Good strategy makes good leaders

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What's the current state of leadership theory? Is there anything new? Corporate executives eagerly pay to have these questions answered, and business schools, book publishers and consulting firms indulge them with a flood of courses, advice books and training sessions intended to produce new leaders, or better leaders, or these days, entrepreneurs and innovators.[1] Ironically, leadership consultants often seem to know little about strategy.

Are educators and consultants simply reheating the same old cauldron of half-cooked theories? Periodically we scan the idea marketplace to identify any breakthroughs in the perennial quest for insights into the field of leadership – who are the leaders others should emulate, what's the evidence that their methods are best practice, how did the acclaimed exemplars get to be leaders and what can we learn from their stories? After reading several of the latest advice books, in my view the conclusion is clear: forget leadership – it's strategy that matters. Companies excel when they adopt good strategies and implement them efficiently. To promote effective, rapid strategic decision making, information and knowledge has to be dispersed throughout an organization, which means the role of the leader is diminishing, and that leadership has little utility as an organizing principle.

In our era of discontinuity and disruption, top-down leadership is passé, for power is distributed. The emerging horizontal approach to management is one response to the problems encountered by top-down bureaucracy in a rapidly changing world. Mature, hierarchical companies have a hard time enabling internal innovation or even successfully acquiring it. Because they adapt slowly and often stumble when attempting to acquire new competencies, they make tempting targets for disruption by new competitors.

Leaders may bridge the gap between managing evolutionary and revolutionary innovation by using some version of a dual operating system. For example, in the model laid out by John Kotter in his recent book *Accelerate*, the hierarchical side of the organization and a new networked organization function work together to nurture and accelerate important changes.[2] Projects that need innovation, agility, difficult change and big strategic initiatives are shifted to a network of committed workers. The keys to success include building a guiding coalition and recruiting a volunteer army of company talent.

Looking back – can leadership drive success?

It comforts us to identify leaders whose behavior we can emulate. But the merciless lens of time quickly vitiates the judgments of even the recent past. Take, for example, best-selling book author and consultant

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Jim Collins' 2003 candidates for the ten greatest CEOs of all time (talk about hyperbole!).[3] Here's his hall of fame: David Packard, Katharine Graham, William McKnight, David Maxwell, James Burke, Darwin Smith, George Merck, Sam Walton, Bill Allen and Charles Coffin. They are rarely cited as models for mastering today's challenges. They fade from memory or, like Shelley's Ozymandias, they fall from grace. New heroes appear as we compose business history to accommodate our current perspectives and value systems. Today's heroes are fighting different battles, contests that require new perspectives and new strategies.

The earlier classic attempt by Thomas J. Peters and Robert H. Waterman in 1982 to explain greatness is more plausible, although equally flawed. From a study of 43 successful US firms, the two McKinsey consultants tried to infer the eight cardinal principles of management.[4] The study is today ridiculed because a number of the "successful" companies, such as Wang, Digital Equipment and Texas Instruments, have since blundered badly or even gone out of business. Peters' and Waterman's *Excellence* seems to have a "sell-by" date.

Nor has time been supportive of Collins' *Built to Last* research.[5] The gap in profitability and stock returns between his outstanding firms and the rest of the pack dwindled to almost nothing in the period following the Collins study. And other studies show that firms having the lowest ratings in *Fortune's* "Most Admired Companies" did better over a twenty-year period than the most admired firms.

Stories of success and failure typically exaggerate the impact of leadership style and management practices on performance, as Professor Phil Rosenzweig confirms in his 2007 book *The Halo Effect*.[6] He observes "things we commonly claim drive company performance are simply attributions based on prior performance." Professor Nassim Nicholas Taleb, labels this the narrative fallacy, an unhealthy mental model informed by flawed stories of the past that shape our views of the world and our future expectations.[7]

We focus on the singularities – the few extraordinary successes – and ignore the many events that failed to happen. We all fall prey to this affective fallacy when we celebrate certain individuals for their style or panache – and then overweight their contribution to the success of their organizations.

Any conclusions we take about leading and leadership are constrained by dubious assumptions about cause and effect, our failure to differentiate causality from correlation. We ascribe leadership to an individual whose organization does well, a modern take on Thomas Carlyle's Great Man theory. A more plausible guide for practitioners and their biographers is the thesis put forward by German philosopher Georg Hegel: leaders emerge fortuitously at a particular time in the history of the firm as a result of the collective effort of the followers. Many so-called leaders are the beneficiaries of the zeitgeist of their time – they're lucky to be in the corner office when the forces of history conspire in their favor. Or in the language of strategic management they gain competitive advantage when the economic tide rises, when the exchange rate is favorable, when a competitor blunders, when customer decisions favor them.

The original Collins example list of success metrics does still apply. As he notes, good leaders leave a legacy, they demonstrate an impact on their industries, they have resilience and they generate good returns to the stakeholders over a significant time period. By this

last measure, we can extol Warren Buffett as a paragon of leadership – he recently celebrated his 50th year as CEO of Berkshire Hathaway. During his tenure, Berkshire Hathaway stock price rose at a compound annual rate of 21.6 percent, far exceeding the S&P average. Other long-serving CEOs include Leslie Wexner of L Brands, Alan Miller of Universal Health Services and Rupert Murdoch of 21st Century Fox who together have been at their helms a total of over 125 years. However, according to The Conference Board in 2014, the average tenure of CEOs in the S&P today is only 9.9 years, though it's up from 7.2 years in 2009. Based on such brief tenures, it should be increasingly apparent that a single leader has limited power over the performance of the firm.

What's new?

Expositions on leadership typically ascribe the success of high-performing firms to the organization's leader. Let's look realistically at recent attempts to show how some CEOs shaped the future of their firms.

Professors David B. Yoffie and Michael A. Cusumano in their new book, *Strategy Rules*, endeavor to explain the era-defining success of Apple, Microsoft and Intel after studying the companies for more than thirty years while teaching business strategy, innovation and entrepreneurship at Harvard and MIT.[8] They mercifully avoid the trap of labeling Steve Jobs, Bill Gates and Andy Grove as archetypical leaders. Indeed, they note that none was infallible, all made mistakes, and they were not paragons of the social skills of leadership. But they label all three as masters of strategy. According to the authors, these are the five guidelines for strategy formulation that characterized Jobs', Gates' and Grove's leadership practice:

1. Look forward, reason back.
2. Make big bets without betting the company.
3. Build platforms and ecosystems.
4. Exploit leverage and power.
5. Shape the organization around a personal anchor.

We can hardly challenge the merit of these commonsense adages, although it is their implementation that made the three leaders masters of their domains. Exemplary is Steve Jobs' "personal anchor," his instinct for customer-focused design. And imitators of these guidelines should beware the authors' caution: new leaders must "discover their own paths forward." They must contend with the realities of new technology, markets, competition and economic conditions. So a reader might ask, what new strategic initiatives is Microsoft capable of implementing?

New York Times financial editor Gretchen Morgenson illustrates this challenge with her case of the post-Gates Microsoft.[9] She reminds us that few companies successfully staged comebacks that restored them to former glory. The 1990s were the golden era for Microsoft, which recently passed the 40th anniversary of its founding. It's hard to believe that today's Microsoft, defanged by antitrust battles and strategic missteps, once ruled the industry. Microsoft's new CEO, Satya Nadella, faces the daunting challenges of overcoming frayed relationship with software developers, shaking off complacency and making some big bets on new technologies.

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Some observers maintain that the qualities of leaders, and their social skills, pay off in better performance. Organizational consultant Fred Kiel, for example, attempts to explain high performance by evaluating CEO character, a composite that includes integrity, responsibility, forgiveness and compassion.[10] In a study of executives in a variety of industries, his data show that firms run by CEOs who display character yield significantly better return on assets over a two-year period. This deduction is wonderfully appealing! But alas, Kiel's sample size is small, the time period of his study is narrow and the characterization of high character comes from employee surveys.

What really matters

We come back again to challenge a familiar hypothesis – great leaders create great companies. The evidence does not support this hypothesis, for over a short period of time, strategy and luck seem to matter more. And over a long period of time, all firms regress to the industry mean: good firms do worse, while the dogs of the Dow often do improve! Furthermore, few firms beat the odds regardless of their leadership. The average age of the corporation in the *Fortune* 500 is less than 40 years and getting shorter. And more than half of the firms expire before they reach the tender age of ten years. The distribution of corporate longevity obeys the classic Pareto Law: most die firms die young, and only a few survive to old age.[11]

Business writers tend to tell their stories from the perspective of corporate heroes and villains; these constructs pander to the reader's need for security, a reluctance to take responsibility for outcomes, a wish to escape from the freedom of choice. Nonetheless, regardless of our vacillation between hero worship and leadership vilification, the fact that corporations generally work and new ones appear means we do have effective leaders – men and women who lead, who practice strategic management. Anyone who has participated in effective corporate management has learned to respect such individuals who:

1. Engage their followers (and in today's climate, where power is distributed, they have little choice).
2. Exercise what portion of power they command in decisions about how to build competence within the organization.
3. Encourage new strategies to emerge as markets, competition and economic conditions change.
4. Practice their craft. There's no substitute for this; two-week or two-year executive programs do not create leaders.
5. Hire strong collaborators, and nurture talent at all levels.

Strategy is the key

We need to refocus our attention on strategy. Successful leadership ultimately comes down to good strategy and good fortune. We have little control over the vicissitudes of the

macro-environment, but firms that adopt the right strategy will do better over the long term. Leaders who endure must be good strategists.

For most leaders a strategy that is informed by a clear-eyed view of modern business conditions is the key to success. Fortunately we have no shortage of guidelines on how to formulate good strategy. They include the Michael Porter industrial organization model,[12] the RBV (resource-based view) proposed by Birger Wernerfelt and others,[13] and more recent refinements such as W. Chan Kim and Renée Mauborgne's blue ocean options.[14] Of course an exceptional strategist always recognizes opportunities that others do not see.[15]

Some of the most compelling recent evidence on the importance of strategy comes from the research by Michael Raynor and Mumtaz Ahmed.[16] From a database of over 25,000 companies they identified 344 "exceptional performers" – firms that realized above average return on assets over a sustained period of time. Their analysis, reported on in their book *The Three Rules*, found that only two strategic decisions mattered:

- Emphasize quality over low price (price competition can be effective only in the short term).
- Emphasize revenue generation over cost reduction (the advantages of higher revenue are more durable).

So the importance of strategy endures. Readers seeking a comprehensive overview of various perspectives should consult military historian Lawrence Freedman's recent overview, *Strategy, a History*.[17] Harvard professors Nitin Nohria and Rakesh Khurana provide a comprehensive overview of leadership thinking in their 2010 *Handbook of Leadership Theory and Practice*.[18]

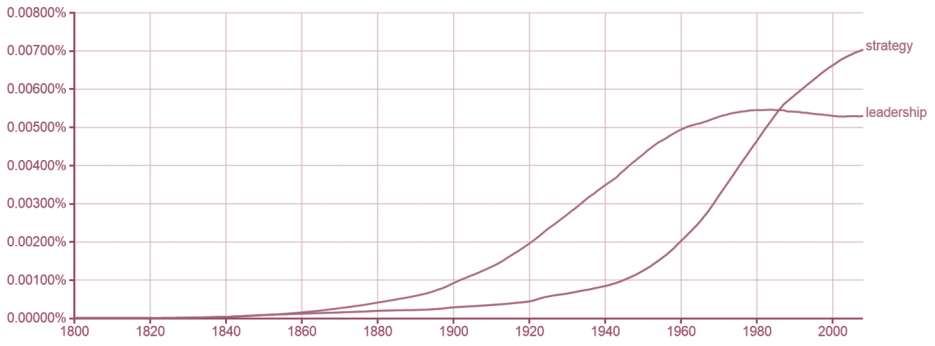
Perhaps the leader is only a mythic figure, a false idol, an abstract entity. One is reminded of Plato's theory of forms: his thesis is that some ideas, like beauty, virtue and goodness exist independently of whether or not examples of the form actually do exist. Accordingly, we modern observers may be like the prisoners in Plato's "Allegory of the Cave" who see shadows on the wall and imagine them to be reality. Although we can perceive only imperfect examples of leadership, we believe we know what it is.

The contemporary analog to the Platonic form is the meme. A meme is an idea, behavior, or style that spreads from person to person within a culture. A meme like "leadership" can act as a unit for carrying cultural ideas, symbols or practices from one mind to another through writing, speech, gestures, rituals or other imitable communications. Supporters of the concept regard memes as cultural analogues to genes in that they self-replicate, mutate and respond to social conditions. The leadership meme has many of these characteristics. Exhibit 1 illustrates how the leadership meme has spread virally over the past few years, although its vigor is beginning to diminish.[19] The strategy meme by comparison continues to flourish.

But can it be that even selecting the best strategy for today will not guarantee it will be an optimal strategy in a matter of months or a few brief years? Is the notion of a Master Strategist itself a myth? After all:

"Regardless of our vacillation between hero worship and leadership vilification, the fact that corporations generally work and new ones appear means we do have effective leaders – men and women who lead, who practice strategic management."

Exhibit 1 Citations: strategy versus leadership, 1800-2015



Source: Google: Ngram Viewer

- Managers today must cope with many variables – and game theory doesn't work under these conditions.
- More data simply creates more mist and fog.
- History is no guide. What worked for yesterday's manager is unlikely to work when the entire competitive and customer landscape has changed.
- The future is increasingly uncertain; natural laws do not determine the course of economic history.
- Managers – and their competitors – don't make rational decisions anyway – most act to maximize their own personal utility.

Furthermore, while developing a strategy is worthwhile, implementation, especially when it involves culture change, can be a minefield, as most practitioners will concede. The longer the sequence of planned moves, the greater the number of human agents who must act their scripted parts and perform according to their quota. The more ambitious the project, the more likely that something will go wrong.

The world of strategy is full of disappointment and frustration, of means not working, of ends not reached, of disenchanted teams. Still, in the long run it is strategy that makes the difference. Of course strategy is not about reaching a prior objective. Strategy emerges, and practical strategy is simply about moving quickly to the next stage.

So here's my advice for those who aspire to be identified as effective leaders:

1. Forget about learning to be a leader via best sellers and fad coaching.
2. Practice the art of strategy formulation, enlisting a wide range of talent to inform, test and innovate as you progress.
3. Concentrate on effective implementation, which can often overcome the deficiencies of a mediocre strategy. Good implementation demands that you inspire, build capacity to motivate and manage others, enhance the culture's decision-making capacity, and above all, learn and adapt as you proceed.[20]
4. Stay alert, nimble, and customer focused. Pray to the gods of capitalism. Hope that they will smile on you, that competitors will blunder and that no interloper will sweep in to disrupt the industry and gorge on your market share.

The bottom line: good leadership starts with good strategy.

Notes

1. These days we extol entrepreneurs and innovators as the paragons of corporate leaders. Hence the glory heaped on Mark Zuckerberg at Facebook, Jeff Bezos at Amazon, Reed Hastings and Marc Randolph at Netflix, Larry Page and Sergey Brin at Google.
2. John P. Kotter, *Accelerate: Building Strategic Agility for a Faster-Moving World*, Harvard Business Review Press, 2014.
3. Jim Collins, "The 10 greatest CEOs of all time," *Fortune*, July 21, 2003.
4. Thomas J. Peters and Robert H. Waterman, Jr, *In Search of Excellence*, Harper and Row, 1982.
5. Jim Collins, *Built to Last*, William Collins, 2001.
6. Philip Rosenzweig, *The Halo Effect,* Free Press, 2007.
7. Nassim Nicholas Taleb, *The Black Swan*, Random House, 2007.
8. David B. Yoffie and Michael A. Cusumano, *Strategy Rules*, HarperCollins, 2015.
9. Gretchen Morgenson, "Microsoft's far-out vision," *The New York Times*, May 3, 2015.
10. Fred Kiel, *Return on Character*, Harvard Business Review Press, Boston, MA, 2015.
11. The classic outlier is Kongo Gumi, a family-owned Japanese construction firm that endured for 1428 years until its liquidation in 2006.
12. Michael E. Porter, *Competitive Strategy*, Free Press, New York, 1980.
13. Birger Wernerfelt, "A resource-based view of the firm," *Strategic Management Journal*, Vol. 5 No. 2, 1984.
14. W. Chan Kim and Renée Mauborgne, *Blue Ocean Strategy*, Harvard Business School Press, 2005.
15. German philosopher Arthur Schopenhauer pointed out many years ago that a man of talent hits a target that no one else can hit; a man of genius hits a target that no one else can see.
16. Michael Raynor and Mumtaz Ahmed, *The Three Rules: How Exceptional Companies Think*, Portfolio/Penguin, 2013.
17. Lawrence Freedman, *Strategy, a History*, Oxford University Press, 2013.
18. Nitin Nohria and Rakesh Khurana, *Handbook of Leadership Theory and Practice*, Harvard Business Press, 2010.
19. The term leader first appears in the English language in about 1300 AD, according to the OED; earlier societies no doubt had synonyms such as tribal chief or sachem. The term leadership does not appear until 1821. But like all memes, it gestates for a considerable time until it is adopted and grows. The Google Ngram analysis would fix the adoption date at approximately 1900. Citations in the literature before this date are minimal, but after 1900 we see an exponential increase in the use of the term.
20. Michael K. Allio, A short, practical guide to implementing strategy, *Journal of Business Strategy*, Vol. 26 No. 4, 2005.

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