1 The Predictable Challenges Faced by Dominant Companies

Overview

- Success means growth, and growth results in complexity.
- *Eight predictable challenges* emerge out of complexity, which we organize into two groups:
  - **Execution**
    - innovation
    - product transitions
    - strategy
    - alignment
  - **Governance**
    - culture of learning
    - leadership DNA
    - governance systems
    - board of directors oversight
- The threads of failure for a great company lie in ignoring or responding poorly to these challenges.
- At the same time, these challenges represent opportunities to achieve a powerful competitive advantage.
Long-term dominance, the goal of many companies, is achieved by few. To understand the difference between the winners and the losers, the great companies and the “also-rans,” it is necessary to understand complexity, a natural by-product of success.

Success in an enterprise necessarily means growth, and growth means new technology, more complicated structures, new processes, more customers and employees, new locations, and so on. This complexity brings with it inevitable but predictable challenges, and these challenges can be met in two ways:

- They can be exploited, to increase competitive advantage.
- They can be ignored and allowed to drag the company into failure (see Figure 1–1).

**Eight Predictable Challenges**

The intrinsic challenges of complexity faced by all growing companies can be organized into two groups: four execution challenges and four governance challenges (see Figure 1–2).

![Figure 1–1 Complexity Is the Source of Challenge.](image-url)
Challenges Can Become Threads of Failure

Each of the eight challenges has the potential to become a *thread of failure*. Seldom will any one thread derail a great company. However, sustained periods of ignoring any one of them can mean that several will become active simultaneously and eventually threaten a great company’s success, if not its very survival. Let’s look at a couple of examples.

Imagine an organization where technology inertia has been allowed to develop—that is, the company has continued to focus on its existing products while the competition routinely disrupts the market with technology innovation (Chapter 4). In its weakened position, if that company also manages its product transitions poorly (Chapter 5), it might not only stagger but could actually fall to its knees.

Or take a large company that is well established as a disruptor and good at product transitions. Imagine that its initial cultural underpinnings have calcified with age and now reinforce the leaders’ tendency to believe that they already know all that they need to know. As the company encounters the normal rough weather of doing business, it can find itself flying blind for lack of the active feedback that a strong learning culture would assure (Chapter 8). Experience can guide the company’s leadership for a while, but if this same company imposes rigid and centralized governing systems

**Recommended Reading**


(Chapter 10) or selects a strategy suited to the past rather than the future (Chapter 6), its ability to navigate bad weather will be lost.

**Threads of Failure . . . or of Opportunity?**

Beyond their potential to erode the strength of a great company, the eight challenges also represent opportunities for competitive advantage. Each predictable thread of failure can be monitored, identified, and turned into an opportunity. An organization that monitors these threads of failure and takes advantage of the resulting information can create a competitive advantage. Exhibit 1–1 explores this idea further and suggests a model for understanding the nature of complexity as a double-edged sword and how that complexity can be exploited to a company’s advantage.

Following that model, our focus in this book is to explore the double-edged nature of the eight challenges—to understand them both as threads of failure and as opportunities. An organization’s ability to leverage the challenges of complexity into a competitive advantage is the mark of a great company. The also-rans lack the rigor and courage to monitor themselves and take necessary action.

Figure 1–3 suggests how each of the eight challenges we address in this book can be seen as a thread of failure and as an opportunity for competitive advantage.

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<tr>
<th>Challenges as Perils</th>
<th>Challenges as Opportunities</th>
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<td><strong>Execution Challenges</strong></td>
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<td>• market disruption</td>
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<td>• poor product transitions</td>
<td>• effective product transitions</td>
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Figure 1–3  
Eight Predictable Challenges, as Perils and as Opportunities.
Exhibit 1–1: Complexity as a Double-Edged Sword

As we describe in detail in Chapter 2, a company’s success breeds complexity. Growth inevitably brings with it a greater quantity and variety of people, products, and processes to be managed. Distribution channels must be expanded and new markets must be cultivated, even as competitive pressures are intensified by other companies seeking to take advantage of the potential for success. If handled correctly, this increasing complexity can be a competitive advantage.

Let’s visualize complexity in three dimensions and see how it might be used to advantage (see Figure E1–1).

Each axis in Figure E1–1 represents a separate dimension of complexity—and of competitive advantage:

- technology/products and their positioning
- distribution—the reach, mix, and productivity of channels
- operational scale and size

Companies can take advantage of complexity and sustain growth by simultaneously innovating or disrupting, relative to the competition, on two of the
Going the Distance: Why Some Companies Dominate and Others Fail

Relative to Geoffrey Moore’s CAP and GAP, the vertical axis translates into GAP (product differentiation), and the combination of the other two axes (scale and distribution) translates into CAP market power. See his book Crossing the Chasm: Marketing and Selling High-Tech Products to Mainstream Customers (New York: HarperBusiness, 2002).

three dimensions of this model—that is, on any one plane, where a plane represents the combination of any two dimensions. Further, we pose that the most common and reliable successes result from disrupting on either of the following two planes:

• technology/market and distribution channel mix
• distribution channel mix and economies of scale

Before we illustrate these two means of disrupting for dominance, let’s look at two alternatives—disrupting on the basis of the plane of technology/market and scale, and disrupting on all three dimensions. We believe more fleeting success is found in the combination of technology/market and economies of scale. This plane has the highest risk of losing invested capital, as disruption on the technology/market dimension usually requires sustained periods of economic and industry stability to enable dominance. In the Information Age, most markets move too fast to be able to rely on such stability. In addition, in the rare cases when a company differentiates on all three dimensions simultaneously, such as Intel and Microsoft, it can achieve a virtual monopoly. This especially strong condition of competitive power carries its own risk.

Early-stage companies naturally focus on a marketing or technology position to create a change in the patterns of purchasing. This competitive differentiation lasts for a while. But to achieve sustained dominance, a company must not only continue to differentiate itself on the marketing/technology dimension but also establish a level of reach (distribution) or economic scale that cannot easily be achieved by others. This can happen by overt strategy or by simple iterative execution toward that end.

To see these dynamics in a non–high-tech environment, consider Longaberger, the maker of premium handwoven baskets. To break out of the pack of its competition, the company decided to redefine its baskets from a commodity to a collectible, upgrading its market appeal. Its success in this transition is illustrated by the fact that a Longaberger basket purchased several years ago for $50 to $100 is worth the same or more today.

At the same time, the company reorganized sales and distribution, embracing a lower cost, more viral approach, using home sales associates, as do Avon, Tupperware, and Mary Kay. Through disrupting on both the technology/market

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and distribution channel dimensions, Longaberger created a high-margin business in a market with seemingly poor margins and too much competition.

Longaberger is an excellent example of our theory of “planar” (two-dimensional) disruption. Given its transformation from a family business that began in Dresden, Ohio, to a highly renowned public company, it represents a great American success story of sustained dominance.

Turning to the high-tech world, in the early 1990s, Cisco Systems innovated on the technology/market dimension by consolidating low-bandwidth data traffic that traveled over widespread, large company intranets, establishing itself as a data communications supplier to 80 percent of worldwide enterprise customers. Simultaneously, Cisco created three complementary distribution channels—direct sales, Tier 1 integrators (big systems integrators such as EDS), and Tier 2 channels (fulfillment houses such as Tech Data)—at a time when competitors were using one or, at most, two channels well.

Conventional wisdom said that channel conflict would foil Cisco; the result was quite the opposite, as we explain in some detail in Chapter 5. Again, this is an example of successful disruption on the plane of technology/market and channel distribution, rather than on a single dimension only.

To demonstrate disruption on a different plane, let’s look at Dell Computer Corporation and Compaq. Dell created a new business based on direct distribution of PCs, establishing customer intimacy while achieving an economy of scale that dramatically lowered costs. Compaq similarly took on scale and distribution as its dual focus. It employed economies of manufacturing as a weapon, thus lowering cost. At the same time, through many thousands of channel partners, Compaq expanded its channel structure more smoothly and more swiftly than any other company. Both Compaq and Dell disrupted on two dimensions—not one, and not three.

In contrast, Ascend is an example of a company that disrupted in only one dimension and could not sustain its success for more than five years. At first, Ascend boosted its strong technology position by creating a new product category, concentrating modem (asynchronous dial-up) and ISDN dial-up communications onto one hardware platform for Internet Service Providers like America Online (AOL), UUNet, and PSINet.

However, disrupting on only one dimension was insufficient to ensure Ascend’s continued competitive advantage. Without creating a second dimension of differentiation, the company was vulnerable to Cisco’s strength in the market and ultimately was absorbed by a company with stronger distribution—Lucent.
Technologies. Before it was absorbed, by the second quarter of 2001, Ascend’s market share fell below 30 percent, when at one point it had exceeded 60 percent. Creation of a competitive gap on only one dimension leaves a company vulnerable to a new disruptor or a company that has much greater market power on another dimension. In other words, dominance tends to be short-lived with only one dimension of competitive differentiation.

Figure E1–2 suggests a few more examples, and there are many more that demonstrate the same point: A plane of competitive advantage can be exploited that creates greater complexity relative to the current way of doing things, thus creating greater complexity for the competition. When managed in this way, this higher level of complexity can propel a company’s growth while creating barriers to entry for the competition over a sustained period of time.

Complexity, then, while a breeding ground for difficulties, is also desirable for differentiation. The body of this book builds on this theme of complexity as a double-edged sword—an agent of peril and of opportunity. We examine this dual nature for each of the eight challenges created by growth and success. Each of Chapters 4 through 11 addresses one of the eight challenges; in each chapter, we suggest specific actions to take as complexity shows itself to be both friend and foe.
Execution Challenges

As introduced earlier in this chapter, we organize the eight challenges into two groups: execution challenges and governance challenges. The execution challenges follow:

- innovation
- product transitions
- strategy
- alignment

Innovation

All markets reach turning points that require new directions; some markets do this more frequently than others. A high level of competition, which drives a high level of innovation, means more frequent points of market disruption. However, companies that have established some success based on past innovation often see themselves as dependent on that past success—usually a function of their original technology—and often ignore the inevitability of change. It’s not the technology they are dependent on, however; it’s the market in which that technology was successful. The market will change, whether a company is part of that change or not.

Technology inertia means leaving the unavoidable disruption of the market on which a company is dependent in the hands of competitors. Technology disruption, however, is an advantage to a company and can put its competitors in peril. Disruption, which creates strong competitive differentiation, often brings great rewards to those who do the disrupting. Although it is true that the strategy of being a fast follower can also bring success, doing neither is the road to mediocrity, if not failure.

Market or technology disruption, which we discuss in depth in Chapter 4, results in permanent change in buyers’ preferences and therefore in the size and segmentation of a market. With this level of change, the winners of the past, who served the former market, are often no longer the winners of the future.

As we discussed in Exhibit 1–1, market disruption occurs on one of three dimensions (Figure E1–1), so managing market disruption means meeting the challenge ideally on two of the following three dimensions:
• **technology/products and their positioning.** The functionality of the technology and the way it is brought to market change a buyer’s preferences.

• **distribution.** The way products are made available to buyers affects a buyer’s preferences and the means of delivery.

• **operational scale or size.** Economies of scale that are great enough to affect the cost at which products can be brought to market (and thus the price) change a buyer’s preferences.

In Silicon Valley, market disruption often occurs based on technology. Steve Jobs and Steve Wozniak, for example, like others at that time, envisioned a *personal* computer; unlike others, however, they had the energy and intelligence to invent one that worked. In one of Silicon Valley’s most famous stories of a great product emerging out of a garage, Wozniak and Jobs invented a user interface for a PC that has become a long-term success and that assisted in the disruption of the then-enormous mainframe computer market. We look at many more examples like this in Chapter 4.

**Product Transitions**

Customer demand drives innovation, and innovation requires product transitions. Yet introducing new products into a market in which a company is already earning revenues is always a risk to those revenues. As a company’s revenues grow and the company becomes more complex, the risk grows simply by virtue of the amount of revenue involved. The ability to take calculated risks in product introductions is an art and is essential to long-term success. No company survives well in a competitive environment without successfully conquering this challenge.

The natural tendency for market-driven product improvements to cannibalize revenues of existing products creates the risk inherent in product transitions. Paradoxically, cannibalization is necessary for progress but is also a thread of failure if the risks are poorly managed. Either a company cannibalizes its own revenues—strategically—or it leaves itself open to the competition.

While product transitions are predictably complicated, they are nonetheless often undertaken with too little strategic and operational planning. Typically, a product manager will assume that in introducing a new product to replace an existing one, the distribution channel and the customer will quickly absorb the new product.
There are many examples of the negative results of this naïve assumption.

In Chapter 5 we pursue these ideas in greater detail, telling the story of a successful and complicated product transition to illustrate a set of axioms we believe can help companies meet this challenge.

Strategy

There are many different moments in a great company’s growth cycle during which it faces critical strategic decisions. Selecting and implementing the strategy that provides sufficient thrust in the right direction—and reviewing this on an ongoing basis—is essential to building and sustaining a dominant position.

There are many ways, however, that companies fail to identify the vector with the direction and power to hit the mark. They select, for example, weak strategies that don’t compete well; strategies that double back and are self-defeating; or strategies that don’t take into account the complexities of the market and go straight for the target when more subtle, flanking moves are required.

Strategy defines direction. A successful company defines the key vectors by which it will approach the vision or destination that it has set. That destination might never be fully reached. In fact, as a company realizes its destination can be reached, it must set its sights on a new one, as driven by the needs of the markets it serves. At any one time, strategy defines the roadmap by which a successful company makes its way to its desired future. Misguided choices about strategy result in missing the long-term target and meeting failure rather than success.

As a company grows and succeeds, the risk inherent in its choice of strategies increases. The stakes get higher, and complexity tends to obscure the organization’s eyesight. Leaders often become overwhelmed with operational challenges. Their ability to see what’s wrong, what’s possible, and how to get there becomes obscured. We call this condition glare. As companies get more complex, glare builds, and decision makers often adapt to and accept it. This lack of being able to see the right direction leads to weak or misguided strategies.

For example, consider the case of a fast-paced company that makes software for wireless telephone handsets and has grown exceptionally fast to exploit the potential of the market. In achieving its growth, the company has made numerous acquisitions without developing an organizing infrastructure, having put all its effort into meeting the next customer demand. Suppose the market shifts, however, slowing down or adapting to a new technology. A new strategy
is required—one that involves, for example, a more thoughtful solutions approach that mandates the coordinated effort of functions that previously operated almost autonomously. In this example, not only is it important to recognize the need for a new strategy and select the right one, but such a significant change in strategy necessarily causes other significant execution challenges. In the case of this software company, for instance, the missing infrastructure and lack of a common culture create real risks to the success of an integrated solutions strategy. In the next section, we will discuss this kind of problem—alignment, a key element in executing strategy.

Differentiating strategies—defined, implemented, and redefined on an ongoing basis—separate the great companies from the also-rans. Such strategies overcome the competition and facilitate a company’s domination of the market. In Chapter 6, we look further at the challenge of strategy and examine in detail how Cisco used acquisitions to differentiate itself and maintain momentum in the accelerated market of the 1990s. As for many other great companies, of particular importance was the alignment of the differentiated strategy with Cisco’s execution engine.

**Alignment**

Alignment is an essential ingredient in assuring execution of the right strategy. Alignment is evident when the flow of work, from the source of a company’s products or services through to the customer, is efficient in a way that achieves sustained customer satisfaction. When companies are large and complex, maintaining such an efficient flow can be very difficult. It means smooth operations flowing from Engineering, where products are born, through Manufacturing and Marketing, and on through Sales and Service, while being capably supported by corporate functions like Finance and Human Resources. Misalignment can occur anywhere in the flow from a product idea to product maintenance. It can be found in disconnects between strategy and structure, structure and processes, and so on. In Chapter 7, we discuss many examples of misalignment.

Even if a company achieves alignment, it must constantly adjust to maintain it across the critical dimensions of the company, given the shifts and changes of growth and adaptation. When done well, this frequent realignment of goals and structure will exploit the fact that *structure biases results*. In other words, the results of any effort are heavily influenced by how that effort is structured.

One result of misalignment is organization *thrash*—organization
energy bounding from one focus to another with little or no productive output. This kind of unresolved conflict arises out of misaligned goals, priorities, or assumptions about roles. If Sales and Service are misaligned about roles, for instance, customers can get mixed or even competing messages. If Marketing and Engineering get out of sync on priorities, they can end up working toward different schedule objectives, again with the likelihood of confusing or disappointing the customer.

Meeting these four execution challenges is the most essential element of achieving dominance and going the distance. However, as a company grows, complexity drives a need for more and more sophisticated governance to ensure the execution challenges will be met. In the next section, we look at what we consider to be the four predictable governance challenges required for going the distance.

**Governance Challenges**

In addition to the four execution challenges, there are four governance challenges:

- culture of learning
- leadership DNA
- governance systems
- board of directors oversight

**Culture of Learning**

A learning culture, marked by openness to information and the willingness to change that information, encourages and provides the foundation for success. A learning culture is built on active, useful feedback loops by which leaders can regularly obtain information from markets, customers, employees, competitors, and shareholders. These feedback loops are the “infrastructure” of learning and good decision making. Using that feedback to spur dialogue, experimentation, and coaching will result in a learning culture that consistently renews itself.

The evidence of culture (as with the other predictable challenges we discuss in this book) can be found in various internal indicators we call *vital signs*. For instance, lack of learning in the culture can be diagnosed by signs of slow decision making or frantic activity.
without focus. These kinds of vital signs indicate problems long before those problems affect the more public, lagging measures of success, like revenue growth and customer satisfaction.

Let’s illustrate this with a comparison of two executive teams operating under (and shaping) two different cultural imperatives. One team meets weekly to keep the business on target, but it spends little time exchanging views and focuses almost entirely on monologue status reports. There is no evaluation or comment, except possibly by the leader, and this often occurs after the meeting is over. In time, this pattern becomes an implicit norm for the team: We don’t critique each other’s piece of the business. The other team, however, operates with a lot of discussion. The team members share status reports, but their purpose is as much to get reactions and ideas—to learn—as it is to inform. The first team is missing valuable opportunities not only to learn from each other but to establish a culture of openness and mutual critique that can sharpen their thinking, lower resistance to change, and model learning for others in the organization.

Early behaviors on a team readily become patterns of behavior (culture) and then are hard to break. Thus, it is essential to establish the roots of a learning culture in the earliest stage of a company’s life. The key to assuring this, as we discuss in Chapter 8, is the attitude of the leaders. Learning leaders breed a learning culture.

Leadership DNA

Leaders who are more concerned about personal success than company success can build great companies, but these companies are not likely to thrive after the leaders depart. When leaders are more concerned about their own reputations than their companies’, the focus is on the short term, not the long term.

Authenticity, an orientation to serving others, and a bias for learning are the ingredients of leadership that build companies for the long term. These ingredients in a company’s DNA mean that company will attract and grow leaders with these qualities. These kinds of leaders grow other leaders, build learning into the culture, and focus on building for success long after their own tenures. A company whose leadership DNA—its ability to grow leaders for the future—includes these qualities will meet a key challenge in building a dominant company. In addition to authenticity, service orientation, and a bias for learning, leadership DNA must generate leaders who are suited to the requirements of the markets they serve. Large
companies serving slow-moving markets need leaders who are skilled at building and maintaining a stable workforce and making thoughtful decisions that help the organization grow carefully, often with appropriate risk aversion, given the inherent scale of the company. The characteristics of such leaders are very different from those of leaders working in fast-paced markets where change is endemic, job security is not expected, and boldness wins the day.

In Chapter 9, we look further at how leadership DNA works and how it can be nurtured.

**Governance Systems**

At a certain size, the informal processes of culture and leadership can no longer provide sufficient guidance to assure good decision making and execution in a company. With more employees located in more places, with many more customers, and with many complex tasks to accomplish, informal mechanisms of governance can’t do enough. Successful companies need formal methods of data collection, review, and problem solving.

However, as small companies grow and feel the need for infrastructure or formal governance systems, they often resist developing them. Too often, governance systems are equated with bureaucracy. Bureaucracy means systems for their own sake. Effective governance systems, on the other hand, are useful tools to ensure a company executes on target, sees the road ahead, and makes the turns it needs to make. Fundamentally, they accomplish this by institutionalizing the flow of useful information and the constructive use of that information for good decision making. At their best, they are a formal representation of a learning culture.

When companies grow exceptionally fast, as did many companies associated with the Internet in the late 1990s, the development of governance systems lags behind the need for them. Cisco addressed this challenge as it grew from a few thousand employees to over 30,000. In this effort, Cisco developed a system of operations reviews that drove a constant, healthy process of measurement and self-critique. At the same time, it built decentralized information systems, which both helped and hurt—they facilitated local growth and measurement but they lacked a common architecture. Eventually, these disparate systems had to be unified, an expensive and necessary step in growth and adaptation. This is not an example of doing it the wrong way, but rather of adapting to new needs over
time. IBM and General Electric are also examples of companies that have found ways to restructure their governance systems to facilitate new business goals. We discuss several examples when we delve into governance systems in detail in Chapter 10.

**Board of Directors Oversight**

A board of directors provides a backstop to management’s ability to assess the terrain and make good calls regarding strategy and alignment. When a board is sufficiently attentive to key vital signs, raises tough issues, and makes the necessary tough calls, it contributes to momentum and success.

However, too often boards are weak instruments of governance, having become the proverbial rubber stamp to the CEO’s ideas or often seeming to fall asleep at the wheel while important problems are arising in the company. The year 2002 saw debacles at Enron, Global Crossing, and WorldCom, to name only three. In these companies, internal governance was not capable or trustworthy enough to protect stockholders and employees, and the boards were too weak to prevent the cataclysmic results.

The solution to the problem of weak board of directors oversight is linked to the other governance challenges. If a company has developed a culture of learning, for instance, it is not likely to be interested in a rubber-stamp board of directors, but will instead build a board that challenges management and provokes learning. Leaders bred by strong leadership DNA will similarly look for strong partners at the board level, not subordinates. In the same way, a company with effective governance systems will see the board as an important governing element; it will establish systematic means of guaranteeing that the board has the information it needs to test management’s thinking, raise tough issues, provoke learning, prevent failure, and propagate long-term success.

We look at these and other means of assuring strong board of directors oversight in Chapter 11.

**Summary of the Eight Challenges**

The eight challenges introduced by this chapter, and summarized in Figure 1–4, are the focus of this book. Each is discussed at length in Chapters 4 through 11.
Execution Challenges

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**Figure 1–4** Summary of the Eight Predictable Challenges Faced by Great Companies.
Governance Challenges

Culture of Learning
A learning culture, marked by openness to information and the willingness to change that information, provides the foundation for success. A learning culture is built on active, useful feedback loops by which leaders can regularly obtain information from markets, customers, employees, competitors, and shareholders. These feedback loops are the “infrastructure” of learning and good decision making. Using feedback to spur dialogue, experimentation, and coaching will result in a learning culture that consistently renews itself.

Leadership DNA
Leaders who are more concerned about personal success than company success can build great companies, but those companies are not likely to thrive after the leaders depart. When leaders are more concerned about their own reputations than the company’s, the focus is on the short term, not the long term. Authenticity, an orientation to serving others, and a bias for learning are the ingredients of leadership that build companies for the long term. These ingredients in a company’s DNA mean that company will attract and grow leaders with these qualities. These kinds of leaders grow other leaders, build learning into the culture, and focus on building for success long after their own tenures.

Effective Governance Systems
At a certain size, culture, leadership, and informal processes can no longer provide sufficient guidance to ensure good decision making. With more people, with more locations, with many more customers and many complex tasks to accomplish, informal mechanisms of governance can’t do enough. With growth, successful companies use formal methods of data collection, review, and problem solving. Institutionalizing feedback loops that promote both local decision making and company-wide coordination ensures learning, effective execution, and ongoing growth as a company increases its size and complexity.

Board of Directors Oversight
A board of directors provides a backstop to management’s ability to assess the terrain and make good calls regarding strategy and alignment. When the board is sufficiently attentive to key vital signs, raises tough issues, and makes the necessary tough calls, it contributes to momentum and to success. Too often, though, boards are weak instruments of governance, having become the proverbial rubber stamp to the CEO’s ideas and seeming to fall asleep at the wheel while important problems are arising in the company.

Figure 1-4 continued
In the next chapter, we address how these eight predictable challenges emerge out of the complexity that naturally develops as successful companies grow. In Chapter 3, we discuss the notion of vital signs—early internal indicators of these challenges beginning to grow into threads of failure. From there we proceed to dedicate a chapter to each challenge, delving into each in detail and citing examples that show how each challenge can develop into either a thread of failure or an opportunity to sustain greatness in real companies.