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# Why Wait for Trouble?

by Kenneth W. Freeman

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Answering three vital questions can help keep the turnaround specialists away.

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Today, hundreds of businesses are in crisis. In many cases, the numbers are going south — profitability, cash flow, and even revenues are declining. Or the numbers may be stable, but the company habitually fails to meet the needs of its customers. Or there may be ethical problems that have led to government fines and compliance monitoring, so that the company must receive regulatory approval before making major strategic decisions. The symptoms vary, but the result is usually the same: The board of directors loses confidence in management and calls in an outsider to lead the company and bring it back to life.

In the circles I travel in, this is called a "turnaround." Professionally, I am among the breed of managers called in to tackle turnaround situations. Personally, I am the sort of person who thrives on it. For more than 15 years, in three different roles — as a senior executive, a CEO, and an external advisor — I have led or helped lead many businesses out of crisis and back to financial and organizational viability. In a wide variety of industrial sectors, from manufactured components to medical diagnostic services, I have learned that the problems that lead to crisis often start in the same way, and I always apply a common set of diagnostics to uncover the causes.

The diagnosis essentially starts and ends with three vital questions:

• Is there evidence of imbalance or excess, either in the company or in the industry around it?

• Are the perceptions held by the senior executives of the company aligned or contrary?

• What is the level of accountability among the employees?

There is no precise formula for success. However, I always start by developing answers to these questions — not just through a one-time diagnosis, but on an ongoing basis. The diagnostics can be very useful for investors as well. Had Enron's shareholders applied these questions to that company in, say, 1999, they might have been forewarned of the collapse to come.

Of course, addressing these questions also works for companies that are already in a turnaround situation. But why wait for trouble?

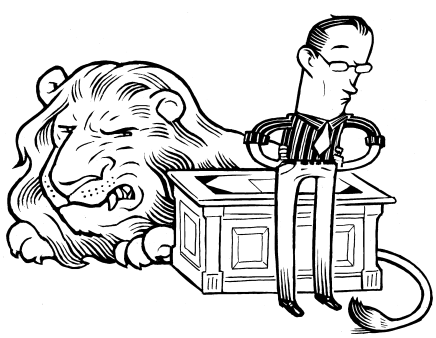

Illustration by Lars Leetaru

Any CEO can apply the same diagnostic tools inside a relatively healthy company, to identify potential problems and address them before the situation becomes critical. And with the right kinds of preventive measures, the senior leadership of a company can dramatically improve the odds of keeping turnaround leaders from showing up at the door.

### Excesses and Imbalances

When I take on the task of turning around a company, I generally start by looking for the obvious but often unseen places where the organization is set up to disproportionately favor one extreme or another. Once you start to look for them, imbalances are visible in every turnaround situation. Some companies are rife with behavioral excesses; people have collectively lost their balance. They do and say things that would provide clear cause for concern for anyone who stepped back and looked at the company as an objective observer.

One typical form of behavioral excess is an oversupply of entrepreneurial zeal. MetPath (now known as Quest Diagnostics) was started in the 1960s by Dr. Paul Brown, who developed a unique model for providing high-quality, low-cost medical testing services grounded in sophisticated information systems. After Corning Inc. acquired MetPath in 1982, the executives of the merged company ran the lab business as serial entrepreneurs; they knew one primary way to make the company go, and that was growth through acquisition. By the early 1990s, Corning Clinical Laboratories had acquired hundreds of small labs across the United States. But the company was imbalanced: Its entrepreneurial zeal far outweighed any focus on reliable, responsive systems and processes. By the time I walked into the business as CEO in 1995, the industry was suffering from Medicare fraud and abuse issues, large numbers of customer defections, and a lack of process discipline. Predictably, profitability and cash flow were declining rapidly. This situation is common in many maturing companies.

**One sign of imbalance is too much entrepreneurial zeal, outweighing a focus on reliable, responsive processes.**

In other companies, an extreme level of pride can become arrogance. In the early 1990s, as an incoming CEO, I led the turnaround of Corning's television glass business in North America. Corning had invented color television glass 40 years earlier, alongside RCA. Now the television set business faced tough international competition, and Corning had reduced its exposure by creating a joint venture with Asahi Glass. Employees in the factories were very proud. They didn't buy the fact that customers were unhappy with Corning's quality and service. They simply denied that their products were anything but the best. The employees weren't

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hearing direct feedback from the customers. "You're the third CEO in five years," they said to me. "You're telling us the customers are going to walk away. We've outlasted the last two guys who told us that. Why should we believe you?"

So I shut down the factory for nine days. I brought in customers to speak with all of our employees, from the factory utility workers to the head of manufacturing. I said to the customers, "You've got to tell my employees exactly what you told me — that if we think we can get by with poor quality, you will figure out a way to get by without having us as a supplier." And they did. The employees, whose pride had bordered on arrogance, suddenly turned their chairs around and started listening more attentively to our customers. After that event they started coming together to improve product quality and service. Together, we turned that business around.

Other companies suffer from the opposite extreme of too little self-esteem. The science products division of Corning Incorporated, at the time a 75-year-old business, had been on autopilot for many years. The team had grown accustomed to the notion that Corning wouldn't give them the resources needed to build the business. One symptom of the self-esteem problem was a collection of garbage cans placed to collect leaking rainwater on the floor where the division staff conducted business. To turn that business around, we had to start by building confidence in our own ability to drive progress.

Another problem is an excess of leadership, which occurs when a leader is too dominant or has been in the job too long. This often manifests itself when a business enters a new phase of its life cycle, requiring a new leader with different capabilities. This was true for me at Quest Diagnostics. I came in as a financial and operations person to turn the business around and make it grow profitably. We had a great run for nine and a half years, and I saw that it was time for somebody else, with different capabilities, to lead the organization. I deliberately chose someone with a scientific background to develop as my successor. This turned out to be a good move, because the business had evolved from a company in need of effective core systems and processes into a company in which success would be determined largely by technology developments.

**A chief executive's job is to call attention to the capabilities that are in short supply.**

Companies can also get out of balance with their portfolio of products or services — either too scattered among many offerings or too focused on a few. In any case, by looking for extremes, you can identify the organizational imbalances that harm your company's ability to function well. If your company is too centralized, with one leader at the helm making all the decisions, sooner or later there will be big problems. But if your company is too decentralized, and decisions are made in Wild West style, without coherence across the company's business lines or functional boundaries, there's a good chance that the company will lack focus. More than likely, it too will find itself in a turnaround situation.

When I arrived at Quest Diagnostics, it was so decentralized that everyone thought they were making the decisions for the company — and they were! At the same time, the company and industry faced compliance issues that led to more than $1 billion in fines. In a discussion about billing practices soon after my arrival, in response to a question about the causes of the fines, a senior executive replied, "You're not a laboratorian; you don't understand. There are 100,000 pages of regulations. No one in their right mind would expect us to comply with them all." This response in itself indicated trouble — a clear sign of an imbalance of perception and integrity issues, which signaled a culture in need of dramatic change.

A CEO's job is to decide how the company's leadership, as a team, can call attention to the capabilities that are in short supply. Some companies, at some times, will need to become more entrepreneurial. Others will need to drive operations excellence, and still other companies will need to develop more customer focus. Different companies need to develop different capabilities to create balance.

### Aligning Perceptions

Every time I have stepped into a turnaround situation, the incumbent management team's understanding of its business has been scattered. Typically, after describing what I call "the five stages of any business" to the senior team, I ask them, "Where is your company in its life cycle?"

I have observed five distinct stages in any company's condition. Stage One is "bleeding." The company is in crisis and its business is deteriorating rapidly. The numbers are getting worse, customer satisfaction is in a nosedive, and employees are leaving for greener pastures.

Stage Two is "stability." It's like riding a sailboat in the middle of Lake Ontario with no wind. Business, although not great, is not getting any worse. In this stage you can predict what tomorrow is going to look like: just like today. Turnaround artists grow accustomed to seeing companies enter this stage after they pull out of the crisis. Some companies never leave it.

Stage Three is "gradual improvement." The company sees small improvements in profitability, productivity, customer satisfaction, and growth. The sun is rising over the lake, and the fish are starting to bite.

Stage Four is "rapid improvement": The fish are biting. The company is making tremendous sustainable gains. Every company wants to be in this stage, and the CEOs featured on the cover of *Business Week* usually think they are here — even if they're not.

Rapid growth can lead to Stage Five, "arrogance." This stage destroys companies. Their leaders have lingered in the sweet spot for so long that they believe their own press. They assume that they have found a formula that will automatically allow them to stay in Stage Four indefinitely, and they don't believe business should be conducted in any other way. This corporate hubris is usually marked by a brief plateau, followed by sharp decline back to Stage One.

IBM enjoyed 35 years of Stage Four, rapid improvement, between 1949 and the mid-1980s. Then it passed rapidly through arrogance and back to bleeding in the mid- to late '80s. The corporate strengths that had yielded great performance for years became weaknesses as the industry changed. IBM had $2.8 billion in losses in 1991 and more red ink in 1992. After a change in CEO leadership, IBM executed one of the great turnarounds in business history.

Of course, sometimes the economy can cause companies to enter Stage One. That happened to the entire U.S. steel industry in the 1980s. But among the companies encountering such challenges, there is always at least one that comes through even stronger than it was before. These companies are led by people who don't waste time blaming the economy, but instead reinvent the core products or capabilities of their business.

No business can avoid the cycle, and you can't leap directly from Stage One to Stage Four. But the amount of time spent in any one stage can vary. One could argue that some large automakers have been only in the arrogance and bleeding stages since the mid-1970s. Several big pharmaceutical companies find themselves in a similar conundrum: Are they in Stage Five after years of phenomenal success? Or in Stage One? Or…? Forming a clear common perspective is the starting point for driving improvement.

You would think that everyone in a senior leadership position would agree about precisely which stage their company is in. But that is rarely the case. I recently met with the 10 top executives of a struggling company. One person said the company was arrogant, three said that it was making rapid improvement, three said that it was bleeding, two said that it was stable, and one said that it was making gradual improvement. When the answers are all over the map like that, the odds are high that the company has a serious and unseen problem. It turned out that critical company performance information was often not shared, even at the senior levels. This contributed to the lack of a common view.

I asked the senior executives: "How can each of us work for the same company, see the same things every day, and yet perceive the company so differently?" It's important to keep this kind of discussion constructive; this is not a time for recriminations. There is a battery of questions to follow up with, but usually it is easiest to start with numbers: What's happening with revenues? What's happening to profitability? What's the voluntary attrition among employees? How is customer retention? How do we compare with our competitors?

**I asked the senior executives: "How can each of us work for the same company, yet perceive the company so differently?"**

The goal of a discussion like this is to align the management team: to develop a common, realistic view of the company's current state and its future prospects. If the top team isn't aligned, then the rest of the company never will be.

**Performance and Satisfaction**

I also check for alignment in two other areas — performance and what I call "satisfaction." Strong corporate performance is a function of two elements: exceptional results, as shown in performance measures, and exemplary behaviors, demonstrated by the way people conduct their work and the values instilled in the organization.

Here again, the perceptions of the senior team are the most significant indicator. So I ask them: "How are we doing? Do we have both strong results and a strong culture?" Corporate leaders profess to want both. But very few companies can consistently demonstrate exemplary behaviors and results. Some companies have strong results with terrible, self-defeating cultural values. Enron fell into that category. Others, like Levi Strauss during its unprofitable years, have an exceptional corporate culture but weak results.

Companies in crisis, as one might expect, tend to have managers who disagree about the state of their performance and especially the state of their values. Some companies still dispute whether behaviors are important (witness the stock option dating scandals), but most companies have learned to recognize the importance of strong values in achieving superior performance. Businesses in emerging nations are just beginning to learn this. I recently led a seminar at Yale University about human resources and leadership with 20 CEOs from state-owned enterprises in China. The importance of behavior was a new concept for them. "What do you mean?" they asked. "Are you telling me I've got to worry about setting the tone for how my employees should behave if I'm going to have a great company?" Yet all they had to do was look at Western companies in trouble to see the answer.

## A CEO's compensation should be linked to employee and customer satisfaction.

The second area where I check for alignment is employee and customer satisfaction. There's often a singular and very heavy drumbeat: "Just show me the financials." Companies in turnaround situations usually have focused almost all of their effort on pleasing the shareholder through hitting today's financials at virtually any cost, rather than addressing the inputs that create sustainable value. If your company has engaged and loyal employees, your customers will be engaged and loyal as well, and solid financial results will follow. Thus, in addition to financial metrics, a CEO's compensation should be linked to employee and customer satisfaction — the metrics that show where leaders can make a genuine difference. If customers are engaged and loyal, then shareholders, who reap the benefits, will also be engaged and loyal. And then what happens to the employees? The odds are, they'll have a better life by working for a successful company that creates wealth and opportunities for personal growth and financial gain.

Unsurprisingly, in companies in crisis, I always hear a variety of misaligned answers about employee and customer satisfaction. This often reflects the lack of any survey data. It also shows that the executives aren't listening. The next step is to find better ways of measuring satisfaction. If the voluntary employee attrition rate is too low or too high, the company has a problem. The same applies to measures of customer churn and retention.

Improving employee satisfaction does not simply mean offering competitive pay and benefits (although these are important). Usually the employees' concerns involve questions like, "Do I know what my company stands for? Does my supervisor know my name? Does he or she care enough about me to know my personal situation? Does the company provide me with the tools and training to do my job? Do managers give me the opportunity to develop and grow?"

To build employee satisfaction, leadership must communicate a clear view of today (I like to do this by describing the company's current place among the five stages) and a compelling vision of the future. All employees need truthful and frequent information about the company's performance, what's happening in the external world, the nature of their own job, and the best ways to measure how well they are doing. They also need to know their supervisors, and the supervisors need to recognize every employee as a business partner — and as an individual human being. This creates an environment of trust, which gives the employee a reason to show up for work every day and help the company run well — thus avoiding the necessity of a turnaround.

**Driving Accountability**

When integrity is lacking at the core of any company's culture, serious problems ensue. So I always ask questions like this one: "Has the leadership set accountability guidelines and expectations for employees, and does it monitor performance?" Without measures that tell if a job is well done, or clear decision rights that outline specific ownership of a particular issue, it's hard to be personally accountable.

I also pay a lot of attention to observable behavior. Within 10 minutes of walking into a factory or a department, it is clear to me if there's an accountability problem. Do the employees make eye contact when you walk up to say hello? Do they know the name of the person who's running the factory or their department? If the answer is no, what are the odds that they have a clear view of their job and its impact on the customers?

Simple procedural questions can also highlight accountability problems. In one situation, on my first day on the job I asked my management team: "Can you describe your organization's structure and give me the names of your key people?" Silence. Only one of the top people had an organization chart for their area of responsibility. There were no job descriptions. There were no performance reviews.

Then I asked for a copy of their personal objectives. And they looked at the floor: "Uh, we don't have any personal objectives." There is no accountability in a culture where there are no objectives and there is no communication. In this case, it was obvious we were in Stage One: bleeding on all counts.

Once an executive team has gone through the three questions and we have gained an understanding of the company's position, it is time to create a targeted improvement plan, or blueprint, to focus everyone's energies. It typically fits on one piece of paper and clearly outlines the game plan in a form that can be shared openly with everyone. This is the first step toward turning around, and it provides a consistent means to communicate the company's vision to customers and employees. This blueprint includes:

**1. The company values:** behaviors that, once established, will ideally be in place forever.

**2. The vision and mission:** two simple, memorable sentences that describe, respectively, where we expect the company to be in five to 10 years, and in three to five years.

**3. A few strategic goals** to be achieved in the next couple of years.

**4. Specific actions** to achieve each of the strategic goals, with clear metrics and accountabilities.

In Japan, where I learned to do this, it is called *hoshin* planning. The effort doesn't stop with putting words on paper. Ongoing communication of the game plan with every employee and with customers and suppliers provides the guidance to take the climb from bleeding to stability to gradual improvement, and in the end, to rapid improvement.

In a turnaround, I create the one-page blueprint with input from across the company and deploy it to every employee through town meetings, facility visits, and update calls. Thanks to the blueprint, everyone at every level has a common view of the world. They all know what the company stands for, what we are going to do, and how each of them fits in.

But that's not what matters most. The company truly begins to turn around when the blueprint exists in the hearts and minds of the people. I have seen this sign of health emerge in the aftermath of a turnaround, when the company takes this diagnostic — the three vital questions — seriously. You need not wait for a turnaround, however: If you lay out the game plan when your company is performing well, then your travels through the business stages to rapid improvement may be so brief and mild that you'll never need someone like me to help pull you out of crisis. +

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