strategy+business

ISSUE 86 SPRING 2017

The Line between Confidence and Hubris

You can identify early signs of failure or success from a prospective CEO's behavior.

BY TIM LASETER

REPRINT 17107

pwc | strategy&

The Line between Confidence and Hubris

You can identify early signs of failure or success from a prospective CEO's behavior.

by Tim Laseter

It is rare for a week to pass without a newspaper or magazine offering a tale of the mistaken path of a fallen business executive, quoting critics who explain the errors that led to the failure. However, investors and boards of directors responsible for selecting a CEO don't have the luxury of hindsight. They should, ideally, identify any shortcomings in their prospective CEO before there is trouble, not after the fact. This is no easy task. Is there some predictable fatal flaw that distinguishes responsible risk taking from something reckless or even sinister?

One field of academic research suggests an answer: executive hubris. Hubris, defined as excessive self-confidence or pride, leads CEOs to make overly risky bets or to ignore relevant warning signs and fail to invoke contingency plans. The problem, of course, is that the difference between *justifiable* and *excessive* self-confidence generally becomes evident only after the damage is done.

Most incoming CEOs have pride and self-confidence well above normal levels, and with good reason. A typical CEO has an elite education and a decades-long track record of superior performance. More important, regardless of tenure or education, a CEO generally earns that title by gaining the trust of the experienced leaders and savvy investors on the company's board. The challenge for an investor, a board of directors, or an advisor to executives is to recognize when the CEO (and perhaps the whole management team) is about to cross a line — from making bold strategic bets with warranted assuredness, to risking the enterprise through reckless and dysfunctional overconfidence.

Four early signals can help in navigating these muddy waters. The first two, narcissism and dismissiveness, are warning signs of hubris. The other two, humility and inquisitiveness, are promising signs of justifiable confidence.

The Narcissism Warning Sign

Signs of narcissism offer the most critical indicator of hubris. In the classic Greek myth, Narcissus perished after becoming captivated by his own image reflected in water. Psychologists characterize a narcissist as someone with a grandiose view of his or her own talents and a craving for admiration. Narcissists exhibit these qualities to the point where they lose perspective and begin to make unreasonable, destructive decisions.

A narcissistic CEO becomes focused on his or her ego rather than the company's stakeholders. This trait is all too prevalent among executive leaders, as Arijit Chatterjee and Donald C. Hambrick of Penn State University showed in a wonderfully titled 2007 paper, "It's All about Me: Narcissistic Chief Executive Officers and Their Effects on Company Strategy and Performance." Their study of 111 CEOs in the computer industry found that those who demonstrated narcissistic traits tended to make more and larger acquisitions, which led to "extreme and fluctuating organizational performance."

A prime case study of the destructive impact of a narcissistic CEO features Joseph Nacchio, former CEO of Qwest Communications. Nacchio launched his business

Illustration by Lars Leetaru

career in the telecommunications industry through serendipity: At a career fair, he mistakenly ended up in an interview room for AT&T instead of Procter & Gamble. Starting as a young engineer in 1969, he advanced through the business ranks while also extending his education credentials by earning a master's degree in business from NYU and a Sloan Fellowship from MIT. In 1993 he became the youngest executive leading a major AT&T business unit: the struggling consumer long-distance business. While the unit continued to struggle, Nacchio's intelligent but highly competitive manner made him stand out. He gained the respect of colleagues, but he could also instill fear. In a 2005 *Denver Post* article, "A Look at Joe Nacchio," former fellow AT&T executive Dick Martin would later recall, "He can be very cutting in a meeting where he's in charge. He doesn't suffer fools easily."

Indeed, one of the earliest signs of narcissism that Nacchio displayed was a tendency to build himself up at the expense of his colleagues, going beyond the competitiveness one might expect from someone who was openly angling for the chief executive role. As a 2000 Forbes profile put it, he was known for having "sniped at [AT&T's] top executives, impugned their intelligence and even questioned their psychological stability." The same article quoted Nacchio asserting that he could have been "a powerful asset" to them as CEO.

But when it became clear in the mid-1990s that Nacchio wouldn't be chosen as CEO, he began looking elsewhere. He landed the chief executive position at Qwest in 1997, on the strength of a plan to turn this relatively small, Denver-based telecom company (US$697 million in 1997 revenues, compared with AT&T's $53 billion) into an industry leader. Launched just a decade earlier, in 1988, Qwest had originally been an offshoot of the Southern Pacific railroad line, installing fiber-optic cable for companies such as MCI along its rights of way. Qwest had grown by laying its own cables alongside those of its customers. Now, in the early years of the Internet, Nacchio proposed that Qwest could step out in front on the basis of its technological prowess.

The difference between *justifiable* and *excessive* self-confidence generally becomes evident only after the damage is done.

Upon accepting the CEO offer, Nacchio quickly developed a business plan — purportedly on the back of an envelope — for an IPO later that year. He was no longer held in check by a staid culture, as he had been at AT&T, and he articulated increasingly grandiose views when talking to journalists. In a 1998 *Wired* magazine article, "Building the Future-Proof Telco," he commented, "I feel like an emerging oil baron." A *Fortune* article published the same year, "Wild, Wild Qwest — The Gunslinger in Telecom," described Nacchio as a "modern-day Wyatt Earp" building a new form of telecommunications company. "People ask if we're telecom guys or Silicon Valley guys," Nacchio said in the opening paragraph. "I like to say we are a Silicon Valley company on the other side of the Rockies."

In 2000, Nacchio made a seemingly prescient and bold strategic bet — one that gained kudos at the time, but also indicated that his narcissism was growing. After rumors suggested that larger telephone companies were ready to acquire Qwest, he turned the tables by initiating a hostile takeover of US West. This $45.2 billion acquisition sent Qwest's stock reeling, but Nacchio remained confident. He could, after all, claim that his acquisitions had tripled Qwest's annual revenue, to $3.9 billion.

Yet by 2001 the company's growth had slowed and it had lost several major government contracts. Nacchio was facing criticism related to his compensation, which, according to the *New York Times*, included a $1.2 million base salary and an estimated $86 million in bonuses and stock options. In the May shareholder meeting, he was unrepentant, reportedly stating, "I know they are big numbers, but I'm neither apologizing for it nor am I embarrassed for it." When questions of accounting irregularities arose, he conceded nothing. "You all think we cheat and lie and steal, obviously," he told investors at a Goldman Sachs conference in October 2001. "Therefore, you trade us at a discount to what a normal company with great revenue and great growth should be traded. And I'm not going to convince you on that. We'll just let the numbers speak for themselves."

Despite his braggadocio, Nacchio had initiated a flurry of personal stock sales totaling more than $100 million from January through May 2001, when the stock hovered near $40 per share. When Nacchio resigned under board pressure in June 2002, the stock price had dropped to around $4 per share. In 2007, Nacchio was convicted on 19 of 42 counts of insider trading and sentenced to prison. The conviction also cost him more than $60 million in forfeited trading profits and fines. Furthermore, the company ended up paying $250 million in fines to the SEC to address the charge that it had booked billions in false revenues over several years.

Released from prison in 2013, Nacchio remains unrepentant and wealthy (prosecutors valued his net worth at $500 million at the time of his trial). He claims that the National Security Agency engineered his SEC conviction because Qwest wouldn't cooperate with the agency's surveillance programs. Even if his claim is correct, there is no question that his narcissism, and the way he expressed it, made it much more difficult for him, and his company, to navigate successfully through the turbulence that he in part created.

Dangers of Dismissiveness

A second sign among potential chief executives — dismissiveness — represents a subtler but equally important indicator of trouble. A dismissive executive is one who takes on unwarranted risk by ignoring input from others.

In-group bias, a concept credited to psychologist William Sumner, is often the root cause of dismissiveness. Although Sumner did not emphasize business, his assertion, made more than a century ago, sounds eerily descriptive of some corporate cultures: "Each group nourishes its own pride and vanity, boasts itself superior, exists in its own divinities, and looks with contempt on outsiders." Pride and confidence, when exhibited either in a group or in an individual, are not inherently problematic. But those attitudes can be destructive when they lead business executives to ignore competitive threats or conflicting opinions. A dismissive attitude suggests overconfidence and potentially an aversion to healthy debate.

A second sign among potential chief executives — dismissiveness — represents a subtler but equally important indicator of trouble.

The bankruptcy of the Schwinn bicycle company under the leadership of the fourth-generation CEO, Edward R. Schwinn Jr., offers a cautionary tale. Founded in 1895 by his great-grandfather, a German-born bicycle innovator, the Schwinn company became the dominant U.S. bicycle maker by the middle of the 20th century. One in every four bicycles sold in the United States was a Schwinn.

Schwinn's original success came through process and product innovation. Though there were hundreds of bicycle makers when the company patriarch, Ignaz Schwinn, teamed with Adolph Arnold, a fellow German immigrant and wealthy meat packer, the company wisely invested in mass production and nationwide distribution while competitors continued to distribute locally and build bicycles by hand. After a few decades in business, Schwinn stood as the preeminent brand for low-cost, functional transportation for children and adults alike.

But at its peak, Schwinn began to coast. It lost its focus on innovation and willingness to invest in manufacturing. For example, in the 1970s, innovators on the West Coast modified Schwinn cruisers with gearing from European-designed bikes to create a whole new category, the "mountain bike" (which they initially called a "klunker"). According to the book *No Hands: The Rise and Fall of the Schwinn Bicycle Company, an American Institution*, by Judith Crown and Glenn Coleman (Henry Holt, 1996), Ed Schwinn Jr.'s dismissiveness of three new ideas — automated factories, dirt bikes, and mountain bikes — prevented the company from meeting the challenges posed by its new competitors.

Some of those competitors actually came to Schwinn seeking alliances, and were swiftly rejected. Gary Fisher, cofounder of the Mountain Bikes company (now part of Trek) and one of the leading entrepreneurs of the new category, had built his original models as adaptations of Schwinn bicycles. But he told the *No Hands* authors that when he approached the Schwinn company, its executives belittled him as an "amateur" and asserted that "We know bikes.… We know better than anybody."

The air of superiority and dismissiveness had been inculcated by the increasingly weak leaders drawn from the Schwinn family. The book describes how Ed Schwinn Jr. actively suppressed debate during a meeting where a few senior executives pressed for change in the company after it had been tossed from its perch atop the domestic industry by a series of missteps. Schwinn interrupted the debate by saying, "Guys, this is not going in the direction that I wanted it to." He then ended the meeting. Within a week, the executive who had been most assertive in pushing for change had been asked to resign.

Schwinn's unwillingness to invest in manufacturing led the company to outsource to a modest Taiwanese supplier, Giant, founded in 1972. Over the next decade, Schwinn taught Giant how to make high-quality bikes. Giant then began producing bikes for some of Schwinn's competitors, including Trek, Colnago, and Scott. When Schwinn abandoned Giant for lower-cost Chinese suppliers in 1987, the now massive supplier began building its own brand. Today Giant makes more bicycles than any other producer in the world; it even sponsors one of the top Tour de France teams. Schwinn, on the other hand, filed for bankruptcy in 1992.

Executives are not expected to have a crystal ball, and it is fair to be skeptical of a new trend that could turn out to be a passing fad. But that skepticism should be considered reasonable only after CEOs have given unfamiliar information a fair hearing. The assertion that something or someone is unworthy of serious consideration, the very definition of dismissiveness, suggests a risk of hubris. Building a culture of superiority that dismisses contrarian opinions leaves a company ill-prepared to manage the inevitable dynamics of a global economy.

Humility as a Predictor

On the opposite end of the spectrum, positive signals in prospective CEOs can offer investors and board members great comfort. For example, visible signs of personal humility suggest that an executive will not fall victim to hubris.

Humility may seem rare among successful people and companies, but it is more prevalent among veteran executives than you might think. They know that it can offer a powerful counterpoint to narcissism and dismissiveness. Indeed, it takes great self-confidence to *not* use power and influence to force compliance, and to humbly expose one's opinions to open debate. Humble executives focus on the larger vision and a broad set of stakeholders rather than their own ego. They listen to others, consider multiple points of view, and do not assume their own opinions are infallible. To be sure, nurturing humility requires patience. It often takes time for a CEO to reflect on a decision rather than leaping to the expedient solutions and self-serving explanations so common in narcissistic or dismissive cultures. Here we can look to Honda for an example.

Humble executives focus on a broad set of stakeholders rather than their own ego.

Soichiro Honda's first successful business, Tokai Seiki, supplied piston rings to Toyota prior to World War II and was acquired by the carmaker in 1945. Over the ensuing years he established the Honda Motor Company, which morphed from a moped maker to a motorcycle manufacturer to a car company.

Soichiro Honda's implementation of an informal, unstructured management style established a culture that embodied his personal belief that success is 99 percent failure. This in itself exemplified humility. The lean manufacturing culture, so natural in Japanese companies, helped Honda establish a consensus-oriented culture that promoted greater humility.

Some might argue that this approach can lead to in-group bias. But as an observer and practitioner of the total quality and just-in-time revolution of the 1980s, I have seen firsthand how the humility embedded in lean management practices can systematically lead people to question and test their biases. Honda has practiced lean principles for decades and continues to follow the principles articulated by its founder: Proceed always with ambition and youthfulness; respect sound theory, develop fresh ideas, and make the most effective use of them; enjoy your work and always brighten your working atmosphere; strive constantly for a harmonious flow of work; be ever mindful of the value of research and endeavor.

My visit to Honda's Marysville,

Ohio, operations in the 1990s drove this home for me in a compelling way. Unlike other automotive companies I had visited over the years, Honda personified humility by disregarding hierarchy and pedigree. Although I had read about the egalitarian precepts of the Japanese "Theory Z" management style, I was mesmerized when I stepped into the Honda America headquarters. The building was made up of large spaces full of desks staffed with hundreds of white-collar workers wearing the same style of jumpsuits as the factory workers in the attached building. They symbolically identified themselves as one with the rest of the staff, decades before companies began moving to open-space architecture.

My interactions with senior managers reinforced the humble image: Rather than hard-charging MBAs or Ivy League graduates, headquarters was staffed by smart, down-to-earth managers with an industrious, Midwestern work ethic. Probed about the company's phenomenal success, they pointed to Honda's philosophy *sangen shugi*, loosely translated as "going to the spot." Soichiro Honda operationalized the concept in the U.S. through adherence to the "three realities" — actual place, actual part, and actual situation — as the foundation of problem solving. Honda managers would not sit behind a desk and bark out orders. Instead they went to the spot, be it their own manufacturing floor or that of their suppliers, to observe and collect hard data to find the root cause of a problem.

Successful executives rise through the ranks by understanding strategic challenges that are not evident to the average employee, but their lofty position also isolates them from critical frontline challenges. Humble executives listen to the front line and integrate that insight into strategy rather than pulling rank and assuming they know better than everyone else.

The best chief executives combine intellectual curiosity with a passionate pursuit of facts. They don't accept assertions.

The Power of Inquisitiveness

A culture of inquisitiveness is even more powerful than humility in reducing hubris. Inquisitiveness provides the greatest defense against risky business bets. The best chief executives lead with high confidence this way. They combine intellectual curiosity with a passionate pursuit of facts. They don't accept assertions but instead challenge their people to support recommendations with rigorous evidence. An inquisitive executive typically has a great gut instinct and strategic mind-set and treats all assumptions — including his or her own — as hypotheses to be tested rather than bold, strategic visions to be imposed. Inquisitive leaders can be inventive and they will make big bets, but only when they have built the organizational confidence that the opportunity is worth the risk.

In Silicon Valley, the "lean startup" movement has established inquisitiveness as a day-to-day practice, through a focus on releasing products rapidly, observing real-world customer response to them, and changing direction as needed. Eric Reis, who coined the term *lean startup*, found inspiration in a variety of places. One source was the work of Steve Blank, a venture investor, entrepreneur, and academic, who invested in a startup founded by Reis called IMVU. Reis integrated Blank's customer development methodology, which is based on in-depth inquiry, with his own experience of agile software development and appreciation of world-class manufacturers such as Honda and Toyota. The lean startup movement frames failure as a positive output of experimentation and encourages "pivoting" to a better path when a trial fails. Proponents do not apply a classic "batting average" mind-set, but instead measure progress by continually asking "what have we learned?" The aspiration to fail fast makes it hard to be narcissistic or dismissive, because there is always a great deal of evidence from real-world launches and trials, which makes it easier to temper your biases.

Although now well beyond the startup phase, Amazon also continues to display this inquisitive mind-set. In 1996, Jeff Bezos established the vision for Amazon to be the world's most customer-centric company, and to manage for the long term. Bezos reprints his original shareholder letter articulating that vision in every Amazon annual report. His 2016 letter offered a perspective on how to avoid hubris: "I believe we are the best place in the world to fail (we have plenty of practice!), and failure and invention are inseparable.… We all know that if you swing for the fences, you're going to strike out a lot, but you're also going to hit some home runs."

Bezos has surrounded himself with highly motivated, competitive individuals with justified self-confidence. Simultaneously, though, he created an organization relatively immune to hubris. His inquisitive nature translates to a desire to learn from others.

This was exhibited in a widely celebrated way with Amazon's acquisition of Zappos. Many analysts, myself included, assumed that Bezos bought the online shoe retailer with a plan to apply Amazon's unmatched expertise and scale in fulfillment operations to convert a marginally profitable business into a winner. Instead, Bezos publicly explained that the Zappos acquisition offered a learning opportunity because it shared the same customer obsession — but had a fundamentally different focus. Amazon sought to serve customers by offering the lowest possible prices whereas Zappos, under CEO Tony Hsieh, articulated a customer service passion for "delivering happiness." Now Amazon could learn from this.

An inquisitive nature leads to ongoing learning and offers the best defense to hubris. Inquisitive people and companies broadly and explicitly look for solutions to the problems no one has solved. They do not accept the status quo, nor do they waste time trying to convince others that they have all the answers.

Too many CEOs fall prey to a hubris built on short-term financial metrics.

Avoiding the Hubris Trap

Eliminating corporate hubris ultimately demands a culture that keeps confidence in check. Company leaders must not believe they are infallible, particularly when making "bet the farm" decisions. Truly innovative leaders don't assume they know how to handle every situation better than anyone else. Instead, they seek to learn by making small bets and constantly adjusting in response to the findings.

If you are a chief executive yourself (or an aspiring one), it may take some discipline to avoid the hubris trap. Don't spend your time reading articles praising your business acumen. Instead, study the reports of the short sellers who question your business strategy. As a member of a board of directors, hire outside consultants (or even academics) and charge them with the task of identifying the weaknesses in your business strategy. Find a way to challenge your assumptions.

Another preventive measure is to build diversity in your teams. Management teams with common backgrounds and perspectives can yield efficient decision making. But quick decisions made by groups with too much uniformity can filter out data that does not fit their theories and overlook alternatives worthy of consideration. Constrained by inherent and often hidden biases, they may simply lack the ability to think broadly about alternatives.

Finally, avoid fueling dreams tied purely to financial success rather than a fulfilling mission. Does the long-term plan emphasize goals such as achieving the top market capitalization in the industry rather than articulating the strategic rationale, such as taking the industry in a new direction? Too many CEOs and their boards fall prey to a hubris built on short-term financial metrics, ignoring the reality that stock market success often proves fleeting. Instead of following their example, you can build an organization that instills pride and enables you to execute your strategy with the right amount of confidence. +

Reprint No. 17107

Tim Laseter
timothy.laseter@pwc.com
is an advisor to executives for Strategy&, PwC's strategy consulting business. He is a managing director with PwC US, based in Arlington, Va.; a contributing editor of *strategy+business*; and a professor of practice at the University of Virginia's Darden School. He is the author or coauthor of four books, including *The Portable MBA* (Wiley, 2010).

This article draws upon unpublished research by a team of faculty at UVA's Darden School, including Yiorgos Allayannis, Sam Bodily, Ken Eades, Greg Fairchild, Luanne Lynch, Dan Murphy, Frank Warnock, and Tim Laseter.

The details about Joseph Nacchio come from the *Denver Post* (Dec. 23, 2005), the *New York Times* (June 17, 2002), *CNN Money* (June 17, 2002), Reuters (May 12, 2011), the *Washington Post* (Sept. 30, 2013), and NPR's *Marketwatch* (Apr. 3, 2014).

strategy+business magazine
is published by certain member firms
of the PwC network.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

- strategy-business.com
- facebook.com/strategybusiness
- linkedin.com/company/strategy-business
- twitter.com/stratandbiz

pwc | strategy&