THE BOARD MINDSET™

The vital attribute of exceptional boards

SHOULDN'T BOARDS FEAR DISRUPTION?

The Berlin Wall came down in 1989, but apparently someone forgot to notify the Ahornia deer of the region. They still refuse to cross the line. At the height of the Cold War, an electric fence, barbed wire, and machine-gun-carrying guards cut off Eastern Europe from the Western world, which also severed the herds of deer. All barriers have disappeared, but the red deer haven't changed their behavior. Even though they weren't alive when the border existed or came down, they inherited a predisposition to avoid crossing it.

Apparently, taking a page from the deer handbook, many directors behave the same way. They don't really know why the silos and processes exist, but their instincts keep them from taking full advantage of the opportunities that would exist if they were not so committed to them. This adherence to the past and fear of disruption has myriad problems, not the least of which involves short-changing strategy formulation and succession planning. Similarly, many self-imposed obligations and constraints live on for outdated reasons—and some weren't necessary in the first place. However, when we understand disruption and the people who intentionally create it, we understand how to *design* it instead of *fearing* it.

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A board's second-worst nightmare is an idiot with initiative (their first is a smart narcissist). A disruptive mindset requires initiative, but only smart directors can discern why and when they should take a risk.

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Virtuoso directors, those who set the bar in their industries, know what it takes to upset the status quo and shift power in relationships. These exceptional thinkers understand why innovation feels easy compared to disruption: primarily because they know they must invite risk to move from the wings to center stage. They recognize that disruption doesn't have to be fast and furious and realize that when the stakes are highest, they must abandon their comfort zones.

Sears, General Electric, Hewlett-Packard, Wells Fargo, and Toys "R" Us—all once-estimable companies—have now suffered the consequences of refusing to disrupt "the way we've always done things around here" thinking. In the 1980s and earlier, Sears was the largest retailer in the United States until Walmart and Kmart surpassed it in sales in 1990.

Sears began to diversify, which they needed to do, but these actions distracted senior leaders' attention

from the competition. In fact, these decision makers dismissed Walmart's threat because Walmart had lower quality products and few salespeople dedicated to appliances. They also overlooked the fact that appliances turn over slowly and don't significantly contribute to net profit.

As it turned out, Walmart disrupted the status quo by resetting prices for the entire country. At about the same time, California sued Sears for a series of pricing scandals that revealed the company had falsely charged customers for unneeded repairs when they brought their cars in for other reasons. By 2018, Sears, the 31st-largest retailer in the United States, had filed for Chapter 11 bankruptcy. Sears apparently saw disruption as negative while Walmart embraced it.

In 1981 Jack Welch welcomed disruption too. He became General Electric's (GE) youngest chairman and CEO—and a leader who understood that if he didn't create disruption, someone else would. A year after taking the reins, he had dismantled much of the existing management approaches with aggressive simplification and consolidation. His famous primary leadership directives became to "Make GE No. 1 or No. 2" in the industries in which it participated.

Throughout the 1980s Welch sought to streamline—not necessarily to disrupt—GE, yet under his leadership, GE increased market value from $12 billion in 1981 to $410 billion 21 years later. At the time of his retirement, he had made 600 acquisitions while shifting into emerging markets, thereby recasting the company in a significantly new mold. Welch also worked to eradicate inefficiency by trimming inventories and dismantling the bureaucracy that had almost led him to leave GE earlier in his career. He closed factories, reduced payrolls, and cut lackluster units.

Jeff Immelt, Welch's replacement, took a different governance path, differentiating himself from Welch in both substance and style. On the one hand, Immelt caused some positive disruption with changes in plastics, appliances, workplace diversity, and GE Capital businesses. On the other hand, Immelt found himself immersed in several public controversies. Lassitude, indecision, relaxation of Welch's ethical standards, and the fall of GE stock price by 45% followed Welch's retirement. Immelt didn't want to inherit the "house that Jack built," so his decisions invited criticism from dividend-oriented investors and board members. Without constant innovation and sustainable excellence in senior management and board directors, even the best leaders flounder and founder.

Effective disruption lessons either came too late or didn't come at all for Toys "R" Us. In 1948, Charles Lazarus founded Toys "R" Us, but by 2017, leaders of the chain had filed for Chapter 11 bankruptcy in response to its $5 billion in long-term debt. At its peak, consumers considered Toys "R" Us a classic example of a "category killer," a retailer that carries an assortment of products of a given type. Through pricing and market penetrations, these stores create a competitive advantage. We consider Barnes & Noble, Best Buy, and Staples successful category killers. With the rise of mass merchants and online retailers, Toys "R" Us began to lose its share of the toy market.

Scandals (Sears), succession planning (GE), CEO selection (HP), a flawed value system (Wells Fargo), and greed (Toys "R" Us) played roles in the collapse of companies we once appreciated. Is this the inescapable future for companies that fail to disrupt in the right ways?

Disruption means bridging the gap between what's happening and what's possible. It can come by invitation, or it can show up like a drunk wedding crasher. Good or bad? More depends on the *response* to the commotion than on the disruption itself. Directors who want to grow and innovate need to understand their own reactions to disruption and to have the tools for creating a safe environment for experimentation for those in the trenches. To answer the question: "Isn't disruption bad?" the answer seems clear: It will be if it doesn't lead to growth.

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