Profit Can Be So Elusive

Is your company shedding senior executives like dandruff? Does the board’s compensation committee meet more often than its audit committee? Did it just pay a fortune to put its name on a ballpark?

If so, watch out: A meltdown may be under way. These are some of the warning signs identified by Sydney Finkelstein in his fascinating “Why Smart Executives Fail.” A management professor at Dartmouth, Mr. Finkelstein spent six years studying the question in his book’s title. He and his researchers investigated 51 companies in detail and an additional dozen briefly, interviewing 197 executives and others to figure out how such billion-dollar blunders as Motorolà’s Iridium satellite system or Quaker’s acquisition of Snapple could have occurred.

The result is a marvel—a jargon-free business book based on serious research that offers genuine insights with clarity and sometimes even wit.

Mr. Finkelstein begins by demolishing the myths usually associated with corporate failure: that chief executives are dumb or crooked or that they couldn’t have known what was coming. On the contrary, he found that most of the CEOs are intelligent, ethical and, in the case of failure, blind to the evidence all around them.

“One of the first things you realize,” writes Mr. Finkelstein, “is that many great corporate mistakes were due to managerial inaction as much as to inappropriate managerial action.” Motorola, for instance, failed to embrace digital cellular technology until its competitors had already rushed into the field. Schwinn derided mountain bikes, even though customers clamored for them.

Many of the failures had to do with mergers and acquisitions, whose promised synergies so often prove elusive. Big mergers in particular seem so prone to disaster—Mattel’s acquisition of Learning Company, AT&T’s purchase of NCR and, most recently, Time Warner’s sale of itself to America Online—that their persistence in the business world can only be explained by Samuel Johnson’s comment on second marriages: the triumph of hope over experience.

Mr. Finkelstein dissects such debacles with admirable brevity and uses them to buttress a set of insights. My favorite, among the lists he offers, is “The Seven Habits of Spectacularly Unsuccessful People.” No. 2: “They identify so completely with the company that there is no clear boundary between their personal interests and corporate interests.”

Mr. Finkelstein’s research suggests that disasters are most likely to occur when there is a self-involved or hubristic CEO, a culture that stifies dissent, a slack board and a record of such success that people in the company start believing their own PR. But there is more to the book than that, which is why it should be required reading not just for executives but for investors as well.