Surprise: Those ‘great’ companies generally turn out to be meh ... or duds

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Outside the Box

By

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After all the hoopla, McKinsey finds that over the long run, most struggle to outperform the S&P 500

What happened to the world's "greatest" companies?

We tracked the long-term fortunes of the 50 companies lauded in the seminal business books of the past three decades. What did we find? Take greatness with a grain of salt—even the greatest answer to trends and forces.

Three books sit on more executives' bookshelves than any others: "In Search of Excellence" (1982), "Built to Last" (1994), and "Good to Great" (2001). They turned their authors into management gurus, especially Tom Peters ("In Search of Excellence") and Jim Collins (the other two titles).

All three use the same basic method: list companies that are "great" or "excellent" or "enduring," then attempt to infer the transferable formulae behind said greatness, excellence and endurance. The promise is that by mimicking their practices, you will be able to mimic their performance too. (For an excellent overview of the pitfalls of doing this, check out Phil Rosenzweig's "The Halo Effect.") But what actually happened to them? And what does their fate suggest about the future of today's corporate greats?

To begin, let's set a few things straight. First, these books are definitely worth reading (more than 10 million readers can't be wrong). Second, the prescriptions in them are fairly sensible, if somewhat vague. Finally, the authors selected these companies for a good reason.

It's this final point that I find most interesting. In the zeitgeist of the day, they were truly incredible organizations with enviable performance, widely admired leaders, and strong cultures. So looking at what happened to them makes for a great natural experiment where the company's quality is a given — the variable is the context in which it operated.

Our three books mention 50 companies — well, actually 60, but 10 of them

get the honor of appearing twice (in fact, half of the “Built to Last” companies were in “In Search of Excellence” almost a decade before). This combined list is interesting in itself. When I talk to our newest batch of McKinsey recruits about a great company called Wang Labs that made these things called mainframes and word processors, they look at me like I’m strange. This is even more the case when I tell them Kodak was once one of the most respected companies on earth.

To see how these great companies fared, our research team dug out their share price and dividend data, and assessed their performance 20 years after the books’ publication (or, in the case of “Good to Great,” 15 years up to December 2016). We then created a “buy and hold” portfolio of $100 invested in each stock. If a stock had been de-listed, we assumed the closing amount was reinvested into the index. Let’s call these portfolios ISOE, BTL and GTG, after their respective books.

So what did we find? If you bought a portfolio of these companies and held them for two decades, you would have beaten the S&P 500 index by 1.7 percentage points. Not bad! GTG is in the lead at a 2.6 percentage-point outperformance, followed by BTL at 1.6 percentage points and ISOE at 1.5 percentage points.

But this rosy picture looks a little different up close—as experienced by the companies themselves. Their fates could not have diverged more:

Performance of the “excellent,” “lasting” and “great” companies vs. the S&P

	"In Search of Excellence"	**"Built to Last"**	**"Good to Great"**
	(1982-2002)	(1994-2004)	(2001-2016)
Stars (more than	Wal-Mart	Philip Morris	Phillip Morris

5 percentage points	Intel	Marriott	Nucor
better than the market)	Merck		
	Johnson & Johnson		
Outperformers (more than	Procter & Gamble	American Express	Kroger
2 percentage points	Avon Products	Johnson & Johnson	Wells Fargo
better than the market)	Walt Disney	IBM	
	DuPont	Wal-Mart	
	3M	Nordstrom	
		3M	
Middle	Dow Chemical	Procter & Gamble	Gillette (a)
	Bristol-Myers Squibb	Boeing	Kimberly-Clark
	Boeing	Walt Disney	Walgreens
	Amoco (a)	Merck	Abbott Labs
	Emerson Electric	Hewlett Packard	
	McDonald's	General Electric	
	Caterpillar		
	Texas Instruments		
Underperformers (more	Maytag (s)	Ford	
than 2 percentage points	Hewlett-Packard		
worse than the market	IBM		

	Delta Air Lines (s)		
Failures (more than 5 pct.	Schlumberger	Citicorp	Pitney Bowes
pts. worse than the market)	Kodak (s)	Motorola	Fannie Mae
	Raychem (a)	Sony	Circuit City (b)
Key	Amdahl (a)		
(a) Acquired during	Dana (s)		
evaluation period	National Semiconductor (a)		
(b) went bust during	DEC (a)		
evaluation period	Data General (a)		
(s) subsequently acquired	Kmart (b)		
or went bust	Wang Labs (b)		

We came to some interesting, even surprising, conclusions.

Great companies were more likely to do really badly than really well.

Their odds of outperforming the stock market were 52-48, hardly better than a coin toss. But there are more big losers than big winners on the lists. Just eight companies outperformed the index by more than 5 percentage points, while twice that number underperformed by the same percentage. Given the difficulty of beating the market, it's no surprise that the biggest group is in the middle band of plus or minus 2 percentage points.

A few great companies is all it takes for a portfolio to outperform.

So if the typical company didn't do so well, why did the portfolios

outperform? The magic of compounding means a few extremely good stocks can offset many poor ones. When you take the four best performers —actually, three companies: Wal-Mart **WMT, -0.83%** and Intel **INTC, +0.38%** in ISOE, and Philip Morris **PM, +0.53%**, which appears in both GTG and BTL—out of the portfolios, the positive margin almost completely disappears.

In other words, if it were not for cigarettes, Jim Collins's outperformance would literally go up in smoke. This elite group of four would end up being worth 27% of the 60-company portfolio.

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Greatness is no guarantee of survival.

It seems the 18 organizations featured in "Built to Last" really *were* built to

last, as all the companies in the BTL portfolio are still around. The other two portfolios have quite a few dropouts, however. During the 20-year evaluation period, about 1 in 7 disappeared as independent entities. Two well-performing companies were acquired (Amoco and Gillette, bought by BP and P&G respectively). Four low performers were also swallowed up (Amdahl, Data General, DEC and Raychem), and three went bust (Kmart, Wang and Circuit City). Another five fell off the list after the period we evaluated, including Kodak’s famous bankruptcy in 2013.

So, did being great matter to these companies’ ultimate fate? In my view, it was good to be great, but the external environments in which these companies found themselves mattered far more. If you look at the stars versus the failures, the biggest dividing line seems to be their position in relation to a megatrend—either a good one or a bad one. Yes, it takes skill to ride a megatrend—Wal-Mart had to manage its meteoric rise from No. 259 on the Forbes 500 to No. 1—but all these companies were skilled, and on the whole that didn’t seem to matter as much.

Contrast, for example, Wal-Mart, which rode the wave of modernized hub-and-spoke and IT-driven supply chains, with Kmart, which stuck to the earlier approach of direct-to-store delivery. Or compare Intel, a champion during the PC era, with Amdahl, National Semiconductor, DEC, Data General and Wang Labs, which were leaders of yesteryear’s centralized-computing world. Merck **MRK, -0.89%** and Johnson & Johnson **JNJ, -0.05%** grew in the age of Big Pharma’s rise to the status of the most profitable industry in the world, while Philip Morris prospered when Big Tobacco became almost as profitable—ironically, on the back of anti-smoking policies that made costs lower (no ads!) and price inflation higher.

Motorola and Sony struggled to adapt to the Apple era, while Pitney Bowes (postage) and Kodak (film) were built on and failed to pivot from declining

technologies. The emergence of global manufacturing also seemed to catch former greats such as Dana and Raychem on the wrong side.

As is often the case, Warren Buffett captures the moral of the story astutely: “When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.”

So, what does all this mean? Take prescriptions of greatness with a grain of salt. In particular, watch out for the common tendency to underplay the role of context and luck, and over-attribute success to things that are easily visible, controllable or flattering. Go to the substance, not the form: It’s not the fact you have a BHAG (Big Hairy Audacious Goal) but whether or not it is actually a good one.

And, above all, respect the trend, do everything you can to get ahead of it, and don’t kid yourself that you can fight it. Even the greatest companies couldn’t hold back the tide.

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