

# Why Smart Executives Fail: Four Case Histories of How People Learn the Wrong Lessons from History

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*In a series of inductive case histories of leadership and strategy, we document the problem of how executives often learn the wrong lessons from history. The costs associated with such misdirected learning are significant, and often tally in the hundreds of millions to billions in losses. These mistakes are seldom due to managerial incompetence or random events, but rather are driven by common patterns of managerial behaviour. The case histories of two American and two Japanese companies highlight how and why apparently talented managers often learn the wrong lessons from history.*

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## Introduction

Senior executives create ‘playbooks’ to guide managerial action, and sometimes as much as the world changes they stubbornly hold on to those behavioural repertoires they have relied on in the past. Rather than respond to their challenges and mistakes, rather than actively learning from the problems of their competitors, they continue unimpeded in their quest for certainty, stability, and conformity.

The historian Barbara Tuchman, the author of *The March of Folly*, coined a perfect term to describe the behaviour of many executives who fail to learn, and learn the right lessons, from history: ‘wooden-headedness’, which refers to the practice of relying on ‘preconceived fixed notions while ignoring or rejecting any contrary signs’. Just as Tuchman describes such examples of wooden-headedness as the refusal of the French in 1914 to alter preparations for an invasion of Germany through the Rhine in spite of evidence that this plan left the French particularly vulnerable to an impending German march through Belgium and the lightly guarded French coastal

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provinces,<sup>1</sup> we wonder why historically innovative companies refuse to introduce second generation products in spite of pleas from customers for precisely such products.

In this article we explore the consequences of ‘wooden-headedness’ in four major companies. These four companies are very different – Motorola, Sony, Wang Labs, and Snow Brands, with two headquartered in the United States and two of Japanese origin. And one of the four – Wang Labs – no longer exists as an independent company. But as the profiles of these companies make clear, each was constrained by history and key leaders of each took lessons from that history that were wrong. Our purpose in discussing the four case histories is to highlight the interplay of history, leadership, and learning, and how remarkably talented and successful leaders so often learn precisely the wrong lessons from history.

### **Motorola: Mistakes in Innovation**

Motorola was founded in 1928, and has had a long tradition of technological innovation, including battery eliminators, the first hand-held two-way radio (the ‘Walkie-Talkie’ of World War II), the first television to sell for under \$200 (in 1948), and the world’s first pager. By the 1970s Motorola had developed its own brand of microprocessor (becoming the primary supplier to Apple), and was solidifying its reputation as a world leader in technology. Then came cell phones.

Developed in Bell Labs in the 1970s, Motorola’s first cellular system began commercial operation in 1983. By the mid-1980s, Motorola’s success in cellular telephony prompted an aggressive price-cutting reaction by Japanese manufacturers. In 1986, however, the US Commerce Department shielded Motorola by declaring eight Japanese competitors guilty of dumping charges, providing Motorola with an additional competitive edge. Motorola thus became the world’s top cell phone supplier.

Initial mobile phone users were hardly price-sensitive; cellular phones were expensive, brick-like analogue devices that appealed to business people and professionals whose lives depended on the ability to make and receive calls when a phone line was not at hand. In the mid-1980s, cellular phones were practically unknown; by 1996, some 85 million were in use worldwide. There was little doubt that Motorola was well positioned in this business. As the then CEO Robert Galvin Sr. said, ‘we were the unbridled leader in analog devices around the world’.<sup>2</sup> From 1992 to 1995, Motorola seemed to prove that even a huge company, if managed correctly, could rack up impressive growth, as revenues grew an average of 27 per cent to \$27 billion in 1995, while net income surged 58 per cent a year to \$1.8 billion.

In 1994, as Motorola claimed 60 per cent of the US mobile market, an alternative technology to the incumbent analogue cellular began catching the eye of wireless carriers. The new technology was digital mobile telephony, first available through the so-called PCS (Personal Communications System). Analogue technology transmitted calls via sound waves. Signals were subject to interference, calls were frequently

dropped, and it was easy for interlopers to eavesdrop. On the positive side, since analogue had been around for some time, area coverage was extensive. PCS on the other hand could translate calls into digital signals: interference could be programmed out, while security codes could be encrypted. On the negative side, PCS could not roam (search for calling signals) and coverage was simply non-existent as it was a brand new technology.

Critically, the powerful underlying economics of digital technology provided a means to support true mass-market subscriber populations for the first time. As a rule of thumb, digital networks could accommodate around ten times more subscribers than analogue for a given slice of radio spectrum, due to the easy-to-manipulate (and ‘compress’) characteristics of digital technology. In essence, digital technology could spread fixed costs over a broader user base, making individual use cheaper.

These powerful technology economics enabled a consumer profile that was very different from that with which Motorola was experienced. Unlike Motorola’s usual analogue cell client, such as successful business people, digital consumers were price-sensitive and less functionally and more aesthetically demanding. Additionally, distribution channels for the new, cheaper digital technology would be different from the incumbent ones.

As the leader in the cell phone business, and as the major American player (Nokia was a Finnish company, Ericsson Swedish), it was natural that US wireless carriers would look to Motorola as they made their move to digital. Consider what one major telephone carrier customer had to say:

We’re telling them we need digital, we need digital, we need digital. They come out with analog Star-TAC. They were thumbing their nose at us. The sales folks – they knew. But everyone knew. We went to Shaumburg [Motorola head office in Illinois] in 1993, 1994, but they didn’t do anything. They told us we didn’t know what we were talking about. Even in 1996, after they missed the first wave of digital, we told them we needed a dual band, dual mode phone, that this was all we would be selling. These were not friendly conversations. But Motorola didn’t do it; instead we launched with Ericsson, then Nokia.<sup>3</sup>

Without a digital phone to offer telephone carriers, Motorola pushed hard to move its analogue phones, creating considerable resentment from some customers. In one instance, Motorola even tried to promote its analogue phones by offering incentives to AT&T Wireless salespeople working at AT&T telephone shops. As one former executive at McCaw Cellular (AT&T Wireless) recalled, ‘Motorola hit on this crazy idea that they’d offer incentives to our own sales force to promote analog. They were bold and brazen – in one instance they had to be physically removed from our property’.<sup>4</sup>

Of course, it was not just customers that were telling Motorola they wanted digital, competitors were also doing so, though in a different way – while Motorola did not introduce a digital cell phone for years, the company held several digital patents it

licensed to competitors like Nokia and Ericsson. The royalties Motorola earned provided clear evidence of the increasing popularity of digital, and acted as an early warning signal on the direction of the market. Yet even with such incontrovertible data on market trends and customer needs, Motorola chose to rely on internal forecasting models that predicted carriers would be better off with analogue phones than digital. In fact, three former Motorola CEOs – Gary Tooker (interviewed 5 July 2001), George Fisher (interviewed 12 July 2001), and Robert Galvin (interviewed 21 May 1999) told us how the company ‘was at the forefront of the development of digital technology’, making it clear that the cell phone story is not about missing out on the next technology, but on choosing not to innovate and change when you had the capability to do so.

So, Motorola had the capability to make digital cell phones, and had extensive data to indicate the market was demanding digital. It could have competed from the start, if not won, in the digital cell phone wars, but chose not to. Hence, we come face to face with ‘irrational’ behaviour in organizations.

It turns out that people and organizations conspire to sometimes produce ‘irrational’ behaviour, as they sometimes do ‘brilliant’ behaviour. At Motorola, cell phone division managers – who had tremendous autonomy because of the company’s decentralized structure and because they were responsible for the ‘forty-three million’ analogue franchise – believed that what consumers really wanted were better, sleeker analogue phones. One phone carrier executive heard this reaction to his request for Motorola to supply digital phones: ‘remember the old phones in WWII – carried on backs – that is what your digital phone will look like. It can’t be done’.<sup>5</sup> Instead, Motorola focused its attention on Star-TAC, a design as small as a cigarette pack, but still an analogue phone. Such ‘smaller and cuter phones’ were technological marvels, but they were not digital. Robert Galvin put it this way: ‘when one or the other thinks we’re so damned smart we got the answer...that’s arrogance’.<sup>6</sup>

The former Motorola CEO Gary Tooker looked at the problem this way: ‘some of the leadership in the business at that time was focused too much on the short-term profits and they weren’t spending enough for the future’.<sup>7</sup> While this view is factually correct, there is more to the story. For years, the company operated with a highly decentralized management system, with significant delegation of responsibility to the operating businesses. While such autonomy often breeds focus and attention to detail, at Motorola it also created ‘a company of warring tribes’ that was exacerbated by strong division-based incentives. This played out in two dysfunctional ways. First, the ‘warring tribes’ mentality disrupted co-ordination across divisions, so Motorola lost considerable time when it decided to develop the chips necessary for digital cellular in-house instead of outsourcing.<sup>8</sup>

Second, like many decentralized organizations, Motorola relied on division-based incentives to motivate divisional managers. Yet each division also had to cover its own costs of investment. The net effect may well have been that ‘decision makers’ thinking [in the cell phone division] was colored by the up-front costs they would

have entailed by shifting from analog to digital'.<sup>9</sup> Motorola's compensation system created a short-term disincentive to take on the costs of the transition to digital cell phones.

In the end, the Motorola story brings us back to leadership. When an organization is unwilling – yet perfectly capable – of coping with change and satisfying clear and persistent customer needs, there has been a breakdown in leadership. And this breakdown does not stop with those immediately responsible for the decision to stonewall customers demanding digital cell phones, but extends to the very top of the organization where ultimate responsibility for strategy, structure, and culture surely rests. To some extent, Robert Galvin acknowledges this: 'we were all lulled into a situation of digital coming at the pace it did. We plain just made a bum decision'.<sup>10</sup> Yet cultural insularity and nominal divisional oversight have been part of the Motorola system for years, and were allowed to propagate.

In the fast-moving cell phone business, by the time Motorola finally launched its own digital phone in 1997, the competition was far ahead. The hit to market share was dramatic. Motorola's US share peaked at 60 per cent in 1994 only to dip to 34 per cent in early 1998, while Nokia's share went from 11 per cent to 34 per cent during the same time period.<sup>11</sup> In June 1998 Motorola announced layoffs of 20,000 people as it looked to cut costs in response to depressed profitability. So began a long series of layoffs, restructuring, and re-strategizing that plagued the company for years.<sup>12</sup>

If you really want to understand a company, you need to understand its history. One of the most common flaws in how we think about organizations – whether we are analysts, consultants, investors, or managers – is to disregard the past in trying to make sense of the present. Why did Motorola miss digital? One of the biggest dilemmas in-house was deciding what type of digital to back. There were CDMA, TDMA, GSM, all different standards with no certainty on which one would win out in the US market, so Motorola waited. Years earlier it had found itself backing the non-standard Apple in the personal computer business (Motorola made the microchips), and it is likely there was concern about making the same mistake twice. So it waited, until Nokia and Ericsson pushed it to the side even in the US market.

Culture is also a major component of history, and Motorola is known as an engineering-driven company. Those who know the company well liken its mindset to an 'internal think-tank'; focus on the market and on customers is secondary. The other distinguishing characteristic of Motorola's culture is its insularity. One knowledgeable observer alludes to a 'fortress mentality, cut off from reality, in-bred, with tremendous self-confidence, and a lack of concern with the outside world'.<sup>13</sup> If this cultural profile is accurate, it is not hard to imagine how senior managers might resist strategies that customers were demanding, or how arrogant attitudes might emerge in dealing with customers.

One would think that learning would occur over time, and of course it does in some organizations. But at others, like Motorola, the culture is so strong that there is tremendous persistence in how systems operate and people behave, even from decade to decade. Whether it is Motorola's history of being an innovative leader which is

pushed aside by more market savvy followers – think car radios, televisions, and... digital cell phones – or its tendency to put technology above customers, the results can be powerful. As one former CEO lamented to us, ‘every time we stumble significantly it is because we have been so successful in one generation of the technology that we don’t focus on replacing ourselves with the next technology quick enough’.<sup>14</sup>

A culture as strong and successful as Motorola’s is resistant to new ways of thinking. In its essence, that is the challenge of innovation, whether it is creating new cell phones, new stents, or new ways to deal with powerful customers. All organizations have an installed base of ideas that define the managerial mindset, and this installed base is very difficult to overcome. This is what made it so difficult for the cell phone division at Motorola to accept digital phones as the rightful, and immediate, replacement for analogue phones, and this is also what made it so difficult for Motorola’s top management to break out of the insular technology-over-customers mindset. In both cases, what was lost was that ‘healthy spirit of discontent’<sup>15</sup> that helped define Motorola’s innovative capability for years. What appears to be ‘irrational’ behaviour is often only too rational when the underlying dynamics of organizations and people are considered side-by-side.

### **Sony: Learning the Wrong Lessons from History**

Masaru Ibuka and Akio Morita founded Tokyo Tsushin Kogyo (Tokyo Telecommunications Engineering Company) in 1946 with a mission to be ‘a clever company that would make new high technology products in ingenious ways’.<sup>16</sup> With the development of the transistor, the cassette tape, and the pocket-sized radio by 1957, the company renamed itself Sony, from the Latin word *sonus* meaning ‘sound’. In 1967, Sony formed a joint venture with CBS Records to manufacture and sell records in Japan. By 1975, with the launch of the Betamax home videocassette recorder, Sony was in the big league.

The Betamax was a watershed for Sony. Here was a breakthrough product – offering consumers the opportunity to record and play their favourite TV shows or watch movies whenever they wanted. Yet within two years a new videocassette recorder (VCR) made by its arch-rival Matsushita using the VHS standard became the product of choice for consumers. Why? Sony, working from a ‘playbook’ that Apple would pick up just a few years later, was more protective of its Betamax format and less aggressive in aligning other electronics firms in its camp than was Matsushita. When VHS started to take hold, motion picture studios began to release a larger number of their library titles in that format, relegating Betamax to also-ran status despite some technological advantages.<sup>17</sup> ‘We didn’t put enough effort into making a family. The other side, coming later, made a family’, Morita later said, referring to the fact that Matsushita had aggressively licensed its technology and created an electronics industry-wide effort to unseat Betamax.<sup>18</sup> As Mickey Schulhof, the former President of Sony USA, later noted in *Fortune*, ‘in the late 1970s we began to recognize the need to take Sony beyond hardware. Through our experience with

Betamax, we discovered that the compelling motivation for the purchase of hardware is software'.<sup>19</sup>

As we saw with Motorola, history counts. If you want to understand a company's strategy, you need to understand its history. And at Sony the history lesson was clear. First came CBS Records, which Sony bought in 1988 for \$2 billion. Convinced that its record library had helped guarantee the success of the Compact Disc, Sony looked to CBS Records to provide the software necessary to ensure the success of its new Digital Audio Tape.

Not long after the CBS Records deal was finalized, Sony acquired Columbia Pictures and its two production units – Columbia and Tri-Star – as well as a library that included such classics as *Lawrence of Arabia* and contemporary titles like *Tootsie* and *Ghostbusters*. Also under the Columbia umbrella was a syndicated television operation that included hits like *Married...with Children* and *Wheel of Fortune*. What did not come with the deal, however, was a CEO: the outgoing Columbia boss, Victor Kaufman, told Sony that he would not stay on to run Columbia after the merger. Sony had its candidate for a studio; now it needed a management team.

Sony's North America chief, Mickey Schulhof, charged with recruiting a studio chief for Columbia Pictures, settled on Peter Guber and Jon Peters, who ran the Guber–Peters Entertainment Company (GPEC). Guber had credits for *The Way We Were* and *The Deep*, and was, well, very Californian. When we spoke to Guber about his track record, he told us: I first tap into my intuitive because I believe every business decision is a creative decision. My intuitive really is the cartel... of all my intellect, my experience, my observations, and my collective unconscious and I tap into it because that's a place I have no fear... I focus on my macro-goal or macro-opportunity before I go to bed to feed my unconscious.<sup>20</sup>

Peters made a name for himself co-producing *A Star is Born* with his then-girlfriend Barbra Streisand. In May 1980, Guber and Peters joined forces and secured credits on many successful projects including *Flashdance* and *The Color Purple*. Hollywood insiders, however, were critical of the team, especially of Peters' notorious temper.<sup>21</sup> Steven Spielberg reportedly would not let the two on the set of *The Color Purple*. Despite having his picture taken with the duo for the Oscar *Rain Man* won, the ex-Columbia boss Frank Price claimed that 'they were never around while it was being made'.<sup>22</sup> Nonetheless, there was no question that Guber and Peters had hands-on involvement in the highest grossing picture in Warner Bros. history, *Batman*.

The recent success of the Guber–Peters Entertainment Company, along with Guber's polished demeanour, was enough to convince Sony that it had found a suitable management team for its studio – even though Guber and Peters had just signed a five-year contract with Warner Bros. This meant that, to get the dynamic duo, Sony would have to purchase their production company, which it did for \$200 million, nearly 40 per cent above its market value. Guber and Peters split a cool \$80 million from the sale of their stock and, as studio chiefs, would receive a salary of \$2.7 million, a share of any increase in the studio's market value, and a \$50 million bonus pool (to be parcelled out at their discretion) at the end of five years.

Columbia Pictures was sold to Sony for \$3.4 billion, which along with assumed debt, brought the total cost to nearly \$5 billion (a 70 per cent premium). Then, when the Warner Bros. chief Steve Ross refused to let Guber and Peters out of their contract at the eleventh hour, Sony ended up conceding to Warner (1) the portion of its Burbank lot controlled by Columbia in exchange for Warner's old MGM lot in less desirable Culver City; (2) a 50 per cent equity stake in Sony's lucrative Columbia House mail-order music club; and (3) the rights to distribute Columbia's library over its cable networks. The settlement terms were 'deemed so disadvantageous to Sony that for weeks afterward they are the talk of the lunch crowd at Le Dome, where they are referred to as "Pearl Harbor Revenged"'.<sup>23</sup> The total value of the settlement was estimated to be over \$500 million.

Sony's total acquisition bill for Columbia Pictures reached nearly \$6 billion when Guber and Peters took control.<sup>24</sup> Almost immediately, the two embarked on a lavish spending spree. The old MGM lot received in the Warner ransom went through an extensive renovation costing almost \$1 billion. Offices were decorated with antique desks and chairs costing up to \$26,000 each. In one famous instance, Jon Peters approved a \$250,000 decorating budget for a producer, something he would not comment on when asked in an interview.<sup>25</sup>

Over the next two years, spending on production, management, and television also ballooned. Overheads increased by 50 per cent to \$300 million by 1991, some \$60 million greater than other major studios, and its \$700 million production budget was nearly twice that of its competitors. The average Sony motion picture cost \$40 million versus the industry average of \$28 million. The excessive overhead and production costs pinched the company in 1991 as the industry saw year-over-year box-office sales slump 25 per cent in the worst take in 20 years. Management was also unstable, as a succession of studio chiefs came and went, invariably with very generous severance packages. Even Peters (\$50 million and funding for a new production company) left. The executive turnover at Columbia caught the eye of the media and prompted *Spy* magazine to write, 'the hottest sport in Hollywood is Sony Lotto – a get-rich-quick scheme in which the lucky player is fired by the studio in exchange for a fortune'.<sup>26</sup>

Despite the spending and turmoil, Guber argued that \$2 billion of Sony's money brought a happy result – Sony was number one at the box-office in 1991.<sup>27</sup> In truth, Sony's ranking in the early 1990s was largely the result of distribution agreements with two small production companies, Castle Rock and Carolco (Carolco's *Terminator 2* alone was responsible for half of Sony's box-office take in 1991). Even in Sony's best year, 1992, its \$400 million operating income was entirely eroded by interest and goodwill charges. With the Japanese recession, a slump in hardware sales, and a rising yen against the dollar, Sony executives in Tokyo started to put pressure on the studio to improve its results.

Sony decided to pull out all the stops for its most anticipated film of 1993, Arnold Schwarzenegger's *The Last Action Hero*. The \$90 million movie was to be the showpiece for every type of 'synergy' that existed between hardware and software: a

Sony movie filmed using Sony HDTV (High Definition TV) equipment; Sony products prominently featured; a soundtrack released through Sony Music; and a premiere in Sony Theaters equipped with Sony's proprietary SDDS surround sound. Everything was in place except for one thing: one of the most expensive motion pictures ever made was a box-office bomb. A string of less publicized but expensive losers followed, paralysing the studio. By autumn 1994, Guber had gone nearly six months without approving a script for production. Altogether, 17 of the 26 movies Sony released in 1994 lost money, bringing the filmmaking loss that year to \$150 million.

That was enough for Sony. On 29 September 1994, Guber 'resigned', but not without extracting one last 'macro-opportunity' – a \$275 million production package that included an annual salary estimated between \$5 and \$10 million. Sony Pictures' market share, after climbing significantly in 1991–92, had returned to where it was in 1989, but the financial damage was yet to be revealed. The Guber–Peters era finally ended in November 1994, as Sony announced a \$3.2 billion write-off related to Columbia Pictures that wiped out nearly 25 per cent of Sony's shareholders' equity. Not long after, Sony USA President Mickey Schulhof would be ousted as Sony set out to rebuild its motion picture operations. When asked what he might have done differently, Schulhof said, 'perhaps they should have changed the management'.<sup>28</sup>

What can we learn from Sony's acquisition of Columbia Pictures? Yes, they sank a tremendous amount of money into the movie studio, and yes they did abdicate management and even oversight to two Hollywood insiders that ended up costing them even more money. But consider the logic behind the deal. Remember that Sony – then as now – is first and foremost a hardware company, yet it believed that the establishment of a new hardware technology required the availability of related software demanded by the marketplace. This logic was a direct outgrowth of its experience with the Betamax video recorder and the compact disk. Recall that the popularity among consumers for VHS hardware spurred movie studios to produce in that format, and Betamax died. CD players, on the other hand, took off because Philips (which owned PolyGram Records) and Sony (through CBS Records) pushed the product aggressively to customers in Japan, Europe and the United States.

While software is clearly an important driver in hardware success, there was another dynamic at work that, while recognized by some at Sony, never really took hold in its strategic calculations. That other factor, acknowledged by former Sony Chairman Akio Morita, was the importance of 'building a family'. With the Betamax, Morita firmly believed that a stronger 'family' was needed after Matsushita built a more extensive alliance that undercut Sony's lead and made the need for Betamax obsolete. In this analysis, the availability of format-specific software was a consequence of the successful alliances created by Matsushita – VHS video recorders dominated the hardware market, so what else would software makers produce?

What is particularly interesting here is that the acquisition of Columbia Pictures could only make sense if we accept the 'software' logic and not the 'family' logic, because Columbia Pictures could never on its own have the market power to dictate market acceptance of Sony hardware products. Controlling a movie studio was seen

as the solution to the old 'Betamax' problem, and as the lever to promote Sony's new HDTV and 8 mm video formats. Unfortunately, the lessons from the past were incomplete and misleading – software availability was a consequence, not a cause, of market power.<sup>29</sup>

### **Wang Labs: When Leaders Refuse to Adapt**

An Wang was an exceptional man, an inventor and innovator. He came to America with little money, earned a doctorate in applied physics in 1948 from Harvard University, and went on to invent the magnetic pulse memory core, a technology that would be essential in computers for the next two decades. He was the first to develop and realize the potential of the calculator market, and Wang was personally responsible for numerous patents and product ideas. This quest for breakthrough technologies was not only his driving force, it was also embedded in the culture of the company he created – Wang Labs – which grew to become a \$2 billion powerhouse.

The early years of the company were prophetic. As the Gods would have it, Wang Labs was intertwined with IBM right from the start. The design for Wang's magnetic pulse memory core was sold to IBM in 1956, but not before four years of arduous negotiations. It did not go unnoticed that this deal closed just weeks before Wang was awarded a patent on this technology; years later, he would suggest that IBM had challenged his patent claim as a means of closing the sale.

In the late 1950s, Wang developed and patented a semi-automated phototypesetting device that increased the productivity of newspaper printing but, in a bungled licensing agreement, lost exclusive rights to manufacture these machines. In need of additional capital, Wang grudgingly sold 25 per cent of the company to a machine tools company for \$150,000, something he regretted for years.

The next two decades were good years for Wang. The introduction of the LOCI electronic scientific calculator in 1965 literally began the desk calculator market, which Wang dominated for the next five years. Riding the wave, Wang Labs went public under much fanfare in July 1967, with Dr Wang personally retaining control of over 50 per cent of the company. The Wang 2200 minicomputer and the cutting-edge 1200 BASIC word processing machine debuted in 1973, but it was not until the company introduced a cathode ray tube-based word processing minicomputer in 1976 that Wang had his next big hit. Over the next four years, Wang introduced VS (virtual storage) computers, its Office Information series, and its Integrated Systems line, all cutting edge products aimed at the lucrative office-automation market. By 1978 Wang Labs was ranked as the 32nd largest computer provider, and cocky enough to launch an aggressive television advertising campaign aimed directly against the number one, IBM. An Wang brazenly proclaimed his company would replace IBM as the dominant computer company in the world by the mid-1990s. As one former manager told us, 'he had two suits, both gray, and in the breast pocket he always kept a little chart showing how Wang Labs would one day surpass IBM.

This at a time when sales at Wang were around \$3 billion and IBM was at \$47 billion’.

Momentum can keep you going for some time, but strategic breakdowns will eventually catch up with you. The story of the word processor and the IBM PC highlights this as well as anything. Rather than see the word processor as a product, An Wang fell head-over-heels in love with it. While an innovating company must truly be in love with the process of creating new products, loving an actual product is much more dangerous. So when his son Fred pointed out that IBM’s PC was a real threat to the word processor, An Wang said, ‘the PC is the stupidest thing I ever heard of’. Then, akin to Apple’s resistance to licensing its technology because no one could be allowed to share in the aesthetic of Apple and later Macintosh, Wang was not only slow to market with a PC but when the company did enter the market it chose to use its own non-IBM compatible proprietary system. With one part arrogance bred on past success, and one part attempted defiance of the emerging IBM hegemony in PCs, An Wang’s blind hatred of IBM created an unwinnable strategy. Ever since he sold his rights to the magnetic core memory, he felt cheated and exploited by the giant computer company and he would be damned if he would let that happen again!

The story of An Wang and the PC – almost a fable – provided a window into the closed world of Wang. Right from the beginning, An Wang had served concurrently as President, CEO, and Director of Research, creating a ‘benevolent dictatorship’ where he retained ultimate control over every facet of the company. In a touching story told to us by his son Fred, An’s desire for control even extended to the initial public offering process:

At night he’d read an Agatha Christie mystery before falling asleep. He’d usually read a page or two before he would just fall off and the book would just plop off to the floor. During the summer of 1967 just before the company went public he had gotten hold of some handbook on taking companies public – one of these coffee table size books – and he’d take that to bed at night, read a couple of pages and then you’d hear the book fall because when that thing fell the whole house shuddered. He basically read through that during the course of the summer and was able to question and direct the investment bankers who helped us with the IPO. He knew more about some of the things than they did just by having spent the time reading through materials.

Where did this preoccupation with control come from? While there were almost certainly psychodynamic attributes that contributed to An Wang’s actions, and in some respects Wang’s behaviour is not much different from other CEOs of family-run companies, there is also a history at the company that is revealing. An Wang always thought that he gave up too much control when the company first went public. He may well have felt that he was bullied and taken advantage of by IBM. And he lost control of exclusive manufacturing rights because of a slipshod licensing agreement. Much of what happened subsequently to Wang can be seen as an attempt to avoid the mistakes of the past, but each solution turned out to be more toxic than

the problem it was meant to cure. These three events – all centred on the theme of loss of control – drove Wang to make decisions that destroyed his company. Once again, a key leader has learned the wrong lessons from the past.

With the market having shifted from word processors to PCs, and Wang's entry stalling, the company was in trouble. The sales force did not want PCs – Wang was an also-ran in PCs, and besides, they made much more money on word processors. The only problem was the word processor market continued to dip, eventually going the way of centralized word processing pools in companies. Losses mounted, and their effect was concentrated because of a decision An Wang had made during the years of growth. Dr Wang was never happy that he had to give up so much of the company when he went public, and he subsequently refused to dilute his holdings to raise additional capital. Well, with limited opportunities for equity, there is always debt, and Wang had managed to accumulate over \$1 billion in debt, including \$575 million in bank loans by 1989. While the company struggled through several more years, by 1992 it was over. Wang Labs – for years one of the most innovative companies in the computer industry – filed for Chapter 11 bankruptcy protection.

Wang Labs died of self-inflicted wounds. That which made the company great – an obsessive desire by a benevolent and brilliant dictator to control every aspect of the company – led to its downfall. Wang Laboratories is a remarkable example of an entrepreneurial start-up that never matured. Driven to control as much of his personal environment as he could, and riding a wave of success that made him a very wealthy man, An Wang made a series of fundamental mistakes that eventually cost his company the longevity, and him personally the legacy, he so desperately wanted.

### **Snow Brands: Not Learning from Their Mistakes**

On 1 March 1955 nine elementary schools in the Tokyo area reported a major outbreak of food poisoning affecting over 1,900 people. Two days later, Tokyo officials announced they had found staphylococcus in low-fat milk produced by a company called Snow Brand Milk. The company – founded in 1925 as a farmers' co-operative in Hokkaido, the northernmost island in Japan and a region known for agriculture and dairy production – was shocked when the contamination was traced to Snow Brand's Yagumo factory in Hokkaido, where a temporary blackout and problems with new equipment caused the problem.

Snow Brand's reaction was swift. CEO Mitsugi Sato immediately ordered a product recall and halted all sales. He took out advertising space in all the major newspapers to publish a public apology, and rushed off to the factory himself to investigate the matter. Several changes emerged from this incident. Responsibility for quality control and testing was consolidated in an independent division and multiple layers of quality testing were integrated into the production process. Sato also set out to instil quality into the culture of Snow Brand, distributing regular messages to all

employees about the importance of quality and elevating quality to a central position in the company's credo.

These efforts were successful, and Snow Brand went on to become one of the most trusted names in Japan. By 2000, the company was the largest producer of milk and dairy products in the country, and a major player in other segments of the food industry, including meat products. So powerful was the brand that consumers in blind taste tests preferred a competitor, but favoured Snow Brand when the labels were left on the product packaging. Snow Brand employed 15,000 people and had consolidated sales of nearly ¥1.3 trillion (about US\$10 billion).

Once again, company history can be remarkably important in understanding strategic actions. At Snow Brand, the story of the Tokyo food poisoning was kept alive for years. However, by the 1990s market conditions began to shift. Deregulation enabled supermarkets to become larger and more consolidated, shifting bargaining power from producer to retailer. Even well-known brands like Snow Brand were pushed to lower prices as retailers filled shelves with their own private label store brands. Seeking to meet profitability targets in this tough market, plant managers looked to cut costs wherever they could. Factory production was stepped up not only to keep up with demand but also to squeeze maximum capacity from existing facilities.

The pressure to cut costs came up against the traditional Japanese consumer preference for product freshness. Japanese food producers historically labelled perishables with the production date instead of the expiry date. Milk production followed what was known as a 'D-1' schedule – milk was delivered one day after it was produced. Product testing actually took place while the milk was already en route to stores; even though the test required 16 hours, if problems were discovered there was still time to recall the product. As pressure grew for product freshness, milk producers even began a 'D-0' delivery schedule that brought the product to stores the same day it was produced. Critically, the 'D-0' schedule prohibited timely testing of product quality, increasing the risk of food poisoning. While the Ministry of Agriculture, Forestry and Fisheries in Japan advised manufacturers not to deliver within the 'D-0' window, some companies chose to continue the practice, including Snow Brand. There was no margin for error.

The pressure for results ran right into a world of dramatically increasing retailer power and consumer pressures for highest quality and freshness. Something had to give, and it was quality. The Osaka factory started producing 100,000 tons of milk, far above its 60,000-ton capacity. Production dates were disguised, milk that was returned from stores was reused in other products unbeknown to customers, numerous breakdowns in cleanliness occurred (for example, machine valves were not washed or sterilized properly), and operational records were falsified.

The public knew nothing of this . . . until 27 June 2000. That morning the customer service centre for Western Japan received a complaint that milk produced by the Osaka factory was causing some people to become nauseous and sick. The first complaint was quickly followed by dozens more, but the Osaka management took no

action. It did not contact head office in Tokyo either, and 'D-0' deliveries continued for two more days.

The next day, 28 June, the Osaka public health office received a report from a doctor concerning food poisoning apparently due to Snow Brand's low fat milk. Public health officials quickly started investigating the Osaka factory. The tainted milk continued to sit on store shelves. The Osaka factory did not report any of this to either the Western Japan branch office or corporate headquarters.

The Snow Brand top management was finally informed on the morning of 29 June that milk from the Osaka factory was causing food poisoning. Later that day, at 4 p.m., the City of Osaka announced that Snow Brand milk was responsible for the outbreak that had made more than 200 people sick. Finally, at 9:45 p.m. that evening, some 60 hours after the first reports had come in, the President of the Western Japan branch of Snow Brand Milk held a press conference where he admitted that the company's products were responsible for the food poisoning. During this entire time, Snow Brand milk remained on shelves and in customers' refrigerators, exposing additional people to the tainted product.

By 1 July, more than 6,000 people had become sick, and consumers and the media were outraged that top executives in Tokyo had not even acknowledged the incident, let alone taken responsibility. Finally, Snow Brand Milk President Tetsuro Ishikawa held his own press conference, fully two days after the initial press conference in Osaka and four days after the first complaints about food poisoning had been received. Additional information about the bacteria was revealed at this press conference for the first time, reinforcing doubts about the company's ability to handle the crisis.

The demand for information and accountability continued. At a late night press conference three days later, Ishikawa abruptly stopped answering questions and rushed off to the elevator. Pursued by reporters who demanded that he continue the press conference, he angrily yelled out at them from the elevator, 'I haven't slept!' A reporter responded, 'So what? We haven't slept either! Have you ever given thought to the poor children who are suffering in the hospital?' Ishikawa had no response, and quietly agreed to continue the press conference. Captured on camera, this scene was broadcast on national television over and over again, not only enraging consumers in Osaka, but consumers, distributors and even Snow Brand employees all over Japan. Two days later, Ishikawa announced his resignation.

The unsanitary and ill-conceived practices in the Osaka plant came to light in subsequent investigations. In all, 13,000 people became ill in this incident, the worst in Japan since World War II. Sales of Snow Brand milk declined by 88 per cent in July compared to the previous year. Market share dropped from almost 40 per cent in June to less than 10 per cent. The company swung from a net profit of ¥3.3 billion in the fiscal year 1999 to a loss of ¥51.6 billion in the fiscal year 2001.

Remarkably, history repeated itself at Snow Brand Milk. The company consisted of several subsidiaries besides the large milk business, one of which was Snow Brand Foods – a major Japanese producer of beef, chicken, and pork. In September 2001

the Japanese beef business was hit with Bovine Spongiform Encephalopathy (popularly known as 'Mad Cow disease'). The Ministry of Agriculture, Forestry and Fisheries reacted quickly to protect the beef industry and started a programme the following month to buy back domestic beef that had to be destroyed for fear of contamination.

With rapidly declining sales, and the same pressure to meet targets we saw earlier with Snow Brand Milk, the temptation to cut corners re-emerged. Japanese beef is considerably more expensive than imported beef, creating an illegal arbitrage opportunity for Snow Brand Foods. Buying cheaper imported beef from Australia and labelling it as Japanese beef, Snow Brand Foods submitted the beef to the Ministry's programme and pocketed the difference. Unfortunately for Snow Brand Foods, the government inspected one of the company's processing centres the following January, and found 13.8 tons of mislabelled beef. Under pressure from the government and consumers, the company voluntarily stopped selling beef and processed beef three days later. Follow-up investigations revealed that the company had not only engaged in similar practices in other processing centres, but had also been disguising the origin of beef and pork for some time to enable higher selling prices.

It did not take long for the hammer to come down. On 1 February 2002 the government brought charges of fraud and police raided headquarters and other offices to gather additional evidence. After the milk poisoning disaster, the company had essentially depleted its goodwill and actually ended up closing down the entire Snow Brand Food subsidiary just three months later. Snow Brand Milk looked for ways to isolate the damage and spun out some business operations to joint ventures, including the manufacture and sale of powdered milk for babies. In addition, the immediate aftermath of the scandal resulted in key asset sales and emergency capital infusions from banking partners. Nevertheless, it appears that many consumers have sworn off the brand and refuse to go back. All this has been reflected in a stock price that sank to as low as ¥150 (from ¥600 a year earlier) before recovering slightly.

In looking back on what happened, it was almost as if Snow Brand management was operating in a vacuum. Delivering milk on a 'D-0' schedule is about as risky a strategy as you can imagine in an industry where 100 per cent safety and reliability is required. One mistake is one mistake too many. In contrast to other high-reliability organizations such as the military, nuclear power plants, and aircraft manufacture and maintenance, the lack of production controls seems extraordinary. At Snow Brand, there was a wilful attempt to avoid and bypass controls that had historically been in place. Why?

There are three primary reasons. First, the pressure for results had built up to such an extent that plant managers found themselves increasingly unable to extricate themselves from riskier, and over time unethical and illegal, actions. At what point does a drive for efficiency go over the line? How do managers in high-pressure environments know where to draw that line? This is probably why revelations of wrongdoing, or at least cutting corners, kept dribbling out from Enron, WorldCom, and Tyco long after the initial 'scandal' story broke. For example, months after Tyco

CEO Kozlowski resigned, we were still reading stories in the *Wall Street Journal* about how the company's ADT subsidiary accounted for cancelled security alarm contracts. And for a while it seemed as though the totality of WorldCom's accounting 'mistakes' would increase week by week. When the culture is wrong, it permeates the entire organization and leaves a mark so far down that it can take years to hear the other shoe drop.

Missing throughout the Snow Brand story is senior executive leadership – people who not only can raise the profitability stakes but can also set unimpeachable ethical standards and provide a guiding light to help meet those aggressive targets. In the absence of clear guidelines on what is appropriate and inappropriate, some people might 'push the envelope' too far. Coupled with a tough competitive environment and intense pressure for results, others might join them. Throw in a traditionally loyal work force, and there is little expectation of dissent or censure that might provide perspective and distance. Snow Brand's managers were caught in a powerful centrifugal force from which they could not extricate themselves. Yes, it is true they did something that was wrong, but where was senior management?

Second, Snow Brand's was not a culture where it is was acceptable to make or admit mistakes. This was a successful company, a star company really, and one that had built a reputation for excellence. When the milk poisoning hit, the Osaka managers were shocked. You can almost see them saying to themselves – for few would openly talk about it – that this was not really happening. Rather than acknowledge that something had gone wrong, very wrong, Osaka managers created the fiction that they could solve the problem themselves. Their resistance to even informing head office about mass food poisoning speaks volumes about their confidence in containing the problem and their incredible fear of admitting that their milk was bad. It is remarkable that Osaka believed they could keep head office in Tokyo off the case; the notion that the corporate office was preoccupied with the shareholder meeting was simply an excuse to avoid informing their bosses. But while Osaka tried to figure out how to deal with the disaster, the products remained on grocery shelves and in refrigerators, infecting additional people that need not have been hurt.

Finally, in the case of both milk and beef, illegal practices and activities were going on for some time before they were discovered. In fact, they might still be going on if not for the milk poisoning, or the government inspection of beef plants. These were not one-time transgressions but a steady pattern of inappropriate behaviour. These practices could not have had such longevity if managers doubted what they were doing. But, in dramatic contrast, it never occurred to Snow Brand management that they could get caught! They were simply too good. This was a company with a stellar brand name, a terrific reputation among customers. They could do no wrong... so they did. The company's response to announcements of milk poisoning says a great deal. No admission of responsibility, no formal investigations, and a CEO who makes the ultimate public relations blunder by demonstrating a lack of compassion. Meanwhile, none of this sinks in with executives at Snow Brand Foods, who proceed virtually to repeat the disaster in the beef business just a few months later.

## Conclusion

Each of these case histories provides evidence for two critical insights that are at the heart of this article. First, companies, and the people who lead them, are heavily influenced by history. Sometimes the lessons of history are subtle, as in Sony's misunderstanding of the importance of family in favour of a view that control over software was paramount. In other instances, history acts as a blunt force for inertia. Motorola could not decide which digital cell phone technology was going to be the dominant one, to a large extent because it knew it favoured the 'wrong' (at least judging from potential market share) player in the personal computer business. Similarly, An Wang was handcuffed by his own history of selling valuable technology to IBM when operating funds were lacking, and losing partial control of the company he founded. And sometimes both long and more current lessons of history are forgotten, as was the case at Snow Brands.

The second major insight is that failing companies consistently heed the wrong lessons of history. This is true both whether key decision makers are generally unaware of history (how many people at Snow Brands around 2001 knew of the 1955 poisoning outbreak?), or allow themselves to be dominated by history. This paradox arises because history becomes encapsulated into the culture of an organization over time, and cultures often form the strongest of organizational backdrops to decision making. An arrogant culture of 'we know best' permeated Motorola's dealing with the customers who kept knocking on its door to order digital cell phones just as much as Wang Lab's culture of 'benevolent dictatorship' dictated that An Wang's predilections would govern that company's decision making regardless of the consequences.

For organizations seeking to avoid the disastrous outcomes that emerged from the four stories profiled here, some solace may be gained by remembering not only that history exists within the fabric of organizational culture, but also that learning the lessons of history is not possible when leaders allow 'wooden-headedness' to predominate over open-mindedness.

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- Tuchman, Barbara, W. *The March of Folly*. New York: Ballantine Books, 1984.

## Notes

- 1 Tuchman, *The March of Folly*.
- 2 Interview with Robert Galvin, Sr., former CEO, Motorola Corporation, 21 May 1999.
- 3 Interview with Emilio Echave, President of Eastern Area, AT&T Wireless Services, 20 Oct. 1999.

- 4 Interview with Bill Oberlink, former President, Southeast Division, McCaw Cellular Communications, 1 Dec. 1999.
- 5 *Ibid.*
- 6 Interview with Robert Galvin, former Chairman and CEO, Motorola, 29 May 2001.
- 7 Interview with Gary Tooker, former CEO, Motorola, 5 July 2001.
- 8 There is an irony in the use of the term, 'warring tribes'. While the lack of co-operation between divisions can be characterized in this way, Robert Galvin, the former CEO, pointed out how it was exactly the absence of such conflict and dissension among executives in the cell phone division, and between Corporate and the division, that was at the heart of the cell phone problems in the mid 1990s. (Interview on 18 Dec. 2002.)
- 9 Interview with Robert Galvin, former CEO, Motorola, 21 May 1999.
- 10 *Ibid.*
- 11 Herschel Shosteck Associates, Ltd., Wheaton, Maryland (<http://www.shosteck.com>).
- 12 Motorola's global market share may have hit bottom in 2000, when it clocked a 15 per cent share.
- 13 Quotations without attribution were drawn from interviews of people inside and outside of Motorola who requested anonymity.
- 14 Interview with Gary Tooker, former CEO, Motorola, 5 July 2001.
- 15 Interview with Robert Galvin, former CEO, Motorola, 18 Dec. 2002.
- 16 Griffin and Masters, *Hit and Run*, 190.
- 17 The Beta format was actually picked up by broadcasters, where it survives to this day because of its superior special effects and editing features.
- 18 Griffin and Masters, *Hit and Run*, 96. In addition, one of the reasons Sony may not have been as aggressive as Matsushita in 'building a family' is that many people within Sony believed that Matsushita had copied the original Sony design. See Lardner, *Fast Forward*, 151–2.
- 19 *Fortune*, 9 Sept. 1991.
- 20 Interview with Peter Guber, former CEO, Sony Pictures, 7 March 2001.
- 21 'The stories of [Peters'] tempestuous explosions are available on every corner in Hollywood, stories of tantrums and bullying and even physical violence'. Boyer, "Hollywood Banzai," 190.
- 22 The Academy Award for *Rain Man* was given to producer Mark Johnson, who allowed Guber and Peters to borrow it for the photograph. Klein, "Lost Tycoon," 68.
- 23 Boyer, "Hollywood Banzai," 135.
- 24 \$3.4 billion cash plus \$1.4 billion in debt for Columbia, \$200 million for GPEC, and \$500+ million settlement with Time Warner. The \$6 billion figure is quoted by Mickey Schulhof in Klein, "Lost Tycoon," 58.
- 25 In fact, Peters was one of a very small number of people we interviewed who agreed to an interview but refused to allow us to quote what he said.
- 26 Griffin and Masters, *Hit and Run*, 320. The distaste with CEO compensation extends to some CEOs. In an interview we did about Mattel with Alan Hassenfeld, Chairman and CEO, Hasbro, Inc. on 28 June 2001, he said, 'I am sick and tired of people in general being overpaid... and you see it happening day in and day out in Hollywood. I want to come back as a failed Hollywood executive. You end up getting more for messing up than for succeeding'.
- 27 Technically, they were not. Guber grouped Columbia and Tri-Star together. If Disney or Warner grouped together all of their production units, they each would have had a higher box-office share than Sony.
- 28 Interview with Michael (Mickey) P. Schulhof, former CEO, Sony USA, 28 March 2001.
- 29 Matsushita responded to Sony's deal by acquiring MCA, creating a stalemate in the software control game.