushed responsibility down as far as possible in every case. The manager of personnel explains, "We tell managers we don't want you to manage anything." They were instead expected to wait for the team to ask for help, and then provide the right support. They were told to "lead by staying out of the way."

The second mandate is to ***promote cooperation and the exchange of information.*** As bureaucracy grows, so do turf boundaries. Best practices, technical discoveries, and other information are hoarded.

Winners in the Evergreen study spend considerable time and money breaking down barriers and promoting the exchange of information. They even go so far as to assign specific staff members to cross-fertilize ideas by absorbing news and spreading it.

At Campbell Soup, for example, things weren't always open. Divisions were in competition. A tomato paste plant in California never bothered to make its technology available to its sister plant in Mexico. When Johnson came in as CEO, he insisted that approach had to change. Every division had to have a representative at every corporate meeting. He banished turf wars. It was part of his overall plan to completely remake the culture at Campbell. The numbers proved him right.

The final mandate is to ***put the best people closest to the action.*** The old notion that the best people rise to the top has been replaced by its opposite: The best people are pushed into the trenches. At Nucor, the smaller size of its executive staff sends a clear message about where the real work is done: not at headquarters.

Everyone in the company shares the same health care plan, the same holidays, and the same amount of vacation. There's no executive dining room and there are no reserved parking places. Everyone wears the same green hard hat. There are no prima donnas in Nucor's lean, fast, flat organizational structure, and the results can be read in the annual report.

Now that we have covered the four primary practices, let's take an in-depth look at the four secondary practices.

Keep Talented People and Develop More

About half the winners in the Evergreen study excelled at keeping and developing talent. Winners lost an average of 35 executives in five years. Losers lost 56. Winners had to hire CEOs half as frequently as losers did.

Through training and promoting from within, the winners developed strong, supportive relationships and company loyalty. The more talent you have, the more you attract. And you can never have too much talent.

There are four mandates involved with managing talent.

The first is to ***fill mid- and high-level jobs from within.*** Schering-Plough, the maker of successful drugs such as Claritin, illustrates this point. Supervisors meet once a year with team members to discuss performance and job advancement.

Between 75 and 80 percent of its vacancies are filled in-house. As a result, many of its 30,000 employees have been with the company more than 30 years.

It's one thing to promote people. It's another to have them prepared for the new job. The next mandate is to ***train and educate talent for advancement.***

Schering-Plough offers 90 percent tuition reimbursement for college. Its internal training ranges from sales and management to language and math. More than 2,000 employees a year take courses in production practices.

The third mandate is to ***keep the best performers challenged and interested.*** Nucor's performance culture, its practice of pushing responsibility down and encouraging risk taking, does just that. Teams will readily change an entire process if they see a better way. They don't have to ask.

A plant manager put it this way: "There are many improvements in cost, quality, and production that are going on that I don't even know about. They just happen, and they don't have to be rubber-stamped." Iverson says his teams are in business for themselves — the company just furnishes the training and equipment.

Because it gives its best performers the freedom to use their talents, Nucor turns out 980 tons of steel per year, per employee. The industry average is 420 tons. Nucor's costs are $60 a ton, while the average is $135.

The last mandate is for management to ***be personally involved in the quest for talent.*** Finding and nurturing talent is too important to be left to a human resources department.

When Schering-Plough moved its sales and marketing headquarters to New Jersey, where most pharmaceutical companies are, the president put it this way: "For us to recruit the kind of folks to make us competitive, we felt we had to be at the heart of the action."

Now that we've covered the management of top talent, let's discuss the talent of top management: Getting leaders committed to the business.

Make Your Leaders Committed to Your Business

The authors concluded from their study that the CEO can influence 15 percent of return to shareholders. In other words, the CEO is crucial. In the wake of recent corporate scandals, CEOs as a group have lost their luster. But the fact is, most are dedicated to business integrity.

The best CEOs can communicate their vision and are quick to face up to moral dilemmas. When employees see a CEO backing up his words with actions, they trust him. And trust is precious in hard times. Whatever a CEO's personal style, the winners followed four mandates.

First, they ***strengthen relationships at all levels of the company.*** Good CEOs present themselves as flesh and blood people — fellow employees, not masters. They walk among the troops like a good general.

When David Johnson was CEO at Campbell, he'd appear at rallies dressed in a red-and-white apron and a white chef's hat, referring to himself as "top spoon." He was the

quintessential cheerleader for his troops. He said, "I want to rip out the bureaucracy, the pretense, the corridors-of-power syndrome, the games that are played." And he did what he said he'd do. He was walking the walk.

The second mandate is to ***spot opportunities and problems early on.*** Winners always have one eye on the future, anticipating change and preparing to adapt.

Schering-Plough is a world-class trend spotter. The prescription drug company had very successful patents when management saw that over-the-counter, or OTC, drugs were beginning to boom. Prescriptions were expensive, and people had a growing interest in self-medication. Since older people buy most drugs, the aging of the baby boomers would naturally increase sales.

The company launched a campaign to get certain drugs switched to OTC status. Moving rapidly and early, they unveiled Coricidin R in 1951. They followed with numerous success stories, such as Chlor-Trimeton in 1976 and Lotrimin in 1990. By 1991, they had three times as many switched products as their nearest competitor.

The next mandate concerns the board of directors, a group that has recently come under fire. In the Evergreen study, the winners made sure ***board members had a financial stake in the company.*** Those boards selected the best CEOs to protect their own interests.

At Campbell, Johnson created a strong and effective board with strict and demanding rules. In the first year, the members had to own 1,000 shares. By the third year, they had to own 3,000. In addition, 75 percent of their pay is in the form of stock or options. The directors' futures are firmly tied to Campbell's, and the same was true with all winning company boards.

The fourth mandate concerns how the top management is rewarded. The winning companies ***pay senior managers according to how well they hit targets for earnings or stock prices.*** In other words, their earnings reflect their performance.

Nucor's officers receive relatively low base salaries and have no contracts, no retirement program, and no annuities. Their entire bonus depends on the total returns to shareholders. In a recession, an executive salary could shrink by 75 percent.

Now let's take a look at the third of the secondary practices for winners: Innovation.

CREATE INNOVATIONS THAT TRANSFORM YOUR INDUSTRY

Innovation is a secondary practice, so it is not necessary for everyone. But for those who depend on it, it is a live-or-die proposition. Mickey Schulhof, former CEO of Sony, said, "If we stop innovating and stop bringing new electronic devices to market, we'll die."

If a company elects to perfect innovation, it must follow three mandates.

First, it must ***pursue innovations that create market discontinuities.*** Consider Avery Dennison, the label maker. Avery once made a big strategic mistake. It challenged 3M, the market leader in the Post-It Notes and Scotch tape business.

Avery's move was a catastrophe. Avery survived by restructuring itself into an innovation machine. CEO Charles Miller trimmed staff and pushed authority down. One of its teams created labels that could be printed on the new computer printers that were springing up and managed to get Microsoft and Lotus to adopt them as a standard.

In 1990, Avery acquired Dennison Manufacturing, ratcheting sales up to an 85 percent share of the office label market. As the vice president of products said, "The best way to control a market is to invent it." Branching out into other products, such as security badges, Avery Dennison fulfilled the first mandate to create disruptive innovations.

The second mandate is to ***use technical breakthroughs to advance both internal and external goals.*** Walgreen's did just that with its computer technology. It was the first to replace cash registers with scanners. It linked its stores with satellite technology. Anyone could get the same prescription at any store.

It further enhanced its internal operation by including insurance companies in the network, transferring information among them and handling 300,000 prescriptions a day.

The same system was then linked to distribution, so that when an item was purchased off the shelf, a computer automatically reordered it and even shipped it. Walgreen's realized not only a major internal cost saving, but was able to give the best prices and maximum convenience to its customers at

the same time, fulfilling the second mandate to leverage technology inside and out.

The third mandate is to ***cannibalize your current offerings.*** This is difficult for many businesses, which are afraid that a new product will damage the sales of an existing product. But, with rapidly shrinking product cycles, the old product, even while it's still making money, is also aging. The new product must be allowed to take hold before the old one dies.

Schering-Plough succeeds by cannibalizing its products, as its strategy of switching prescription drugs to over-the-counter drugs confirms. The OTC drugs are cheaper and easier to get, so they do displace the prescriptions. But their enormous sales make this a winning practice.

The last of the secondary practices involves mergers and acquisitions, a practice that many winning companies employed for innovation and growth.

MAKE GROWTH HAPPEN WITH MERGERS AND PARTNERSHIPS

Winners in the Evergreen study pursued acquisitions as a route to growth, but only when it leveraged or complemented existing business.

Of the 25 deals analyzed, 93 percent of the winners created value. Meanwhile, only 9 percent of the losers did so, and 27 percent actually *lost* value.

Rather than make one huge purchase or merger, the winners tended to engage in several smaller ones each year. They developed an internal talent for spotting and closing the right deals. Let's discuss the four mandates for successful mergers and partnerships.

The first is to ***acquire businesses that leverage existing customer relationships.*** Building the customer base means growth, and one way to do that is to buy it.

For example, recall Avery's merger with Dennison. Dennison was Avery's prime competitor and controlled a quarter of the office label market at the time. It also had products that Avery didn't have. It was a match made in heaven. Each company got the other's customer base and product line, and by merging, reached the critical mass needed to dominate that market and drive 3M out of it.

The combined company then went on to implement the second mandate: ***Enter new businesses that complement your company's existing strengths.*** After the merger, the company acquired Stimsonite, a maker of highway safety products with reflective coatings. Then it purchased Bear Rock Technologies with its barcode design and printing software. It fit perfectly with Avery's product line and gave the company a major stake in that market.

Avery was pushing for the top when it implemented the next mandate, to ***move into partnerships that create new businesses.*** Many of the winning companies in the study sought out suitable partners.

In 1998, Avery partnered with E-Stamp and Stamps.com, which had been licensed to sell postage on-line. Avery provided the special mailing labels. In another ingenious partnership, Avery leveraged its expertise in adhesives to invade the wine industry. It allied with Neenah Paper to produce more options for graphic design. It also created a label that wouldn't come off when wet.

The final mandate is to ***develop a capability to find and close appropriate deals.*** Valspar, the Minneapolis paint and coating company, is a perfect example. It has 6,500 employees worldwide, and much of its growth has come from mergers.

Its CEO, Angus Wurtele developed a system for finding the best deals. He chose public companies, not wanting to get involved in family squabbles. He selected underperforming companies that could eventually match Valspar's 20 percent profit level.

He would then establish and maintain friendly relationships with the leaders. This put him in a good position to understand the strengths and weaknesses of the target firms, and he was the first to know if they wanted to sell. When it came time, he was able to operate from a position of mutual trust.

Wurtele's talent allowed Valspar to execute this key mandate. As a result, the company's total returns to shareholders grew by 30 percent a year during the study.

The Evergreen study set out to learn what separated winners from losers, and it did just that. By examining the best practices of the companies that created the highest total returns to shareholders, the authors discovered that winning companies excel at four primary practices:

1. Devising a clearly stated, focused **strategy.**

2. Developing flawless operational **execution.**

3. Creating a performance-oriented **culture.**

4. Building a fast, flexible, flat company **structure.**

The winners also excelled at two or more of the following secondary practices:

- Holding onto people who show **talent** and finding more of them.
- Keeping **leaders** committed to the business.
- Developing **innovations** that transform their industry.
- Making growth happen with **mergers and partnerships.**

The result is a formula for lasting business success that any business leader can follow with the confidence that it is not just the next management fad. Instead, it is what really works.

Even a Winner Can Turn into a Loser

Now that we've taken a look at how winning companies execute the four primary and four secondary practices, let's take a look at how even the most successful companies can falter by ignoring them.

In the spring of 1997, Nike had $9.2 billion in sales, up 140 percent from 1994, and profit growth of 30 to 40 percent. Stock had soared 320 percent in two years. But Nike's major market in Asia was collapsing with the economy there. Teenagers were losing interest in athletic shoes. Retail chains were going out of business. And there were public protests against working conditions at Nike's plants. Winners always recognize it when outside forces change. Nike didn't.

Success can breed complacency, and even arrogance. It can turn winners into tumblers. Phil Knight, co-founder and CEO, eventually failed at every primary practice as well as several secondary practices.

Nike was always about performance, not fashion. It was also about male jocks. But success jammed its, and when teenagers changed their shoes in the 1990s, Nike was blind-sided. As market share fell, it made another classic mistake: brand extension.

By the mid-'90s, Nike was producing not only 500 footwear products, but also accessories, watches, back packs, headsets, shirts — customers were confused. The brand became even more unfocused as Phil Knight went up against The Gap, Nautica, and Ralph Lauren. Knight had fumbled the first primary practice of *clear strategy.*

The second primary practice is *flawless execution.* Once upon a time, Nike could "just do it." But when living and working conditions in its plants attracted angry attention in the early '90s, Nike said the reports weren't true. Caught in that lie, Nike then insisted it wasn't responsible. As the boycott spread, sales fell. The refusal to make things right reflected a clear loss of customer focus and a failure of operational excellence.

At the same time, the quality of Nike products, once a hallmark, was sinking, even as its tremendous volume overwhelmed distributions systems. Retailers were unable to get products in the stores. Nike responded by spending $400 million on supply chain software and took a $50 million cut in profit outlook when it didn't work right.

The third primary practice at which Nike failed was to sustain a *culture of performance.* Nike once had it, but as Knight later put it, people got bored. In fact, Nike people were overconfident, aloof, and even confrontational.

The more the company suffered, the more its people withdrew into the walled headquarters in Beaverton, Oregon. In this embattled mentality, performance naturally suffered as the third primary practice was lost.

The fourth primary practice, having a *fast, flat, flexible organization,* suffered, too. As Nike grew, so did bureaucracy. Departments became unwieldy, and important decisions were delayed as they moved slowly through channels.

Nike did no better at secondary practices, such as *managing talent.* Nike needed new blood, but the new blood drained away quickly when they found out what a stagnant and arrogant company they'd joined. Failed, too, was the effort to *make leaders*

commit to the business. **Phil Knight's brash, unconventional leadership style helped make Nike. But in later years, it helped bring it down, too. He didn't take criticism well and was often too confrontational for shareholders. He'd drop out of sight for weeks at a time, and missed the fact that his company's other leaders had also taken their eye off the ball.**

In such an atmosphere, it's no wonder *innovation* wasn't working. Nike had introduced waffle soles, wedged heels, cushioned mid-soles, and nylon uppers. But the innovation ran out, even as the mature industry demanded more of it. The spark was gone, as Nike tumbled from winner status.

Nike's xenophobic culture made it impossible for the company to grow through *acquisitions and partnerships.* It was given a golden opportunity to buy bankrupt Converse and ignored it. Nike's president of outdoor products cringed as he watched management pass up the chance to buy North Face. As he later said, the purchase "would have doubled the business overnight." It was a sad day: Nike had failed at all the primary and all the secondary practices.

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