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Business Classics: *Built to Last*

By Mary Pat Campbell

Mary Pat Campbell, FSA, MAAA, is vice president, Insurance Research at Conning in Hartford, Connecticut. She can be reached at *marypat.campbell@gmail.com*.

In 1994, James C. Collins and Jerry I. Porras published *Built to Last: Successful Habits of Visionary Companies*. In this book, Collins and Porras detail their research into visionary companies, which were denoted as such using a broad-based CEO survey. After using these survey results to identify long-lasting visionary companies, they also picked comparison companies, operating in similar sectors and of similar longevity. Several business myths were busted—no need for charismatic founders or CEOs, for example.

In addition, it was shown that not only had these visionary companies greatly outperformed the broad public market, they had outperformed their comparison companies (which had also outperformed the market). Given the length of time it took Collins and Porras to do their research, the time period they investigated for stock market performance covered Jan. 1, 1926 to Dec. 31, 1990.

The broad market performed at a 9.7 percent CAGR (compound annual growth rate) over the period, the comparison companies had an 11.1 percent CAGR, and the BTL (built-to-last) companies had a 14.4 percent CAGR. Over 65 years, these returns add up: If one had invested in the BTL companies over the time period, weighting each company equally, one would have ended with over 15 times the accumulated money, versus if it had been invested in the broader market.

DO THESE RESULTS STILL HOLD?

Given that over two decades have passed since the research was done, I thought it would be good to see if these BTL companies still had what it takes. I started the investment clock at Jan. 1, 1991, when Collins and Porras had left off. Given our own publication strictures and my research limitations, I stopped the clock on Aug. 1, 2014.

The results will amaze you! (Check out the graph on page 9 and the chart on page 10.)

To be sure, there are only about 23.5 years of returns, so one doesn't get the eye-popping differences seen in the book, which showed the results of 65 years of outperformance.

What have the overall returns been like for the subsequent period? For the S&P 500 index, the CAGR is 7.6 percent, which isn't too shabby considering the roller-coaster economic environment. The BTL companies were not too shabby themselves, with an 11.2 percent CAGR. But check out the comparison companies! They outstrip the BTL companies with their 13.0 percent CAGR!

Well, unlike Collins and Porras, I'm being deliberately deceptive. To see why, check out the individual companies in these groups, and how they've individually performed. There is a severe survivorship bias.

Of the 18 BTL companies, I could find some major form of them still traded, and could get enough data to estimate CAGR. Only Marriott gave me trouble because it had split itself into two companies in 1993. I followed the larger piece that still used the MAR stock ticker. Several of the BTL companies were components of the Dow Jones Industrial Average at the time the book was published and still are, and one of the groups (Walmart) was added in 1997. While a few are stinkers compared to the S&P 500, 15 out of the 18 companies outperformed the broader market.

On the comparison company side, we see results all over the map. Most notably: I could calculate returns for only eight out of the 18. Two of the missing companies were acquired by the BTL companies (in the case of McDonnell-Douglas, it was acquired by the company it was being compared to). Some were difficult to follow, as they were carved up into various pieces, sometimes completely going defunct. I could have included GM in my calculation … somehow. You may have remembered the company going bankrupt, and then later reissuing stock in 2010. If I had included GM, the comparison group return would have been pulled down somewhat.

Maybe Collins and Porras really were onto something.

The timing of the publication of the book was an important one—one of their "visionary companies" had fallen onto hard times around the time the book had come out. IBM had just lost an astonishing $8 billion in 1993, a record-setting loss at the time (oh, for those halcyon days). Lou Gerstner was brought in as CEO from outside the company, and indeed from outside IBM's sector—which broke one of the BTL "rules" of success: home-grown management.

This is what the authors had to say about the move:

"How does this massive anomaly fit with what we've seen in our other visionary companies? It doesn't fit. IBM's decision simply doesn't make any sense to us—at least not in the context of the seventeen hundred cumulative years of history we examined in the visionary companies."

I think I have some insight as to what happened. You see: I'm an IBM kid.

THE IBM WAY

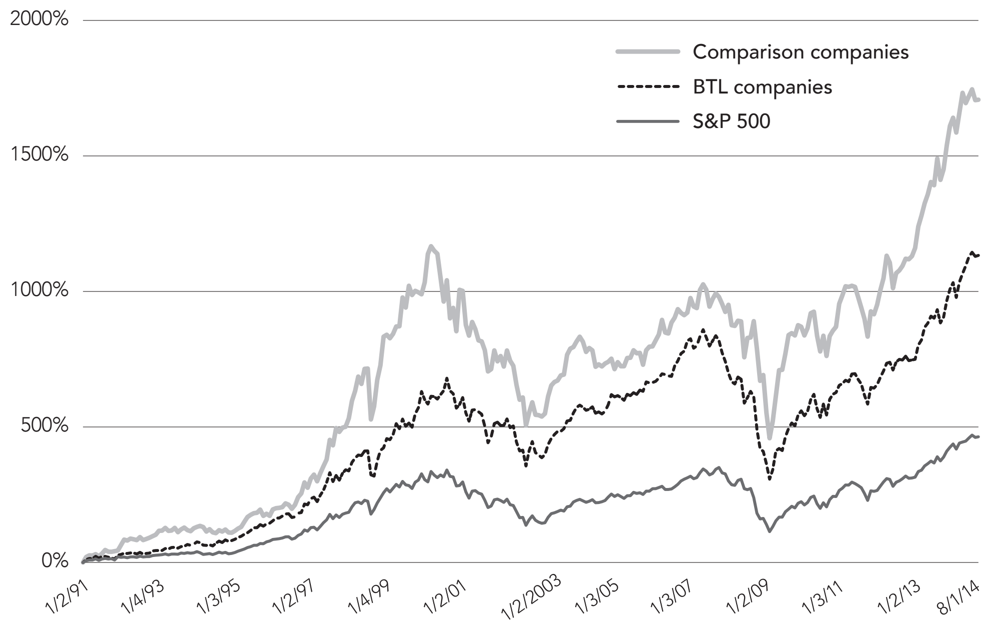
First, a note.

I got my copy of *Built to Last* via a book sale at my local library in North Salem, New York. Checking the copyright page, I see this hardcover was a first printing—probably bought in 1994. This was a privately owned book, not a discarded library book. Whoever had owned the book had gone through and highlighted every single IBM reference.

This is hardly surprising. After all, IBM is headquartered in Armonk, New York, only 20 miles away from the library. More to the point, there is an IBM building in Somers, the immediately adjacent town to North Salem. I bet someone at that IBM office had bought this book in 1994, trying to figure out what had gone wrong. They especially highlighted the items about Lou Gerstner. They also highlighted some non-specific-to-IBM lines: "It is

How does this massive anomaly fit with what we've seen in our other visionary companies?

STOCK PERFORMANCE COMPARISON, CUMULATIVE RETURN



Data source: Yahoo Finance

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absolutely essential to not confuse core ideology with culture, strategy, tactics, operations, policies, or other noncore practices … the *only* thing a company should *not* change over time is its core ideology….” While these lines aren’t IBM-specific, it does point to some of the troubles IBM was going through in 1994.

But back to me.

I come from an IBM family. My father was a systems engineer at IBM, first working in Savannah, Georgia (seven years), then moving to Atlanta (four years), Baltimore (three years), and then finally Raleigh, North Carolina. My maternal grandfather had been an account manager at IBM, having gotten his first big break by being given the 3M (another BTL company!) account when they lived in St. Paul (he similarly moved around: St. Paul, New Canaan, Memphis, Indianapolis, and finally Orlando). My mother’s three brothers all worked at IBM. My mother’s oldest sister, Mary Pat, was head of a division producing technology and programs for disabled people.

At summer family gatherings, I would sit and listen to my dad talk with my mother’s siblings about IBM goings-on while my retired grandfather would remark on the executives he had known, who were still there. In the early 1980s, it was very exciting. While I still wanted to be an astronaut as my first-choice career, having visited the IBM buildings (replete with skirt suit and requisite floppy tie … as an 11-year-old), I could see the allure. I could work at IBM if the astronaut gig didn’t work out.

But in the late 1980s, it was obviously going wrong. When my dad had his first managerial posting, in Baltimore, it was clear that was a toxic office. The most notorious event I recall was my dad having to fire somebody else’s direct report, because the actual manager could not handle it. Top management was completely disconnected from

BTL Companies	CAGR since 1/2/1990, as of 8/1/2014	Comparison Companies	CAGR … or Fate
3M	11.4%	Norton	Acquired by a French company, 1990
American Express	14.1%	Wells Fargo	16.1%
Boeing	9.4%	McDonnell-Douglas	Merger with Boeing, 1997
Citicorp	5.5%	Chase Manhattan	15.0%
Ford	8.2%	GM	Went bankrupt, reissued stock in October 2010
GE	9.8%	Westinghouse	Dissolved, 1999
Hewlett-Packard	11.3%	Texas Instruments	14.9%
IBM	9.6%	Burroughs (became Unisys)	-0.6%
Johnson & Johnson	12.9%	Bristol Myers Squibb	8.9%
Marriott *(Marriott split in 1993, following MAR)*	13.6%	Howard Johnson	Various bits sold off over time, primarily part of Wyndham now
Merck	9.3%	Pfizer	12.1%
Motorola	7.0%	Zenith	Went fully private, 1999
Nordstrom	12.0%	Melville (became CVS)	10.7%
Phillip Morris *(became Altria)*	15.7%	RJR Nabisco	Separated the tobacco and food companies, pieces sold off over the years
Proctor & Gamble	11.7%	Colgate	14.4%
Sony	0.2%	Kenwood	Japanese-listed, couldn’t get return data
Walmart	11.0%	Ames	Bankrupt, 1990; defunct, 2002
Disney	11.3%	Columbia	Acquired by Sony, 1988

Data source: Yahoo Finance, Wikipedia

anything going on, whether inside the company or outside it, other than their own internally political games. IBM's lunch was getting eaten by all sorts of upstarts, and the IBM name was losing cachet.

My father ended up working on an internal management review when he moved to Raleigh. The diagnosis: top-heavy, unresponsive management. The group that had commissioned the report said "Thank you very much" and went on as they had been. They didn't really need a report for anything other than to tell interested parties (i.e., the board) that they had investigated the matter. Further study was required.

This is why somebody external had to be brought in. The board of directors couldn't trust any of the top insiders. They needed someone who would make a clean sweep, and Gerstner did. There was precious little deadwood at the top when he was through. Perhaps an insider could have done the same, but there wasn't much evidence of the intestinal fortitude to follow through.

THE WEAKNESS OF *BUILT TO LAST*

This points to one weakness of the book: The items that are highlighted as key to long-lasting success are fairly difficult to sustain. They have to be worked on all the time. Why would one expect the engine of success to keep chugging along given the difficulty of the items required for it to keep going? Exactly how "built to last" is it if one must keep working above and beyond to keep the enterprise going?

In specific, they point out the need for BHAGs (Big, Hairy, Audacious Goals … really, they couldn't have come up with a better name?). These are specific, bold, clear, and compelling targets, such as aiming to be top in your market even though one is in sixth place (Philip Morris' BHAG). Put a man on the moon within a decade. Those are BHAGs.

Obviously, these are difficult goals to attain; otherwise they wouldn't be audacious (or big … or hairy). Not only are they not easy to attain, I doubt they're easy to formulate in the first place.

Let's look at how this manifests in IBM's problems. In the epilogue, the authors answer a question about IBM—maybe in the past it was visionary, but events overtook the writing of the book. What was their advice for IBM?

A portion of their response: "IBM committed to some of the most audacious BHAGs in history, including a bet-the-company decision to go with the IBM 360 and render obsolete nearly all of its prior product lines. Bold! Yet then IBM got conservative in the 1980s, protecting its mainframe line. It lost sight of its own past…. We'd challenge IBM to once again obsolete itself, to bet the company on the success or failure of that BHAG, just like it did on the 360."

How easy that is to say. In the case of the sclerotic IBM management, they had become fat and satisfied. It is so easy to let success ride, to sit on the "good enough." The main lesson of *Built to Last* is that long-term success is not an accident, that it requires continual, hard work. In the chapter on BHAGs, they note how easy it is to become complacent after achieving a BHAG, so once one is knocked down a new one must be set up.

How exhausting.

The biggest problem in most of these recommendations for success is that they ignore how one gets people to do these things. This is a very high-level book. It will tell you the big things to shoot for, but there's not much there to help with the very practical problem of how to achieve this extremely difficult goal.

THE STRENGTH OF *BUILT TO LAST*

However, this book is a worthwhile read, even if you don't plan on building your own visionary company, due to its own core strength: solid business research.

It is so rare that I find a book that is so well-constructed in its plan of research, with sufficient notes that one can follow later. I had a great time reading through all the appendices before I even read the middle of the book. Every rebuttal I could think of was found either in the first chapter of the book, in which they set up their plan of research and their process, or in the appendix, where they admit some of the shortcomings.

I have read some critiques of the research done. In specific, about 10 years after *Built to Last*, Phil Rosenzweig wrote his own critique of these types of business and management books called *The Halo Effect*, where he claimed that the very success of the companies by 1990 is what got them classified as visionary companies.

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The main lesson of *Built to Last* is that long-term success is not an accident, that it requires continual, hard work.

However, Collins and Porras did realize that this could be a problem—this is why they picked comparison companies, and this is why they tried to make sure that what they found was really different for "visionary companies" compared to their more pedestrian competitors.

I cannot speak to the subsequent work by Jim Collins, as I haven't read those books (yet). Perhaps they got far afield of the rigor of the research displayed in *Built to Last* when he wrote *Good to Great* or *Great by Choice.*

However, I think the results of the past two decades have shown that they were onto something when it came to outstanding companies who were outstanding for decades … maybe even more than a century. Yes, it takes a lot of work—whether to run such companies, or to research them.

That may be the main lesson—one can never rest if one wants success. That may be an exhausting finding, but it does not make it less true.