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2011 Best Business Books

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Bob Lutz, **Car Guys vs. Bean Counters: The Battle for the Soul of American Business** (Portfolio/Penguin, 2011)

Roger L. Martin, **Fixing the Game: Bubbles, Crashes, and What Capitalism Can Learn from the NFL** (Harvard Business Review Press, 2011)

Tim Harford, **Adapt: Why Success Always Starts with Failure** (Farrar, Straus and Giroux, 2011)

MANAGEMENT

The Battle for Management's Future

by David K. Hurst

AS THE TUMULTUOUS DECADE of the "noughties" fades into history, the battle lines for the future of Western management practice and thought are becoming clearer. Each of the best business books on the topic of management reviewed this year sheds some light on where and why we went off the rails, and what we should do about it. One book's author is a respected U.S. auto company executive, another is the dean of a Canadian business school, and another is a British journalist. They come at their subjects from very different perspectives, but all their views are insightful, and the overlaps among them are intriguing.

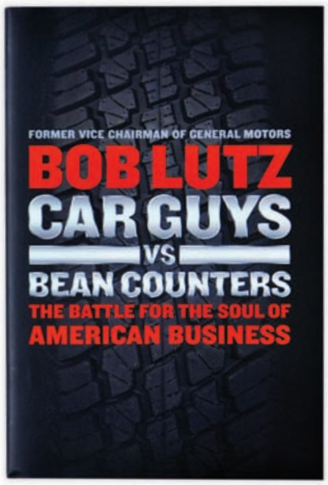
A Detroit Swashbuckler

In *Car Guys vs. Bean Counters: The Battle for the Soul of American Business,* veteran auto company executive Bob Lutz uses his varied experience in Detroit, particularly his nine years as vice chairman of General Motors Company, to show how the U.S. auto industry lost its soul and is trying to recover it. Lutz is a former fighter pilot and a self-confessed "right-brained car guy" with a multicultural background unusual in Detroit (he was born in Switzerland and worked extensively in Europe). He has been described as an opinionated swashbuckler, and he lives up to that reputation in this book, with his outspoken views and entertaining turns of phrase.

Lutz dates the decline of GM to the 1960s, when, in the interests of volume and cost efficiency, the design function was progressively subordinated to the "empire" of finance and accounting, eventually ending up under the auspices of product planning. Instead of producing cars that were objects of passion, he says, "the system created research-driven, focus-group-guided, customer-optimized transportation devices, hamstrung in countless ways."

Lutz's firsthand description of the charisma-challenged, nitpicking, customer-distant "culture of excellence" that GM developed makes for painful reading. He reports how attempts to adopt brand management practices from the consumer packaged goods sector failed because of the much larger scale and longer time frames in the auto industry. Worse still, according to Lutz, GM's elaborate Management by Objectives–based Performance Management Process (PMP) was a "ritualistic time suck" without "a smidgen of customer value." PMP allowed senior managers to hit all their numeric targets and earn bonuses, even as GM steadily lost market share. "[A] senior executive who needs a quantified list of objectives to know what he or she should be working on should not be a senior executive in the first place," he writes.

Not all GM's wounds were self-inflicted. Lutz is highly critical of the government's CAFE (corporate average fuel economy) regulations, which warped the market toward trucks. He also accuses U.S. politicians of failing to bite the bullet and impose a gas tax, which would have raised domestic gas prices to world levels and encouraged drivers to switch to more economical vehicles. Although he is a climate-change skeptic, Lutz says he would raise gas taxes by 25 cents per gallon annually until parity with other countries was reached, just to reduce the country's dependence on foreign oil. In addition, he blames the U.S. government for allowing Japan to maintain an undervalued yen for many years, granting its auto companies a strong foothold for exports before they established U.S. manufacturing operations.



Lutz is equally scathing in his denunciation of the media for what he considers its knee-jerk badmouthing of domestic cars. And notwithstanding his own MBA, he reserves his heaviest salvos for business schools. He argues that their sense of academic inferiority has led to the "needless intellectualization" of business — an economics-influenced perspective from which the customer is never discussed. As a result, the customer has become a "hapless victim" of "MBA bean counters"; any successful products are likely to be value engineered (read: cheapened) to generate short-term gains and long-term disasters. "Rather than bask in the false belief of the superiority of American business education, the big business schools should be asking themselves how and why it all went wrong," he declares. "They have produced generations of number-crunching, alternate-scenario-loving, spreadsheet-addicted idiots-savants. They should be ashamed."

Bob Lutz's charisma comes through in his writing, and it's easy to see how he became an icon in the industry and the champion of car guys everywhere. In the book's next-to-last chapter, he speculates on what he would have done had he become CEO of GM, although he points out that boards of directors typically don't appoint "creative right-brainers" to that post. He would have focused on products first and foremost, creating joint ventures for R&D, and done everything possible to eliminate superfluous activities, scrapping the hallowed PMP and reducing the power of product planning. GM's current leaders may agree. Lutz was retained by the company on a part-time consultancy basis a few months after the book was published.

Lutz wouldn't have acquired many of the car companies that GM actually purchased, but he says he would have bought Chrysler for the significant savings the two companies could have realized in scale and scope. As for trimming the too-numerous GM brands and the inefficiency of GM's sprawling dealership network, he acknowledges that Chapter 11 was a huge enabler in this regard, allowing reductions in both.

Lutz also contends that in the car business, a knowledgeable, autocratic management style is much more effective than the bland "'respect other people's emotional equity' approach that so long characterized GM." But he places the emphasis on *knowledgeable*; executives must be steeped in the business and have almost infallible "taste, skill, intuition, and sense for the customer." He may be right for the car business, although the constraints on unilateral action, even by the CEO, in pre-bankruptcy GM must have been formidable. Lutz's broader recommendation that U.S. companies need to throw out the intellectuals and get back to business will probably not be heeded, but his pragmatic warning that schemes that appear sound in theory often fail in practice is bolstered by many of the findings from behavioral economics, and managers will ignore them at their peril.

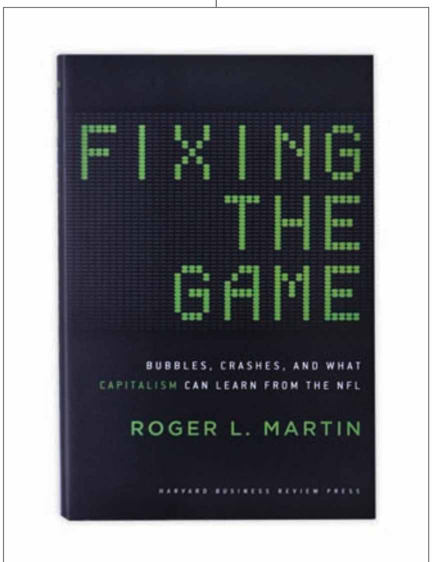
The Parasite Hunter

Roger L. Martin, dean of the Rotman School of Business at the University of Toronto, is fighting to change the way we think about and teach management. His newest book, *Fixing the Game: Bubbles, Crashes, and*

What Capitalism Can Learn from the NFL, has its origins in a fine, prescient article he wrote for *Barron's* in 2003 and is one of the very few business books that is better for the expanded treatment.

Martin sets out to show why capitalism in America has gotten into trouble over the past few decades. He argues that agency theory, derived from neoclassical economics, together with the gospel of shareholder value, has led to managers being compensated for doing the wrong things. Stock-based compensation, for example, focuses executives on expectations markets rather than real markets, where customer value is created. It is this focus on maximizing what should be an ancillary goal that has led to the marginalizing of customers as "marks" to be exploited.

Martin says that executives fix the game of business and try to manage expectations in much the same ways professional athletes would, if they were allowed to bet on games in which they play. Executives indulge in the business equivalents of "point shaving" (sacrificing a few points of advantage to win a game by a lower margin than expected) and "tanking" (making results appear worse than they are to lower expectations and make beating them easier).



The unintended consequence of agency theory, according to the author, has been the creation of a business environment that is akin to a casino, with zero-sum gambling games in which executives win and everyone else loses. Hence the lessons that capitalism (presumably in the guise of regulators) can learn from the National Football League (NFL): Keep real and expectations markets separate (players are banned from gambling), and focus on creating customer value, continually adjusting the playing field to ensure that the players concentrate on improving their performance in the real game.

This real game should be a positive-sum one that has meaning and motivation. Martin thinks that transactional communities have largely replaced the communities of long-term interest, with which public company executives once identified and to which their companies once catered. This has forced executives to lead inauthentic lives, becoming people that they are not, in order to satisfy the desires of an unhealthy, insatiable community of gamblers and speculators. Martin would restore authenticity by having executives focus on creating customer value, a worthy, challenging goal that includes providing a fair return for shareholders.

Many readers will consider Martin's battle plan radical. One of his immediate recommendations is the repeal of "safe harbor" provisions that protect company executives from accepting accountability for their forecasts. He also suggests that accounting rules such as FASB 142 (which mandates goodwill write-downs if share prices fall) be amended to focus only on changes in real markets, removing the need to manage expectations to avoid write-downs. He also wants to outlaw stock-based compensation except for long-term grants that would vest only several years after the recipient's retirement. Anything less, Martin writes, will lead to bubbles and crashes, more corporate scandals, and lower shareholder returns.

Martin turns his attention to corporate governance by contrasting the murky state of governance in Major League Baseball (MLB) — where the commissioner is also an owner — with that in the NFL. He finds that the NFL has shown continuity, purpose, and diligence in the provision of a compelling customer experience. In contrast, MLB has not focused on its customers, running the league for the benefit of the owners and players rather than the fans. As a result, growth in the popularity of football has outpaced that of baseball over the past three decades.

The problem with corporate directors, who Martin likens to the MLB governors, is that they lack both the capability and the incentive to serve outside stakeholders. This leaves them susceptible to the same temptations as executives — perquisites, compensation, prestige, and so on — all of which makes it highly unlikely that they will oppose the CEO on behalf of outsiders. He would have the job descriptions of directors changed so that they focused on customer value and public service, with directors acting like judges, protecting the long-run interests of the community at large, rather than the narrow interests of shareholders. However, the mechanism for this change is unclear.

In the book's penultimate chapter, the author attacks the hedge fund industry and its 2/20 fee formula (2 percent of assets under management and 20 percent of any gains), which he characterizes as predatory. In venture capital and leveraged buyout contexts, the formula is acceptable; any upticks can come only from an increase in real value. In the zero-sum world of hedge funds, however, gains come only if others lose. Thus, Martin believes that hedge funds perform no socially useful function, promote market volatility, and are parasitic. He recommends that they be outlawed or, failing that, taxed to suck excess profitability out of the industry and compensate the community at large for the damage they cause. It's bold recommendations like these, backed by reasoned arguments — together with Martin's call for collective action to protect capitalist society's civil foundations — that make *Fixing the Game* my pick for the best management book of the year.

A Resurrected Russian

In *Adapt: Why Success Always Starts with Failure,* Tim Harford, an economics columnist for the *Financial Times,* describes the economy as "an evolutionary environment in which a huge variety of ingenious profit-seeking strategies emerge through a decentralized process of trial and error." His key conclusion is that evolution is much smarter than we are; therefore, to be successful we must use evolutionary methods.

An evolutionary perspective means, as the book's subtitle states, that success invariably begins with failure. Harford devotes his book to exploring the implications of this idea for organizations and individuals, illustrating his conclusions à la Malcolm Gladwell, with a wide-ranging collection of anecdotes that are often drawn from studies of dysfunctional economies and organizations.

The hero of the book, to whom the author continually returns, is Peter Palchinsky, a brilliant, stubborn, opinionated Russian engineer who was an economic advisor to the tsar and then to the Soviet government, before being executed by the Communists in 1929. His crime was that he saw too clearly that centralized control over economic development could not work, because it did not permit variation and selection — the critical processes of evolutionary adaptation.

Harford identifies three Palchinsky-esque principles for success: "first, seek out new ideas and try new things; second, when trying something new, do it on a scale where failure is survivable; third, seek out feedback and learn from your mistakes." This sounds simple, but applying these principles is more difficult than it seems, as the author shows by tackling some of today's major political, economic, and social challenges.

For instance, Harford uses the invasion of Iraq to demonstrate how a refusal to learn from mistakes and adapt led to a failure in the city of Tal Afar — a near-rout that was rescued from disaster only through an improvised experiment. The conductor of this experiment, which harnessed the efforts of the locals to expel the terrorists, was Colonel H.R. McMaster, another of Harford's heroes and a veteran of the Vietnam War.

McMaster wrote a definitive examination of the failures of leadership in Vietnam, which showed how Lyndon Johnson and Robert McNamara had enforced a rigid hierarchy, insisted on unanimity, and put too much faith in the centralization of data and the use of quantitative methods for analysis. (Their story sounds eerily like the actions of the senior executives at GM that Bob Lutz describes.) It's instructive, too, that in the process of winning over the local insurgents in Tal Afar, McMaster makes enemies of his superiors and is repeatedly passed over for promotion to brigadier general, an omission that was recently remedied by McMaster's like-minded boss, General David Petraeus.

A short review cannot do justice to all the perspectives that Harford uses to illustrate the application of Palchinsky's principles. He discusses how new ideas can be created, how to conduct experiments to tease out the webs of cause and effect, and the multiple ways in which leaders can profit by admitting failure and learning from experience. My only criticism is that at times Harford appears to regard variation as the opposite of standardization, with the implication that "uniformly high standards are not only impossible but undesirable." Certainly this is true of mindless standardization for the sake of uniformity, but it is not true of the rigid but mindful standardization of approaches like the Toyota production system, where standards form the foundation of the controlled experiments that take place on the factory floor every hour of every day. Without such standardization, there can be no helpful variation. One feels sure that Peter Palchinsky would agree.

An Exciting Future

For much of the 20th century, American management was preoccupied with managing growth and the burgeoning scale of corporate operations. By and large, organizational solutions such as decentralization, functional specialization, and hierarchy were successful in meeting the challenge. Now that challenge has changed, and management, especially in the West, is engaged in a struggle to reinvent itself and its institutions.

Neoclassical economics, which provided managerial logic and legitimacy in the last century, is less and less relevant. It doesn't answer questions about how to create value, for instance, and its assumptions of market equilibrium are unhelpful. In fact, for many companies, market failure is no longer an aberration, but a starting point and a source of opportunities.

The actions taken to exploit these opportunities will not necessarily benefit the community as a whole. Indeed, as we have seen throughout history, market failures can be fertile ground for antisocial and even criminal enterprises. So, along with the field of innovation, the whole philosophy and practice of regulation will have to be rewritten.

These tasks will require evolutionary and behavioral perspectives that enable us to better understand the origins and actions of institutions, markets, and firms. Management scientists may even become a little more humble, with a renewed respect for and interest in entrepreneurs and their practical wisdom. This year's best business books on management lay out the battle lines. ✚

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is a contributing editor to *strategy+business* and author of its Books in Brief column. His writing has also appeared in the *Harvard Business Review*, the *Financial Times*, and other leading business publications. Hurst's next book, *The New Ecology of Leadership*, will be published by Columbia University Press in the spring of 2012.

Michael Spence, **The Next Convergence: The Future of Economic Growth in a Multispeed World** (Farrar, Straus and Giroux, 2011)

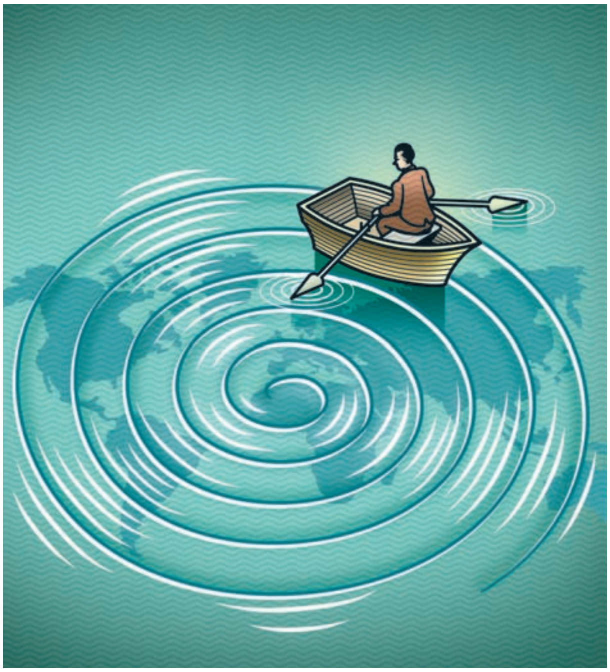
Jeff Madrick, **Age of Greed: The Triumph of Finance and the Decline of America, 1970 to the Present** (Knopf, 2011)

Sylvia Nasar, **Grand Pursuit: The Story of Economic Genius** (Simon & Schuster, 2011)

ECONOMICS

A Dismal Outlook?

by David Warsh



IT'S BEEN A GOOD YEAR for economics books. Autopsies on the economic crisis of 2008 continued to tumble out in 2011, some of them quite compelling. But it is clearly time to look to the future, and a spate of notable books describing the changing profile of the global economy did just that, including *World 3.0: Global Prosperity and How to Achieve It,* by Pankaj Ghemawat (Harvard Business Review Press, 2011); *The Post-American World: Release 2.0,* by Fareed Zakaria (W.W. Norton, 2011); and *The Globalization Paradox: Democracy and the Future of the World Economy,* by Dani Rodrik (W.W. Norton, 2011).

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