PART I

The Ephemeral Nature of Firms

CHAPTER 1

Meet Carl Berger

Luke was the driver and general errand runner for the top executives at American Health Devices, Inc. (AHD), a global medical products company based in Trenton, New Jersey. It was an unusually sunny and warm day in November 2004 when he stood nervously at the JFK airport, waiting to meet his new boss.

The last guy, Rittenhouse, was pretty harsh, all business and all boss, never even a smile, so Luke was pretty surprised when Carl Berger emerged, having cleared customs after his flight from Tokyo. This young-looking man, with an open face and dark hair, had to be the new CEO. He'd already nodded and smiled when he saw Luke's AHD sign and he was heading directly toward him.

Luke gulped, "Good morning, Mr. Berger. I'm Luke, your driver."

"Nice meeting you, but call me Carl," Berger said as he reached out for a handshake. Luke then reached for Carl's fine, but worn, leather suitcase, but the new CEO hefted it himself. "I've got it," he said. "Show me where you parked."

Luke appraised his new CEO, getting used to his unassuming manner. To his shock, his CEO seemed to be appraising him, too.

"Thanks for coming to get me, Luke," Carl said. "Have you been with the company for a long time?"

"Five years or so, Mr. Berger," Luke said, as he drove the car swiftly down the road heading toward AHD's offices. "I drove your predecessor, Mr. Rittenhouse."

"Please call me Carl," the new CEO said again. There was no edge to his voice, but still, it was clear how naturally he could exercise authority.

"Yes, Mr. Berger, ahh. I am sorry, I meant Mr. Carl, uh, Carl."

"That's fine, Luke," Carl said. "How are things at AHD? Do you like your work?"

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"Working at AHD is a big honor for someone like me, who hasn't been to college. After all, it's one of America's top firms," Luke said.

Carl sat back and enjoyed the view of New York's skyline as they drove toward AHD's headquarters. He was so proud to be back home.

Carl's thoughts wandered to the events of the past few months.

AHD was a leading firm in the global medical device industry. Medical devices are products used for medical purposes in patients, in diagnosis, therapy, or surgery. Products include implantable devices (such as orthopedics, dental implants, optical devices, and hearing aids), capital equipment (like MRI and PET scanners, or X-ray machines), and related supplies.

In 2004, the medical devices industry was fast-growing and highly profitable. AHD was a strong and respected player in three market segments: orthopedic implants, dental implants, and diagnostics.

AHD was a long-standing leader in the reconstructive *orthopedic implants* market. In the late 1970s, due to a breakthrough innovation in coating technology, it had built an enviable market position and reputation with implant products such as joint replacements for hips and knees.

In the 1990s, AHD had seen *dental implants* as a natural extension of reconstructive implants, with a chance to exploit its core product development capabilities and unique manufacturing technologies. Dental implants was a small, niche market. However, given a large unaddressed patient population in industrialized and developing countries, it was growing very fast.

The *diagnostics* market on the other hand was large, mature, slow-growing, and commoditized. Diagnostics companies provide laboratory equipment and supplies to clinical labs, hospital labs, and large specialized labs for tests such as tumor screening and blood testing. AHD, however, focused on point-of-care (POC) diagnostics, which included testing equipment used in practices and clinics, a fast-growing and profitable niche in the broader diagnostic market.

AHD was based in New Jersey, but—with more than 25,000 employees in 40 countries—it was a truly global firm. The board of directors and the management team alone were composed of individuals of 10 different nationalities.

AHD's former president and CEO, Everson Rittenhouse III, always "Mr. Rittenhouse," and usually "Mr. Rittenhouse, sir," had retired in the summer of 2004 without having cultivated any obvious successor. The board of directors had been discussing the succession for almost a year, a period in which it screened several internal and external candidates and deemed them unsuitable for the top job.

In the spring of 2004, Hubert Meyer, the senior member of AHD's board and the head of the nomination committee, had contacted Carl, who was already known in the medical products industry as a young, competitive, and ambitious leader. At the time, Carl was the vice president of marketing and sales and a member of the executive team of KenkoInc in Japan. KenkoInc was a small but very fast-growing orthopedic implants company owned by two Asian private equity firms. It was located in Osaka and had sizable market positions in several Asian markets. Carl had been the vice president of marketing and sales of KenkoInc since its founding in the second half of the 1990s. It was clear to everyone in the medical device industry that he was the man behind KenkoInc's growth and success.

In the spring of 2004, Hubert was traveling in Japan. He visited Carl in Osaka "to talk business," as Hubert put it. Hubert was a tall man in his early sixties and, like Carl, an American citizen. He was soft-spoken, thoughtful, and well-educated. He had made an impressive career in the electronics industry and commanded respect in the broader American business community and the international high tech community for his business acumen, his judgment, and his integrity.

Hubert and Carl talked little business, though. They spent much of their time talking about family and personal matters. This was somewhat surprising, since they had never met before. Carl immediately felt at ease with Hubert, however.

At the end of the day, while they were driving to the airport for Hubert's flight back to the United States, Hubert—almost casually, it seemed—asked Carl, "Would you consider moving back to America to work for AHD?"

Hubert talked about an emerging opportunity to run one of AHD's three divisions, but did not specify which one. The ambitious Carl was obviously very interested, as AHD was 10 times the size of KenkoInc.

"Well," Carl said, "I'm honored by the possibilities your question implies. Joining AHD's management team would be quite an opportunity."

But in the months that followed, Carl heard no more from Hubert and Carl thought that he had probably changed his mind.

Then, six months later, when he had almost forgotten the encounter, Hubert called: "Carl, we are considering you for the position of president and CEO of AHD. Can you meet some of our board members?"

"Wow," said Carl. This was beyond his wildest expectations. All manner of thoughts rushed through his mind, and he had to control his emotions. "When do you need an answer, Hubert?" he asked.

"You have 24 hours; is that sufficient?" responded Hubert.

Carl took a few hours off. He went for a walk in Sankaku Park, close to KenkoInc's head office. He had to sort out his thoughts, to think the matter through. In the evening, he and his wife, Gwen, talked about the opportunity for several hours. In the mid-1990s, Carl had received an offer from two private equity firms to help set up and develop KenkoInc in Japan. The move looked very risky, but Carl saw it as a unique opportunity to accelerate his career. At the time, Gwen had accepted the move reluctantly. It hadn't been ideal for her career as a radiologist, but now after eight years, she loved living in Japan. They had many friends, and their two children, Dave and Alex, were happy, doing well at school, and developing marvelously. Gwen knew what the CEO role at AHD meant to Carl, and she was ready, though certainly not immediately happy, to move the family back to New Jersey.

For as long as he could remember, Carl had worked hard, really hard, for this opportunity.

Carl was a product of institutional foster care. His parents died in an accident when he was four. He grew up in an orphanage in New York, where affection and care were in short supply. Fighting for care makes one competitive. Under an apparently soft-spoken and unassuming exterior, there was a competitive and ambitious Carl. He was always under pressure, under pressure to demonstrate to the world, and to himself, that he was worthy.

Carl's appointment as head of AHD would be the culmination of an impressive career, and an ultimate demonstration of Carl's abilities. To a man in constant search of recognition and admiration, it felt like a triumph.

"After all these years, and these sacrifices, I've got a shot at becoming the head of AHD. This is incredible," he thought.

Carl spoke the following morning with the chairman and the main shareholders of KenkoInc, and they agreed on a way forward. Then he called Hubert: "I would be delighted to interview for the position of head of AHD. Just to be offered a shot at it is a great honor for me. Thank you for your trust in my abilities. When do you want me to come over?"

"Can you be here next week?" asked Hubert.

Two months later, the board appointed Carl as president and CEO of AHD. Despite his success with KenkoInc in Asia, Carl's appointment to the top job at AHD was a surprise to everyone, in the company, in the industry, and in the country. The U.S. media covered Carl's appointment extensively. Some newspapers saw it as a huge mistake. They described the matter as if one of the leading companies in the country had been entrusted to an inexperienced child.

In his early forties, Carl was indeed young and inexperienced. Rittenhouse had retired at the age of 65, after 10 years at the head of the company. Most members of the top management team were in their fifties. Carl had no relationships with any of AHD's important customers. He had no experience in two of AHD's three business lines. And he had not received any exposure to the U.S. medical device market, which represented nearly 50 percent of AHD's sales.

From Day One, Carl's start at AHD was rocky.

After a series of short introductory meetings—with his executive assistant, with the head of the CEO's office (a kind of chief of staff), with the group executive committee (called the Group Executive Team, or GET, for short), and with the staff in the large auditorium of the Trenton headquarters—Carl met with the CFO, Monica, to discuss AHD's upcoming fourth-quarter results.

Monica was Australian. She was highly respected in the investor community. She had been one of the two internal candidates for the top job, but she did not seem to resent the Board's decision. Her short hair, clipped Aussie accent, and severe suits bespoke serious competence, an impression soon undermined by the unfolding of events.

"The estimates of the earnings for the last quarter of 2004 show a 38 percent decline from last year," Monica had told Carl shortly after he took office. She continued: "This is due to adverse exchange-rate movements, and to some hypercompetitive moves at the edge of legality by some of our competitors. Our underlying position and momentum remain strong. Don't worry, the investors will understand it."

They didn't. On the release of the fourth-quarter results in mid-January 2005, AHD's share price fell by 11 percent.

But the fourth-quarter results weren't the only issue. Just one week later, Carl was informed by Monica of a pending U.S. class-action lawsuit against AHD related to diagnostic instruments sold in the United States in 2002. "We weren't expecting this, Carl. But don't worry, our lawyers believe that we can easily manage it," proclaimed Monica.

When he discussed the matter with a lawyer he trusted, Carl did worry. In 2002, AHD had experienced a serious problem with the quality of the products in one of its manufacturing plants. Nevertheless, knowing that the problem existed, AHD still had delivered faulty diagnostic instruments to customers. Subsequently, AHD had been obliged to recall a large number of products, which had seriously damaged its reputation in the U.S. market. When Carl had interviewed for the top job, AHD executives had told him that the quality and recall matters had been resolved. Now, to his surprise,

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he found himself confronted with a class-action lawsuit hanging over AHD like the Sword of Damocles.

Nor were the poor fourth-quarter results and the class-action lawsuit the only unpleasant surprises Carl encountered. As he learned more about the company, Carl soon realized that AHD was no longer exactly the lighthouse firm that he and others had thought. It seemed that AHD had lost its edge in the past few years.

AHD had missed several technological developments. The medical device industry was dynamic. Many technological innovations and scientific advances—such as molecular markers for diseases, genomics, electronics, and material science—had vastly expanded the scope of new customer solutions. Unfortunately, this also had greatly enlarged the number of competitors, who were taking advantage of new technologies to make inroads into the industry. Also, AHD had failed to expand into new geographies.

In a dynamic and fast-growing industry, AHD had struggled to keep up, and had grown more slowly than its competitors. It had lost market share in all three product lines and in most of its markets. Since its infrastructure was designed for growth, and for increasing sales and production volumes, profitability was depressed. AHD was hardly making any money.

In early 2005, a Wall Street investment banker visited Carl. The fourth-quarter results had triggered a wide range of market rumors about AHD. There was much speculation about a possible imminent takeover. Deutsche Medizinal-Technik (DMT) AG, a young and innovative German medical device player that had outgrown AHD in recent years, was believed to be preparing a takeover bid for the weakened AHD. The investment banker came to test the waters, trying to understand how the management of AHD would react to a takeover bid.

Carl was frustrated with the situation. He had been successful in developing KenkoInc in Osaka. He knew what it took to compete and win in the medical device industry, but he was not so sure that he knew how to carry out a turnaround for AHD, a company that might soon be confronted with a takeover bid from a competitor.

Carl felt isolated. It seemed that he couldn't count on much help from his colleagues on the senior management team. The welcome for the whiz kid—as he was cynically, but not openly, referred to—from his colleagues in the senior management team had been frosty, to say the least. He had learned in his life that it was an advantage to appear unassuming with people—but now he wasn't so sure. A slightly more intimidating manner might come in handy right about now.

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One evening over dinner, Carl shared his frustrations with Gwen. He spoke of his fear that he might become known as the last CEO of AHD, his fear of failing. He asked her: "Will this be the end of my career? I cannot let this happen. But how can I turn AHD around? Why did AHD get here in the first place? How can it be that one of the greatest firms in the medical device industry has become a takeover target? How is it that DMT AG, a much younger and smaller firm, can now threaten the existence of AHD? It is as if AHD, a once young, vibrant, healthy organization, has become old and fragile."

Gwen listened carefully, and Carl's last comment provoked a thought. She told him about a meeting with Carla, an old friend of hers, who was now teaching strategy at Yale. She was doing research on the process of how companies emerge, grow, and eventually die. "She studies the aging process, Carl, and how it affects organizations. Maybe you might find some insights there. Shall I see if I can get a hold of her most recent study?"

The next day, she did. That day, Gwen had also news of her own that she wanted to share with Carl. A prestigious laboratory had offered her an excellent part-time position working on a significant radiology research study. But seeing Carl plagued with doubts and uncertain about what he would do next, she decided she would wait and tell him over breakfast the next day. Carl needed time to think about AHD.