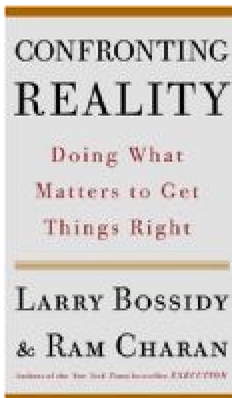
Larry Bossidy & Ram Charan, “Confronting Reality, Doing What Matters to Get Things Right”



From Publishers Weekly
On the heels of their business bestseller *Execution*, retired Honeywell chairman and CEO Bossidy and corporate guru Charan take a step back and focus on the more fundamental issue of figuring out what to execute in the first place. The message is simple ("relentless realism"), and their solution is a return to the "ancient analytical tool" of a three-part business model that includes external realities (such as customer demand and industry conditions), financial targets (such as cash flow and revenue growth) and internal realities (such as operational and workforce capabilities). Bossidy and Charan use that model to analyze how companies such as EMC, Cisco and Sun reacted to the meltdown of the high-tech sector, and how Home Depot built efficiency, 3M reignited growth through innovation and Thomson Corp. restructured its focus. The book loses steam in the final quarter, getting repetitious but still managing to make a few familiar points feel fresh, some as simple as developing one's own "business savvy" and "need to know." The authors use the same winning formula as in their first book. The concepts are basic, the tone is conversational and the content is not unique, but sales of the previous book (600,000 in the U.S.; 1.5 million worldwide) and the authors' personal platforms virtually guarantee widespread attention in the business media and corporate sales.
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From the Inside Flap
Confronting Reality will change the way you think about and run your business. It is the first book that shows how to connect the big picture of the new era of business with the nitty-gritty of what to do about it. Through a completely new way to understand and use the business model as the primary tool for confronting reality—a breakthrough that will become the management innovation of this decade—you’ll know sooner rather than later whether your fundamental business premise is under assault, where your best opportunities lie, what you should change and what you should leave alone, and how to realistically plan the future of your business.

The fundamentals of how a business makes money are being rapidly and permanently altered by sweeping structural changes. With their extraordinary depth and breadth of experience, Larry Bossidy and Ram Charan are the ideal guides for everyone—entrepreneur, mid-level manager, or CEO—about what is to be done so you can get things right in this challenging, radically changed world. They start by showing you how to understand the most fundamental element of any business: whether you can realistically make the money you hope to in the game you’re playing.

Bossidy and Charan show how to use the business model to develop a robust, reality-based process for thinking about the speci?cs of your business in a holistic way. They

show how to tie together the financial targets you must meet, the external realities you face, and internal activities such as strategy development, operating tactics, and selection and development of people.

Through the lens of the business model, as well as the skillful use of initiatives and development of people with the right leadership characteristics, you'll see how Robert Nardelli at Home Depot, Jim McNerney at 3M, Dick Harrington at the Thomson Corporation, Michael Wisbrun at KLM, Joseph Tucci at EMC, and John Chambers at Cisco confronted reality. Whether they faced crisis or opportunity, all made the right kinds of changes through a combination of business savvy (the art of understanding the fundamentals driving a business) and business model thinking.

About the Author

LARRY BOSSIDY is the retired chairman of the board and CEO of Honeywell International, a global $24 billion advanced technology, controls, and manufacturing company. He began his career at General Electric, where he served in a number of executive and financial positions, including COO of GE Capital, executive vice president and president of GE's Services and Materials Sector, and vice chairman and executive officer. In 1991 Mr. Bossidy joined AlliedSignal Inc. as chairman and CEO and merged the company with Honeywell in 1999.

RAM CHARAN is a highly acclaimed business advisor, speaker, and author, well known for his practical, real-world perspective. He was a Baker Scholar at Harvard Business School where he earned his MBA degree with Distinction, as well as his DBA. Dr. Charan is also the author of **What the CEO Wants You to Know**, **Profitable Growth Is Everyone's Business**, **The Leadership Pipeline**, and **Boards at Work**. His articles have appeared in Fortune and Harvard
Business Review.

Excerpt

CHAPTER 1

When Reality Bites: The Stories of John P. and Lou G.

The most widespread unrealistic behavior when the game changes drastically is to violate the First Law of Holes (when you're in one, stop digging). People redouble their efforts to do what they know best. They often achieve heroic results-which are, alas, almost as often pointless, because they fail to confront the new realities.

For example, many managers facing competition from abroad are still fighting yesterday's war. That's the one the Japanese started with their efficient manufacturing processes. Today even the Japanese can't win it. Doubling your productivity is a wonderful accomplishment, but it does not confront reality because it won't save you when your competitors have global supply chains with costs that are a small fraction of what you can hope to achieve in your home country. Services are now in the equation too. Customer support, back-office operations, product development, and even some

segments of R&D can be as outsourceable as factories.

Consider John P., a business unit leader we know. In mid-2003, John and his top managers were preparing the 2004 strategic plan for their $500 million division, which made protective coatings for a highly specialized industrial market. John had run the division superbly for more than five years, and was considered a candidate for senior leadership of the parent company. He knew operations, and had good relationships with his customers.

Recently those customers had been telling him that their sales were down because of competition from abroad. They allowed that John's products were the best on the market, but they were under tremendous pressure to reduce their costs, and they expected all their suppliers to do the same. John took their message seriously, and told his people what he'd heard.

John's team agreed they could do a number of things to cut costs. They worked out a plan to close one of their four U.S. plants, consolidate three European plants into two, tighten other expenses wherever they could, and increase R&D spending to further distance their product from the competition's. Based on past experience and on what everyone present at the meeting knew, the plan looked realistic.

Then the new CFO spoke up. He'd joined the company only recently and was seeing the issue from a broader perspective. "From my point of view, you appear to be heading down the wrong track," he said. "Your recommendations would be good if the problem was our traditional domestic competition. They might satisfy the customers in the short term. But I know for a fact that two of those customers have already started moving to China. The others will undoubtedly be doing the same soon. Don't they expect us to reduce our costs just as significantly? Closing a U.S. plant, consolidating in Europe, and cutting costs by a few percentage points won't do that."

John looked around the room and noted that the other members of his team seemed just as uncomfortable as he felt. "I'm not sure what to do," the CFO continued, "but I urge you to consider the pros and cons of moving the whole operation to China or licensing our technology to a China-based supplier."

John knew that lots of businesses were outsourcing to China these days. Still, the idea stunned him. It just didn't make sense for this company.

"Mike," he said to the CFO. "This is not something we need to do-or even necessarily can do. You surely know that a lot of our differentiation comes from the application process. That's all about proprietary techniques and human experience. How could anybody duplicate that elsewhere?

"But let's suppose we did move production to China. We'd have to take a huge write-off on our plant here. The unions would raise hell. Morale in the whole division would be hurt. And while you can't necessarily take this to the bank, we'd get a huge black eye in

the community. I've been part of this town for years. I'm on the school board and coach in the Little League. I don't know how I could look my friends and neighbors in the face if we did this.

"We can cut our costs significantly with our plan. Maybe they won't be as low as they would be in China. But we're the leader in this technology, and that's got to be worth a premium to our customers."

"You could do all the things you plan to do, but they're probably not enough," said the CFO. "Our differentiation is real enough, but frankly it's not worth it to people who can save a lot of money from another supplier. Besides, our customers will expect us to be located in close proximity to their operations. If you don't make the move, they'll sooner or later find somebody who will."

In the quiet that followed, John thought back to something one of his customers had said a few weeks before. Talking about his costs, the customer had remarked almost casually that he'd reduced a big chunk of them by dropping a longstanding component supplier in favor of one based in China. Could that have been a hint John didn't want to hear? In light of what Mike was saying, it sure looked like one now.

As he pondered, he gazed out the window. The first shift was leaving the plant for the day. He saw the faces of people he knew-guys and gals he'd talked to on the plant floor. They were as dedicated a bunch of workers as you could find anywhere in the world. Many of their kids went to the same school as his kids.

Life really isn't fair, John thought to himself. Nobody should have to make decisions like this. Finally he turned back to the CFO and looked at him bleakly. "Okay," he said. "I hate the idea, but you've convinced me that we'll have to do this at some point. But our current plan will buy us enough time to do that in an orderly fashion-won't it?"

The CFO responded sympathetically but firmly. "Let me rephrase my thoughts," he said. "You're looking at the world from the American Midwest, and you're looking at it as you've seen it for your whole life.

"These days, later is a lot closer to sooner than it used to be. There's big change going on, and it's happening fast because the global economy has gone real-time. It's not cyclical change. It's structural change, and it means total change in how this business will make money in the future. By the way, your customer is also probably going through similar structural change. And it begins with one simple fact in this case: You've got to have global cost parity, meaning that you cannot be out of line with the lowest-cost source, no matter how fine your product may be.

"Now, you can't just pick up and relocate to China overnight. You've got to integrate vertically, which means not only getting a plant built but getting acclimated to the new environment, selecting suppliers, and picking and training the right people. This requires a knowledge of China, and nobody in this company has it. If you do bite the bullet,

you've got a lot of work to do before you even start to build an operation there."

Within a week, John's team had a new message for the CEO. They wouldn't present the strategic plan he was expecting. Instead, they'd be back in six weeks with a fully-detailed China proposal-including the names of experts to engage, along with plans and a budget for a new plant and a plan for structuring the necessary write-offs in the United States.

John handed the report over with mixed emotions. He suspected the pain of making the decision would never entirely go away. But he also recognized that he'd been lucky. He and his team thought they were being realistic about their situation, and that they had taken the necessary hard actions to correct it. A person with a fresh viewpoint had shown him realities that would have sunk his business and his career if he hadn't faced up to them.

IN THEORY, CONFRONTING REALITY is what business is all about. More than most, business people like to think they're realists. Their actions look like realism: they work hard to gather relevant facts and data, they research alternatives rigorously, and they bring their cumulative knowledge and experience to bear on the issues. They test their thinking in arguments and debates. Then they reach conclusions. Surely, after all this work, the conclusions are realistic.

But the implicit faith in realism is all too often unjustified. Unless you're in a rare organization, you've seen this your-self. In our decades of experience, we've wrestled firsthand with it in hundreds of companies and many industries. The best strategies, the most rigorous research, the clearest of operating plans-all are undermined because the key people behind them have missed the reality of the situation for one reason or another. The fact is that the greatest consistent damage to businesses and their owners is the result not of poor management technique but of the failure, sometimes willful, to confront reality.

Lou Gerstner's fundamental contribution to IBM was to force reality on a company that had become cripplingly unreal. His autobiography offers a telling portrait of what he found when he arrived in 1993.

When Gerstner took over, the conventional wisdom was that IBM needed to be broken up into smaller companies. In the new, decentralized world of information technology, the reasoning went, new companies with bright ideas and new products were multiplying almost as fast as desktops. CIOs would want to pick and choose the best hardware and software and integrate it into their very own systems. Nobody wanted to deal with yesterday's monolith.

This view was shared by almost everybody in the industry, along with Wall Street's analysts and the business press. It's what investment bankers had urged upon John Akers, Gerstner's predecessor. Akers was starting to put the plan in place, but by then IBM's liquidity and cash position had become so poor that the board began looking for a new

CEO.

Gurus were expecting a CEO with a technology background who would take IBM from a mainframe business to one with the PC at the center. To its credit, the board instead chose Gerstner, whose expertise was not in technology but who had superb business savvy, honed through years of experience. Initially a McKinsey consultant, he'd been president of American Express and at the time was CEO of RJR Nabisco.

Gerstner was all but certain that breaking IBM into pieces was the wrong thing to do. He had been an IT customer at RJR Nabisco and American Express, and he knew other customers. All agreed that in the real world of the IT managers, not many wanted to undertake the complex job of cobbling together workable systems from an infinity of vendors. Integration, he wrote, was becoming "a gigantic problem. . . . I believed there was a very important role for some company to be able to integrate all of the pieces and deliver a working solution to the customer." Instead he made the decision-a courageous one in the face of universal views to the contrary-to keep the company intact, and to reshape it to deliver just those kinds of solutions.

He traced IBM's financial problems to the mainframe business. IBM's flagship System/390 was being undercut by competing products based on cheaper open-system technology and priced 30 percent to 40 percent less. Because fixed costs were high, the market share losses were rapidly draining cash.

"Why don't we lower our prices?" asked Gerstner. IBM's executives explained that they needed the profits they were getting from wide margins earned on mainframes. But it was clear to Gerstner that milking System/390 would kill not only the line but also, in all likelihood, IBM itself. It had not occurred to the management team that the company needed the cash more than the profits after he showed them why they completely reversed their old beliefs and behaviors. The price cut enabled the mainframe product line to rebound.

Meantime IBM was continuing to pour tens of millions of dollars into developing OS/2, a desktop operating system it had created some years before. OS/2 would have been the natural system for IBM's own PCs, but IBM had chosen instead to use Microsoft's Windows because at the time it wasn't convinced the PC had much of a future. Nevertheless, IBM continued to press on with OS/2 development in an effort to compete with Microsoft. "The highest levels of IBM executives were almost obsessed with the effort to unwind the decisions of the 1980s and take back control of the operating system from Microsoft (and, to a lesser extent, gain control of the microprocessor from Intel)," Gerstner wrote. "Not only were we banging our heads against a very hard, unrelenting wall, but I had to wonder if anyone was paying attention to the strategic direction we were talking about. If we truly believed that the reign of the PC was coming to an end, why were we pouring energy, resources, and our image into yesterday's war? It was counter to our view of where the world was headed."

These were not isolated problems. Unreality at IBM, Gerstner discovered, was systemic

and endemic. IBM had all the assets it needed to succeed, Gerstner says. "But in every case-hardware, technology, software, even services-all of these capabilities were part of a business model that had fallen wildly out of step with marketplace realities."

How did this happen? The organization was so focused on processes and turf battles that it was almost oblivious to what its customers wanted. For example, Gerstner recalls his first strategy meeting as possibly the low point of his first year at the company: "While the people in the room were extremely bright, very committed, and, at times, quite convinced of what needed to be done, there was little underpinning for the strategies discussed. Not once was the question of customer segmentation raised. Rarely did we compare our offerings to those of our competitors. There was no integration across the various topics that allowed the group to pull together a total IBM view."

A similar eye-opener was his first meeting with the top-level Management Committee, "the ultimate position of power that every IBM executive aspired to as the apex of his or her career." In the distant past it had been organized as a forum for contention, where staff people would challenge the recommendations of line units. "The problem was that over time, IBM people learned how to exploit the system to promote their own agendas," Gerstner wrote. "So by the early 1990s a system of true contention was apparently replaced by a system of prearranged consensus. Rather than have proposals debated, the corporate staff, without executives, worked out a consensus across the company at the lowest possible level...Too often the MC's mission was a formality-a rubber-stamp approval."