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Why Successful Companies Usually Fail

The dynamics of corporate collapse are caused by three phenomena.

The annals of business history are replete with the names of once great companies that dominated an industry, only to lose pre-eminence and become shadows of their former selves or even disappear. Understanding why powerful companies fail and how to avoid such failure is one of the holy grails of business and management research, not to mention having spawned an enormous and lucrative consulting industry.

Yet, the very fact that successful companies continue to fail is testament to an incomplete understanding of the drivers of corporate demise. Some argue that strategic outcomes and ultimately a firm's future are determined by the choices, commitments and actions of top management. In this logic, stellar performance is linked to incumbent CEOs (think Jack Welch at GE, Lou Gerstner at IBM, Alan Mulally at Ford or Andy Grove at Intel) as is poor performance, even if the leader has only been in office for a short time (like Ellen Kullman at DuPont, Fritz Henderson at GM, Christopher Galvin at Motorola or Jorgen Centerman at ABB).

Another school of thought puts the emphasis of corporate demise on an organisation's structures, processes and business models which foster rigidity and so make adaptation and change extremely difficult, if not impossible. And finally, proponents of Schumpeterian creative destruction attribute corporate decline to a firm's inability to adapt to a radically changing external environment – which has become all too apparent across a range of industries from bricks-and-mortar retail to publishing and communications in the face of technological disruption.

While all three of these arguments are compelling, none alone is sufficient in explaining why and how companies fail – this calls for a more holistic view of a company over its lifecycle. We have been very fortunate and privileged to have such a perspective with over 20 years of research at Nokia Mobile Phones; a business that shaped an industry it came to dominate with one of the strongest brands in the world, only to all but disappear in a fire sale to Microsoft.

"Ringtone: Exploring the Rise and Fall of Nokia in Mobile Phones", our recent book which won the 2018 Academy of Management's prestigious Terry Book Award, charts and analyses Nokia's journey. But our findings are relevant far beyond the realms of Nokia's experience in attempting to explain why successful companies fail. We found that what leads a company down a competitive dead-end is a combination of management volition, organisation adaptation and industry evolution, with each playing a more or less prominent role over time, and the interdependencies between them becoming lethal.

Management choices

Management choices obviously contribute to a company's decline, but it isn't just the decisions of the incumbent management team that play a role. The seeds of strategic stasis are usually sown by management choices made a decade or so earlier. It is these decisions that lead to the heuristics, creeping commitments and hubris that create a context in which future action is taken.

Strong heuristics, particularly from the unconscious or unintended learning a company experiences as it grows and overcomes crisis situations, become implicit 'principles' in decision-making. So, for example, in its early days, having invested huge sums in technology development, Polaroid found there was a very limited market for its expensive instant cameras and certainly not one large enough to sustain the company. In the face of this crisis, Polaroid adopted a film-first, 'razor blade' model whereby it sold cameras at cost but made a huge margin (around 70 percent) on the film for its cameras. This simple heuristic, that only film makes money, became entrenched and shaped future management decisions for the next 30 years. Even though Polaroid recognised the need to invest in digital technologies as early as 1985, successive management teams framed the challenge too narrowly in terms of 'printing' digital images rather than producing affordable cameras to capture images (as Japanese competitors Sony and Canon were doing). After numerous CEOs, restructurings and 'new strategic directions', Polaroid filed for bankruptcy.

Poor and inadequate cognitive framing can also result from 'creeping commitments' – past decisions to which a company becomes hostage and which sets them on a direction from which it is difficult to deviate. Here, Nokia's Symbian operating system provides a good example. Initially adopted by a consortium of mobile phone producers in 1998 in a bid to stave off the threat of Microsoft entering the industry, over time Nokia's commitment to and continued investment in this device-centric operating system had a profoundly negative impact on its ability to adapt to a platform and ecosystem approach.

Success tends to breed hubris and this, in combination with the voracious appetites of certain classes of shareholder, can lead to managers focusing on the operational issues which will drive greater efficiency for the benefit of short-term results and not long-term sustainability and growth. This is what happened at IBM under the leadership of Sam Palmisano, who was so focused on doubling shareholder returns every five years he failed to see, or acknowledge, that the competitive environment was changing. With no response to this shift, IBM was in serious trouble – although this wouldn't become apparent to the outside world until a few years later.

Organisation adaptation

Management choices lead to the implementation of structures, processes and business models which if left unchallenged can result in dysfunctional rigidity and become a formidable constraint to much needed adaptation further down the line.

At IBM, it wasn't long after Ginni Rometty succeeded Palmisano as CEO that the depth of problems began to show. Fewer corporate customers were buying hardware in favour of cloud solutions and 'software as a service' (SaaS) and this had a significant impact on the firm's performance. Yet IBM was trapped in a highly integrated, symbiotic business model in which hardware sales were tied to both high margin software sales and the proliferation of IBM consultants to install and maintain this. For years, this business model had stifled growth initiatives and made change extremely difficult. After brave choices and a long, difficult and painful reorganisation, IBM is finally beginning to re-emerge to fight in a new competitive environment.

Organisation structures can prove just as big an impediment to much needed change as out-of-date business models. Both ABB and Nokia found themselves mired in infighting and intense internal competition due to matrix structures which proved difficult (and ultimately impossible) to manage as different groups with vested interests sought to protect their corners. In this scenario, under performance pressure, misinformation from business groups tends to filter upwards giving senior management a false impression of how a company is faring. Combined with a lack of internal collaboration that prevents people from 'connecting the dots' which point to changes in the external environment, it becomes clear how structure can play a large part in pushing a company towards failure.

Changing environment

When the very nature of an industry changes, this is bound to result in casualties and successful incumbent companies are perhaps the most vulnerable as they are more likely to be locked into a co-evolution with existing partners, suppliers and major customers when it comes to a vision for the future. In addition, both management choices and the level of organisational adaptation will make it more or less difficult for a firm to step out of its current business model and recognise the environment around them is radically changing.

Neither the board nor the management of Kodak understood how fast the environment was changing from film to digital photography, and so management choices fatally reinforced the importance of the core film business. With the support of IBM's board, Palmisano was so focused on increasing shareholder returns that he failed to see the locus of competition was shifting to the cloud and on-demand. And Nokia was so locked into its product-centric view of the industry, its management couldn't conceive of the platform-based future Apple and Google were creating.

Weathering the storm

While external shifts in the nature of an industry clearly play an end-stage role corporate failure, it's the interdependencies between these changes, management choices past and present, and the structures and business models a firm has adopted which ultimately determine whether a company has the ability to ride that change or be brought down by it. It is only companies that have made bad management decisions and have poor organisation structures and business models that succumb to the external forces of change.

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