CHAPTER 1

What Were They Thinking?

Avoiding Common Management Mistakes

LEADERS OF COMPANIES and, for that matter, nonprofits and government agencies and departments face a number of challenges. First of all, in confronting high-stakes situations with substantial economic consequences, senior executives need to make numerous decisions about how to hire and obtain the discretionary effort of employees, how to compete, how to lead, how to deal with various external constituencies and policy issues, how to best manage their own careers—basically, to figure out "what works" and what to do about a number of important issues. Second, today's managers often need guidance and advice in figuring out what to do but can't—or won't—spend lots of time reading long treatises on each of these topic domains. And third, if and when companies follow prevailing conventional wisdom, they often discover, if they are attentive, that much of that conventional wisdom is wrong or misleading.

Beginning in January 2003, I have written monthly columns for *Business 2.0*, a Time Warner business magazine, that appear in the "What Works" section. The columns have covered a broad range of issues, but have mostly focused on common mistakes I see in how companies manage their people and their business, and also on how to do things better. The columns cover many of the important topics and decisions—like those just described—confronting organizations of all types. The columns are only about 650 words long—a single page. That very tight word limit has precluded me from developing arguments and explanations as thoroughly as might be most helpful, putting in as much data as I would like, providing more examples and context, and, most importantly, having the space to explain not only "what works" but "why it works"—the logic behind the analysis.

Thus, the genesis of this book. I have taken some of those columns, combined some others, and in each instance have redone and expanded the arguments, examples, data, and logic to provide a concise yet comprehensive discussion of what I consider to be a number of the most important management issues and management miscues and triumphs. Because the chapters are each only a few pages, the reader doesn't have to commit to becoming an "expert" on a particular subject. To provide additional help to people facing the challenge of making important decisions in a welter of conflicting and often incorrect information, the chapters include some endnotes and ideas and data so that for anyone who wants to, it is possible to pursue each topic in further detail.

The chapters are designed to provoke reflection and thought. My objective is, as it is in most of my activities, to "educate" the reader. Education, as I have come to understand it during more than three decades as a business school professor, is not telling people things they already know nor providing them with ideas that they necessarily already agree with. Education is concerned with helping people see and understand things in different ways, getting them to question previously unquestioned assumptions and ideas, and mostly helping them think and ask questions to uncover some fundamental insights.

Although the chapters cover a wide range of management topics, as I wrote this book I discovered that common ideas appeared in many of the examples. So, to help the reader see what the various discussions of management topics have in common, let's consider the threads that run through most, if not all, of the discussions.

Common Themes

Almost every day, sometimes many times a day, I read an article about some organization or see a company or its leaders in action and exclaim, "What were they thinking?" It frequently seems as if organizational management is something drawn from a *Dilbert* cartoon, except with serious consequences for both the companies and their employees. But organizational leaders are hardworking, serious people, often expending enormous amounts of time and effort trying to do a good job. The problem is not one of intelligence or effort. Why do so many companies and their managers do so many things that seem so incorrect? In the spirit of the quality movement that has taught us to look for the root cause of problems so they can be fixed at the source, it is important to see what mind-sets and behaviors underlie many of the difficulties organizations face.

There seem to be three themes that unify many of the ideas in the chapters that follow and that help explain how companies make poor choices: (1) the importance of considering feedback effects—the idea that actions often have unintended consequences; (2) the naive, overly simplistic, almost mechanical models of people and organizations that seem to dominate both discourse and practice; and (3) the tendency to overcomplicate what are often reasonably straightforward choices and insights. By considering these ideas and their implications, I believe it is possible to, in many situations, come to a better understanding of what to do and make sounder judgments.

Feedback Effects

Actions have consequences. Decisions have repercussions. When companies do things to people, those people react. In too many situations, problems arise when we don't think through the likely consequences, repercussions, and reactions. There are literally scores of examples in the chapters that follow and in daily life. Here are a few.

When many companies get into financial difficulties, the first thing they do is cut wages and benefits. Cutting labor costs by cutting the expense of employees ought to help the financial condition of the organization. But things often don't work out quite as planned, and the reasons for this can be anticipated.

When I teach executives, I sometimes run the following little thought experiment. I will go up to one and say, "Assume that you work in my company and that you are who you are—a competent, experienced, hardworking, intelligent individual, doing your best to do your job as you think you should. Now I come to you and say, 'Our organization has fallen on hard times—which, by the way, may be because of strategic mistakes you had no part in making—and in order to restore profitability and financial viability, we need to cut salaries and other employee expenses such as benefits, by about 25 percent.' How do you feel about this, and what are you going to do in response?" I have never once had an executive respond by thanking me for making the tough decisions required to keep the organization economically viable. Instead, I typically get one of two responses. The first, often communicated with a reasonable amount of anger and emotion, is that the person is immediately going to look for another job and leave. The second response, if I add that general conditions of the job market preclude such a move, is that he is going to withhold effort and ideas, cut back on what he does, and maybe even find ways of getting back at management by intentionally messing things up.

Note what cutting salaries does beyond the immediate benefits of reducing the wage expense. First, it drives people to leave. And who is most likely to be able to find another job? Usually, the best people—those who have the most skills, experience, and the highest levels of performance. As the best people leave, turning the company around becomes more difficult, because turnarounds require insight and skill, and both are being lost. Second, cutting salaries creates a desire on the part of those who remain to passively (by slacking) or even actively (by sabotaging) harm the company. Such actions, or inactions, obviously make organizational performance worse and improvement in results more difficult to achieve. As a consequence, companies frequently find themselves in a pernicious race to the bottom, to see whether or not they can cut costs faster than the unintended consequences of those cost cuts reduce subsequent organizational performance.

Or take another example. As I was writing this book, the Tribune Company fired the publisher of the *Los Angeles Times* for the audacity of refusing an order to sack a quarter or more of the newspaper's newsroom staff. Many newspaper companies seem to have an interesting take on competitive dynamics in the media business and the source of their success. Facing increased competition from alternative news sources, including television and the Internet, their typical response is to cut reporting costs and other editorial expenses. Having cut the number of people who gather and write the news, the companies still have to fill their pages. So, their actions leave them filling up their newspapers with items from standard sources such as news services that can be accessed online or articles from other newspapers.

Consider the *San Francisco Chronicle*, owned by the Hearst Corporation. A high fraction of the articles in the first two news sections of the typical Sunday paper (and many of the daily papers as well) comes from the *New York Times*. This raises the question of why one would buy a paper whose quality and uniqueness is declining because of inadequate investment in staff; why not just buy the paper from which the *Chronicle* gets a lot of its stories and which has invested in its own, unique news gathering and reporting? The point is that the more newspapers cut their quality, the less incentive there is for anyone to subscribe. So subscriptions fall, more cuts are made, and the death spiral continues, if not accelerates. The only thing that can possibly provide competitive advantage in a saturated media marketplace is the quality of the writing and the ideas. An undifferentiated, unoriginal product of low quality is not going to save any company in the newspaper, or for that matter any other, industry.

There are ways to consider feedback effects and their likely results before taking actions. Some sophisticated analytical methods entail building formal models; for instance, as is done in the MIT systems dynamics lab by people such as Nelson Repenning and John Sterman. But it doesn't require formal modeling or scenario analysis to spend some time thinking about the likely consequences of interventions and taking those reactions into account as companies plan what they should do.

A More Nuanced View of What Motivates People and Makes Organizations Successful

The second thing that seems to get companies into trouble is holding and therefore acting on naive, simplistic, and inaccurate theories of human behavior and organizational performance. Again, there are many examples in this book and even more in the world.

The prevailing view that seems to form the foundation for many interventions is almost mechanical—if you want employees to do something, they need either positive inducements, or threats or punishments, or some combination of these inducements. In the absence of some external force, it seems to be assumed that people would be inert, just like objects in Newtonian physics where a body at rest will remain at rest unless impelled by some force into motion.

But we know this view of human behavior isn't true and that incentives and punishments have numerous problems. The use of monetary incentives can decrease or undermine intrinsic motivation, as extrinsic incentives provide a way for people to make sense of doing something without their having to believe that they like it. The attempt to control people's behavior through rewards and sanctions can engender psychological reactance, a process in which people rebel against constraints on their behavior—and are driven to do the very things they have been constrained from doing. Incentives are often very blunt forms of intervention, so we sometimes get the behavior we have rewarded only to discover we didn't really want it. For example, school systems that reward teachers for improving student test scores have sometimes found that the improvement was achieved by various forms of cheating.

Our view of organizational success and where it comes from is also often equally simplistic. We venerate the lowest-cost organizations. We admire the largest firms. But in many industries, success goes to the companies that offer the best value proposition, not necessarily those with the lowest costs. For instance, in the grocery store industry, Whole Foods Market is more profitable than its competitors even though many aspects of its business model raise its costs. But people will pay more for food they actually want to eat. Similarly, in many industries the most profitable firms are not the largest. Toyota is only now on the verge of overtaking General Motors in sales, but it has been much more profitable for a while. Southwest Airlines has been consistently profitable but it is not the largest airline. And so it goes.

If companies act on the basis of simplistic and inaccurate theories of human behavior and organizational performance, their decisions will not be good ones and the results will be poor.

Companies that are serious about overcoming this problem can spend more time getting informed about the facts, about history, and about alternative theories of behavior. Yes, this requires an investment of time and effort. But some forethought and learning can prevent some expensive errors.

Sometimes the Right Answer Is Obvious

The third problem that seems to get companies into trouble is making things overly complicated. This may seem to be inconsistent with the preceding issue, but it isn't. The fact is that human and organizational behavior is often quite comprehensible and readily understood, but not by using many of the more conventional and well-accepted perspectives.

For instance, the norm of reciprocity is both a simple and powerful idea. It is simple because it means just that favors will be reciprocated and so, probably, will harmful actions. People try to keep their interactions with others in a sort of balance, and don't want to do things for others when those efforts will never be repaid. People are unlikely to be friendly toward those who are unfriendly toward them. The idea is powerful because reciprocity is virtually a universal human norm, found in essentially every society that has ever been examined.

Now consider how the norm of reciprocity might help companies make decisions about managing people. If a company provides training and thereby makes an investment in its people, those people will be motivated to reciprocate through loyalty and effort. If companies provide wages and benefits that are perceived as generous, as being more than what would be required by the market—what economists such as George Ackerloff call efficiency wages—people will be likely to reciprocate for this generosity through increased discretionary effort and enhanced attachment to those companies. And vice versa. Cutting training and cutting the deal offered to employees is likely to induce reciprocal diminished effort and loyalty on the part of those who see the exchange as unbalanced.

The message in these chapters is that we ought to think before we act, taking into account feedback effects and using the insights of not only the large body of evidence on behavior but our own common sense and observations. It turns out both common sense and careful thought are in short supply. But that means there are great opportunities for those people and organizations willing to spend the effort to get beyond conventional management wisdom.

A "User's Manual" for This Book

Many business books today have lots of pages to describe one idea. My objective has been to have lots of ideas per page, and a lot of different topics and insights collected for you in one place. Consequently, there is a very simple but important way for you to use this book. Decide what topic you are currently interested in learning more about, what are the most important decisions you face. Are you deciding about your benefits policies and thinking about reducing benefits to cut costs or off-loading a lot of the responsibility and decisions to your employees? Are you in the process of hiring someone and thinking about how to use background information to make that decision? Are you faced with the challenge of influencing others, and do you need to become even more effective at doing so? Are you wondering about all this emphasis on "maximizing shareholder value" and if stock price really is a good measure of company or management performance? Do you feel as if the budgeting process is keeping you and your colleagues from making sound business decisions? Or even if you are not an organizational leader, do you want to better understand how to think about some business issue in your role as an employee or a customer of a particular company?

This book covers a lot of topics, so begin by thinking about what you are most interested in at the moment.

Then, use the chapter titles and section headings to find the pieces that appear to be most relevant to your current problems or interests. Look at those chapters. Think about the arguments, ideas, and data. And then, better educated about the issues and maybe a little more insightful about how to think about them, go about doing your job better informed and stimulated to think differently about management topics. This book is *not* intended to be read in any particular order, or from cover to cover. You should follow your own interests in navigating the material.

This book is a collection of management insights and data designed to help you do your job more effectively, whether that job is leading a company; working in it; or being a better-informed observer of organizations, what they do, and how they might do it even better. But you should also know at the outset that the chapters aren't going to tell you specifically what you ought to do. Each person's company and circumstances are too different for these chapters to offer advice about what particular actions to take. My presumption is that the readers of this book are like most of the managers and employees I have encountered over the years—serious, hardworking, intelligent individuals who are well grounded in the particular circumstances of their company and industry and career. This book can help by providing some unconventional insights into common management topics and problems. And just maybe by doing so, the chapters can help you think differently and more clearly. That increased insight, coupled with your own experience and judgment, can make both you and your organization more effective.