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Features

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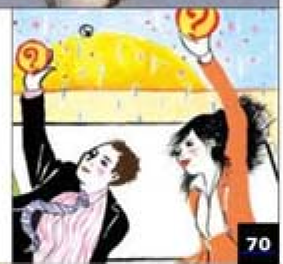

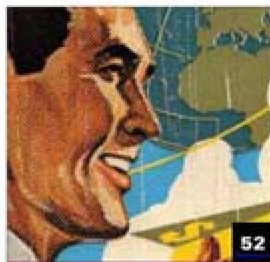

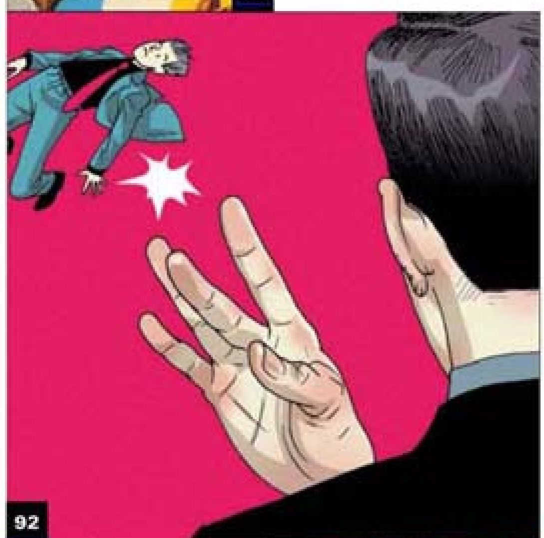

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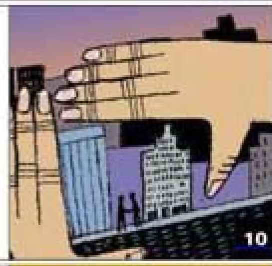

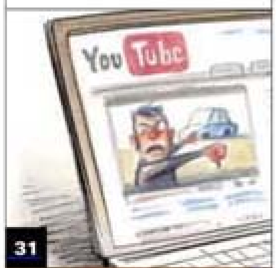

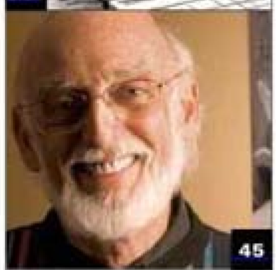

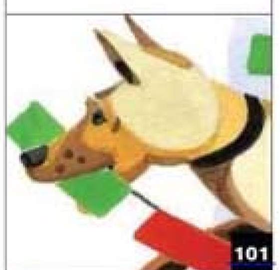

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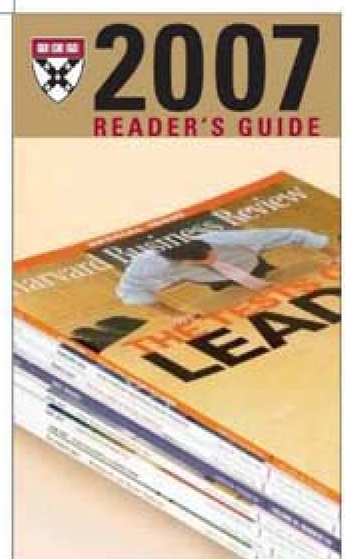

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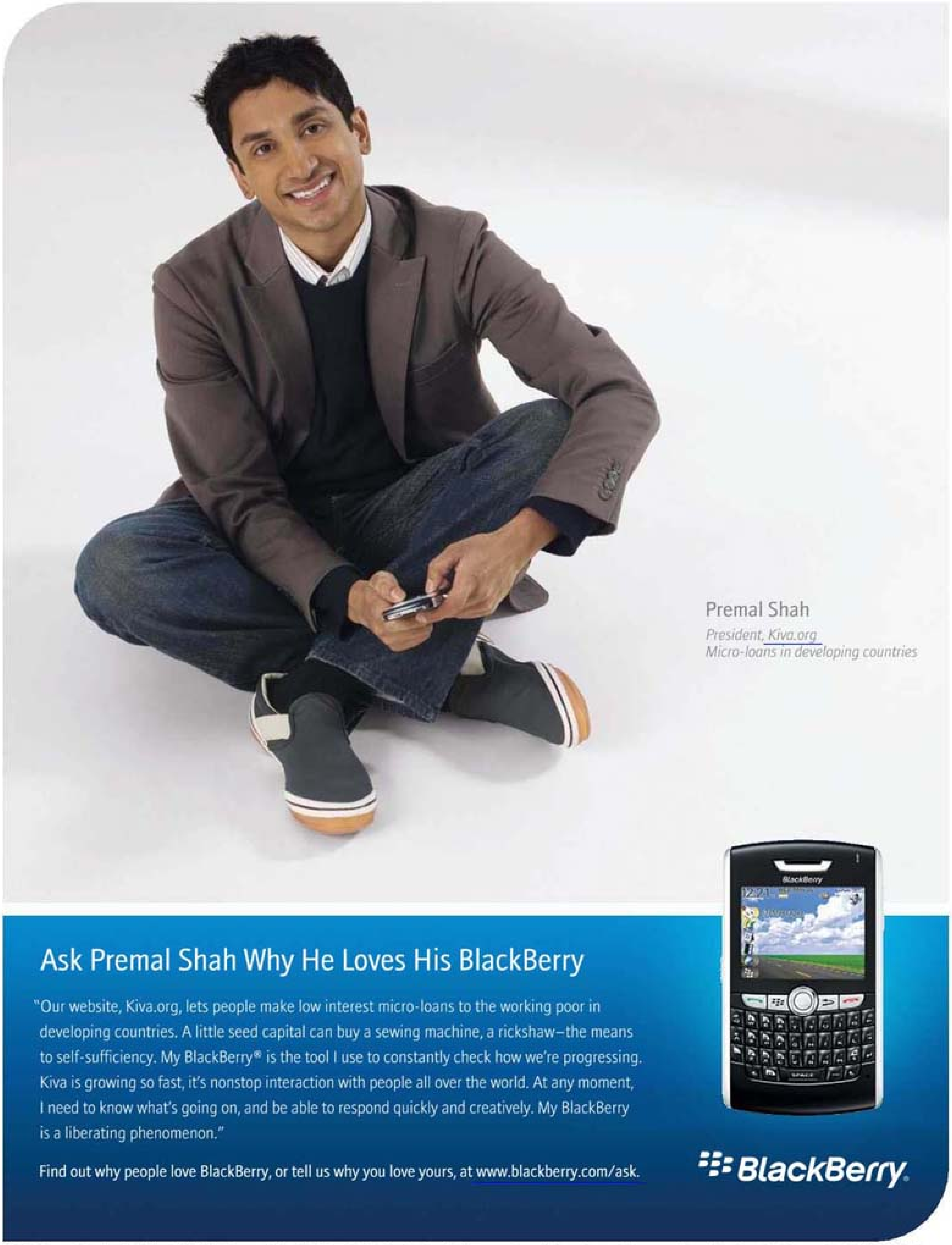
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"Quotes, woof, woof, woof, woof, closed quotes."

Roy Delgado

Vision, Frame, Action

LEADERSHIP IS the art and science of getting things done through people. In last month's editor's letter, I wrote about the leader's role as a sense maker: a person who helps others see pattern, meaning, and direction in data and events – to see constellations where others see stars. A number of articles in this month's HBR are about the leader's role as a storyteller, an important topic because it is through stories that leaders so often enlist others in support of their ideas – so that they, too, aim for the stars.

I've always been struck by the paradox that we want leaders to be authentic at the same time that we expect them to be good performers. Conversely, we admire actors whose performance convinces us that they're not acting. For a time, when my older brother and I were children, he had thumbtacked to his bulletin board a postcard that struck him as funny (and me, too, or I wouldn't have remembered it). It read, "Always be sincere, whether you mean it or not."

It takes a truly expert storyteller to explain that paradox, and we've brought you one. Peter Guber has made his (considerable) fortune on the basis of his gift for knowing a good story when he sees one and his skill at developing good stories into great ones. The CEO and chairman of Mandalay Entertainment, he has produced extraordinary movies (*Rain Man, Batman, The Color Purple,* and *Midnight Express,* among others) and run big companies (including Sony Pictures, PolyGram Filmed Entertainment, and Columbia Pictures). He has also learned how to preach what he practices, as a long-serving professor at UCLA's School of Theater, Film & Television, where last spring he taught an MFA/MBA course on the philosophy of storytelling.

From his experience as artist, executive, and academic, Peter has distilled what he believes are four essential ways a story must be true in order to engage and move its audience: truth to the teller, to the audience, to the moment, and to the mission. I'll leave it to him to expand on those points – and commend "The Four Truths of the Storyteller" to you as one of the smartest leadership articles you'll have read in some time.

Barbara Kellerman's article looks at this topic through the other end of the telescope. "What Every Leader Needs to Know About Followers" isn't about stories, but it is about what leaders try to do with stories – namely, to enlist the support of other people. Barbara, a lecturer at Harvard's Kennedy School of Government and the author of several other HBR articles (including last year's "When Should a Leader Apologize – and When Not?"), here makes it her purpose to help us understand the different ways in which followers engage with – and disengage from – their leaders. Understanding the five different kinds of engagement she describes will, I am sure you'll agree, help you be a better leader.

From a December issue as rich as a Christmas pudding, let me pull out one more plum: George Day's "Is It Real? Can We Win? Is It Worth Doing?" For many years, George, a professor at the Wharton School, has been helping companies analyze their innovation portfolios. Invariably, he finds they are disproportionately full of small projects that soak up resources, including attention, but generate only incremental gains. To help managers address that problem, he has put before them a brilliant decision framework whereby they challenge each project to show that it's real (Is it a marketable innovation or just pie-in-the-sky?), to demonstrate that it connects to the company's competitive advantage, and to prove that it's big enough to matter. Over a period of more than 20 years, George has perfected this framework and used it with superb results at companies like GE and DuPont. Senior editor Gardiner Morse persuaded George to write it down. You'll be glad he did.

Thomas A. Stewart

Robert Meganck

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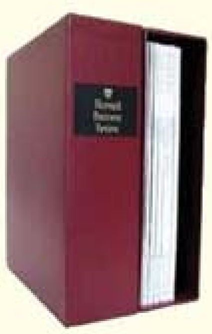

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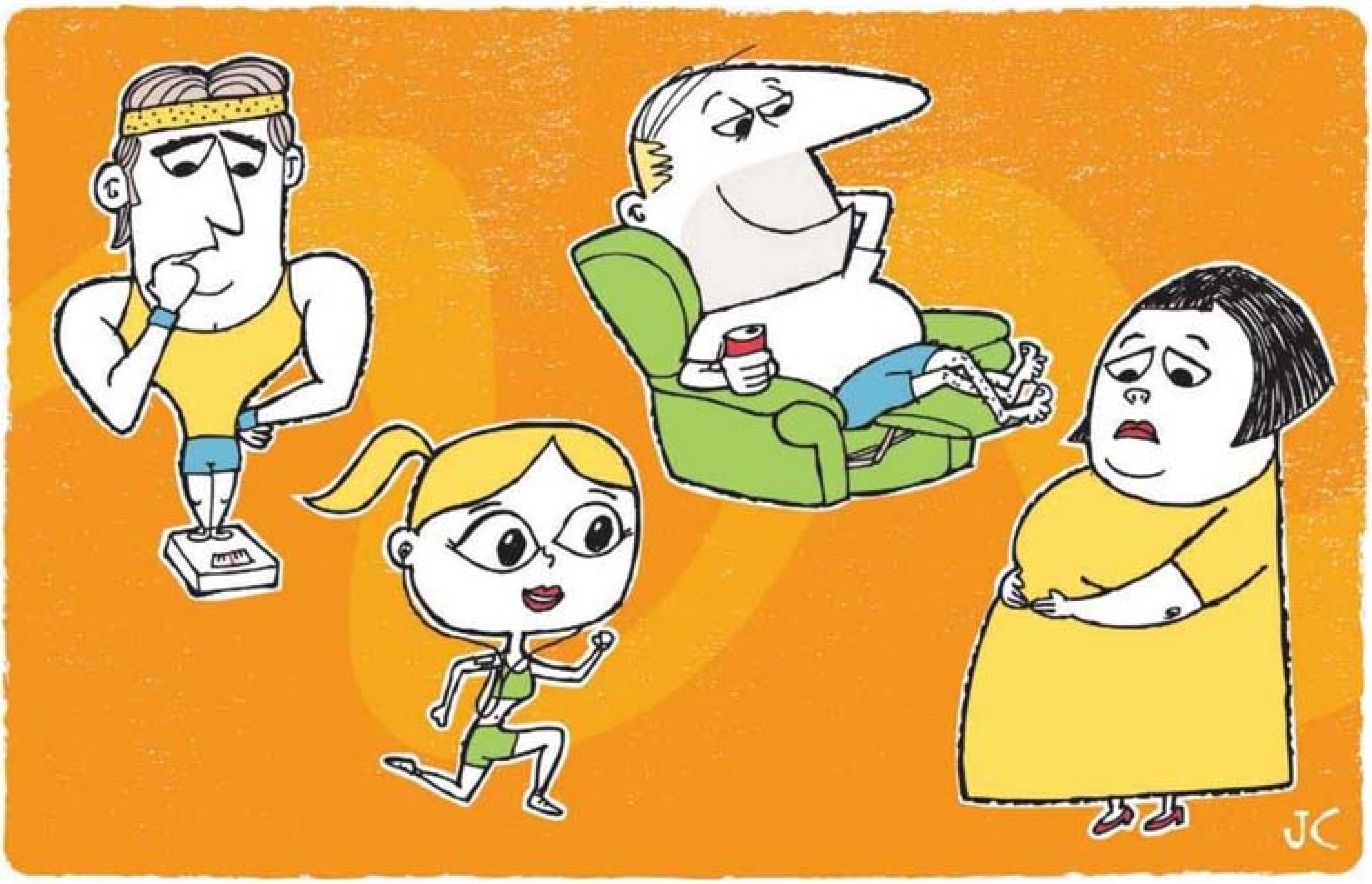

GRIST

What Health Consumers Want

by Caroline Calkins and John Sviokla

Consumers of health care constitute a market that is as diverse as a market can be, yet the idea that companies might profit by segmenting customers to address their varied needs seems almost foreign to the health industry, despite the billions of dollars at stake. We believe companies can uncover areas of untapped value by analyzing patterns in demand for health products and services. A particularly revealing way to segment health consumers, according to our research, is to analyze health and wealth at the same time.

In a survey of 570 people, we looked at consumers' medical needs, their attitudes about staying healthy, their financial requirements, and their financial confidence. We also asked about a range of related issues, such as which providers the respondents trusted and which they didn't. (The research was conducted with Patricia O'Brien, MD.) Our analysis revealed four broad groups of consumers, each with a distinct health/wealth profile:

Healthy worriers are receptive to new health products and services and are willing to change their behavior to improve their health. But as they see health costs rise faster than their income, they feel intense financial pressure. They believe they must make trade-offs between their health and their wealth, and they lack confidence about their ability to pay for future care. Their survey responses

John Coulter

indicate that the best way to reach them may be through their employers and that these consumers want services to be convenient and simple. Indeed, many of them feel overwhelmed by choices.

The *healthy, wealthy, and wise* are the most fit, health conscious, and financially confident of the survey respondents. Many of them would purchase complex health- and wealth-related products such as high-deductible health insurance, confident they would use them effectively. They want more choices. Relationships, self-directed analysis tools, and quality service are the keys to influencing their decisions.

The *unfit and happy* are self-directed when it comes to finances but are overconfident about their health and ability to pay for future care. They tend not to trust doctors or other health care providers, and although relatively affluent, they are the least receptive to new products and services. Serving these individuals means providing tools and incentives to enable them to help themselves.

Hapless heavyweights score below the mean on financial confidence and are the least health conscious; some 72% of them are overweight. They resist help yet feel incapable of improving their situations on their own. Of all the segments, this group needs the most external motivation, including support groups and financial penalties.

Segmenting consumers this way, we believe, will generate innovative thinking on the part of companies within and on the edges of the health industry – organizations ranging from medical practices to life insurers. As an example: Financial services firms could target certain of the segments, offering savings and investment programs that meet segment members' particular needs. They could respond to healthy worriers' desire for simplicity – and their desire to save for future health needs – by marketing "opt out" savings programs in which an amount is deducted from each paycheck unless participants go to the trouble of declining the offering (such programs have radically higher compliance rates than the opt-in variety). Focusing on the healthy, wealthy, and wise, firms could market tax-free health savings accounts to consumers who choose high-deductible insurance plans.

Providers, insurers, and employers could use the segmentation to better communicate with and engage members of the various groups. For the benefit of the unfit and happy among its employee base, for example, a company could explain the financial incentives of various health options, showing how much of their own money consumers could save over time by participating in, say, a diabetes management program. Studying consumers' health/wealth profile will have additional implications for many participants in the health care industry.

Caroline Calkins (caroline.calkins@diamondconsultants.com) directs research on consumer, technology, and management trends for Diamond Management & Technology Consultants, based in Chicago. **John Sviokla** (john.sviokla@diamondconsultants.com) is vice chairman of Diamond and a former professor at Harvard Business School.

Reprint F0712A

PANDEMIC PREPAREDNESS

Who's Your Weak Link?

by George Abercrombie

The 2004–2005 flu vaccine shortage that followed British regulators' shuttering of a Liverpool plant for manufacturing violations was a wake-up call for me. Pandemic preparedness is top of mind at Roche because we produce a frontline antiviral drug that the World Health Organization and the Centers for Disease Control and Prevention agree will be important in a flu pandemic. The sudden evaporation of nearly half of the expected U.S. flu vaccine supply that year brought home how vulnerable our complex supply chains really were and how serious a vaccine disruption could be during the annual flu season, let alone during a pandemic. It became crystal clear that while Roche had a comprehensive pandemic plan to maintain business continuity and to protect our 68,000 employees worldwide, our supply chain was only as strong as its weakest link. With this in mind, we set out to engage our suppliers, to ensure that their pandemic preparedness was as robust as ours, and to see what we could learn from them.

Here are the steps we took that every company should consider:

Play host to educate suppliers about pandemic planning. Earlier this year, Roche gathered executives from more than 100 of our suppliers and business partners at our headquarters for a daylong discussion. The focus was on making supply chain central to business continuity management in general and to pandemic planning in particular. The meeting was designed to raise awareness about supply chain vulnerability as well as pandemic-related legal and medical issues companies may face. It also served as a forum for exchanging preparedness strategies with leading experts.

Determine which partners are critical to your operations. To identify weaknesses in our supply chain, we rank each of our vendors on a three-point scale (high, medium, low) according to how critical they are to our ability to maintain operations in a pandemic. For example, we might rank the manufacturer of an essential pharmaceutical ingredient higher than a company that provides market data services. On the basis of this ranking, we prioritize our approach to suppliers and engage in one-on-one dialogues to ensure that each vendor has a thorough understanding of what we expect from them in a pandemic. During the conversations, we ask our suppliers about their ability to maintain operations and continue to meet our needs during a pandemic.

Consider incorporating pandemic response into contractual agreements with vendors. Such contracts could be especially important for companies that share vendors with several of their competitors. In a workshop Roche cosponsored for hospital leaders, much discussion focused on the importance of contractual agreements to ensure that, in the event of a pandemic, suppliers would not favor one customer over another. While this is a chief concern of hospitals that will care for massive numbers of patients in a pandemic, it also applies directly to other types of businesses.

Work with local government officials to gauge how their actions might affect your supply chain or the delivery of your product. Roche maintains communication with local officials in areas where we do business to keep abreast of local governments' anticipated actions during each stage of a pandemic, to share information, and to coordinate plans. For example, if we learn that a state might close certain roads during a pandemic, we will work with our transportation vendors to plan delivery alternatives for customers in the affected area. We encourage our suppliers to foster such relationships with their local governments.

Make pandemic planning a C-suite priority. In addition to hosting company-to-company meetings with suppliers, we engage with them through peer-to-peer outreach. Members of our operating committee, myself included, reach out to our counterparts at partner companies on an ongoing basis to discuss the potential impact of a pandemic on their businesses. We are exploring what their information needs are, where potential vulnerabilities lie, and most important, how we can work together to address them. Besides helping to ensure business continuity in a pandemic or any disaster, we've found, engaging suppliers in this planning has improved supply chain efficiency and our ability to service customers in times of relative normalcy.

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Reprint F0712B

GLOBAL PARTNERS

Mao's Pervasive Influence on Chinese CEOs

by Shaomin Li and Kuang S. Yeh

Executives of multinationals partnering with Chinese firms can benefit by being alert to Mao Zedong's lingering influence on some of the country's most successful executives. One leadership tactic, in particular, can undermine a joint venture.

Our research on the practices and attitudes of Chinese CEOs offers abundant evidence that Mao's principles continue to influence top executives: All but one of 15 CEOs we interviewed told us they often turned to Mao's teachings for management ideas. Consider the manner in which Mao wielded power: by keeping the country in a state of chaotic flux, often playing one group against another. To make a change in the political landscape, Mao would orchestrate a movement that sucked in the entire population, such as the campaign against Liu Shaoqi (the number two leader in the Chinese Communist Party) and his allies, then resort to a mixture of agitation, networking, and rallying to mobilize people at the grass roots to denounce certain cadres, or senior officials. Most of the cadres would be forced out of their jobs, and Mao would rehabilitate a few. Deng Xiaoping was denounced in this manner, rehabilitated, and denounced again.

In our study, conducted with Garry D. Bruton of Texas Christian University in Fort Worth, we found several Chinese chief executives who employ a business version of that tactic: They cement their authority by keeping even senior managers in a constant state of uncertainty, sometimes mobilizing lower-level employees to criticize and pressure mid- and upper-level executives.

A wireless-paging company we studied offers an example. Rather than directly fire some of her middle managers, the CEO mobilized lower-level employees to defy them, leaving them with no choice but to resign (the CEOs we spoke to did not want their names used). In another instance, a former general manager of a call center told us she had to quit after her subordinates were directly mobilized by the parent company's CEO to circumvent her orders and pressure her to resign.

High-profile Chinese business leaders who have used this and other Mao-style tactics to dominate their managers include Zong Qinghou, the founder and former CEO of Wahaha, the French-Chinese beverage joint venture. Zong recently circumvented the formal organizational procedures during a dispute and mobilized Wahaha employees to publicly denounce the French management.

As of this writing, no settlement of the dispute was in sight.

A multinational partner of a Chinese firm should recognize Mao's tactics and regard their use as an indication that the company is dealing with an authoritarian leader who tends to be secretive (secretiveness was a characteristic of many of the CEOs we studied) and who is likely to bypass formal decision-making processes. Such companies often have vague organizational structures and CEOs who can easily nullify any of the company's agreements, hampering the JV's attempts to implement official strategy.

Recognizing a CEO's penchant for Mao-style tactics isn't easy, but the chief executive's age is often revealing. Mao left an indelible imprint on the thinking of Chinese people who are now in their forties or older. Another indicator is a firm's inability to select a second in command or successor (one analyst has wryly noted that Ren Zhengfei of the telecom equipment company Huawei has "more than 100 second in commands").

A multinational that chooses to work with a CEO who uses those tactics needs to have effective procedures – both formal and informal – in place for monitoring the Chinese leadership. A JV should create a standing executive committee with members from both companies that meets frequently and monitors the CEO and the decision-making process. At the same time, the foreign partner should take note of small details: For example, one way to anticipate management reshuffles is to pay attention to clues such as who sits where at receptions and who gets invited to play golf with whom. A former senior executive of Procter & Gamble in China described successfully following similar procedures during his P&G tenure.

Additionally, a multinational should always be ready with a contingency plan to thwart the Chinese leader's attempts to get around organizational procedures. Had Wahaha's French managers anticipated Zong's tactic, they might have been able to defuse it by providing rank-and-file workers with objective information on the dispute.

Shaomin Li (sli@odu.edu), a professor of management and international business at Old Dominion University in Norfolk, Virginia, was the founding CEO of a Hong Kong–based IT firm with subsidiaries in China. **Kuang S. Yeh** (kuangyeh@gmail.com) is the chair of the Department of Business Management and EMBA director at National Sun Yat-Sen University in Kaohsiung, Taiwan. Reprint F0712C

INVESTING

The Truth About Private Equity Performance

by Oliver Gottschalg and Ludovic Phalippou

Rising credit costs have already taken the bloom off private equity's rose, but some funds (and some investors) are due for another shock. Our research shows that the way PE fund performance is most often reported overstates the truth.

Here's the problem: Private equity returns are often reported as the internal rate of return (IRR) – the annual yield on an investment – of the underlying cash flows. This implicitly assumes that cash proceeds have been reinvested at the IRR over the entire investment period – that if, for example, a PE fund reports a 50% IRR and has returned cash early in its life, the cash was put to work again at a 50% annual return. In reality, investors are unlikely to find such an investment opportunity every time cash is distributed.

Finance 101 teaches us a simple solution to this problem: the so-called modified IRR (M-IRR). This measure is similar to the regular IRR, but rather than assuming reinvestments at the IRR, it specifies a fixed rate of return for investing and borrowing. We looked at this measure in a study of 1,184 private equity funds raised from 1980 to 1995, considering all investments and corresponding cash flows through 2004. The highest IRR in our sample was an impressive 464% per year; when we applied the M-IRR measure to that fund and specified 12% per annum for borrowing and investing, we got an M-IRR of 31%: a far cry from 464%, and certainly a better representation of the fund's true return.

Doing the same for all funds in our sample, we found that the top 25% as ranked by IRR had an average net-of-fees IRR of 35.32%. However, the top 25% as ranked by M-IRR (assuming borrowing and investing at 12%) had an average M-IRR of only 18.56% – much more in line with other investment opportunities.

In addition to skewing the apparent performance of "star" funds, IRR calculations can mislead investors who are trying to compare the returns of different fund managers. We ranked the funds in our sample according to IRR and M-IRR and found immediately that the top two according to M-IRR don't even appear in the list of the top 10 according to IRR. As the table shows, the top 10 IRR funds in our sample shift dramatically when ranked by M-IRR. What's more, the astronomical returns suggested by IRR calculations plummet to earth when an M-IRR calculation is applied.

Overstated private equity performance may partially explain why investors continue to allocate substantial capital

continued on page 20

Radical Shift

The returns and relative rankings of the top 10 private equity performers (among 1,184 funds studied) change dramatically when fund performance is calculated according to the modified IRR rather than according to internal rate of return.

Top 10 private equity performers

Fund	Fund IRR %	Fund rank	Fund M-IRR %	Fund rank
A	464	1	31	9
B	313	2	42	4
C	248	3	30	10
D	244	4	41	6
E	190	5	43	3
F	166	6	41	5
G	155	7	33	8
H	153	8	28	15
I	147	9	23	21
J	143	10	29	13

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to this asset class, despite our finding (forthcoming in the *Review of Financial Studies*) that PE funds have historically underperformed broad public market indexes by about 3% per year on average.

Oliver Gottschalg (gottschalg@hec.fr) is an assistant professor of strategy at HEC Paris. **Ludovic Phalippou** (l.phalippou@uva.nl) is an assistant professor of finance at the University of Amsterdam Business School. The full paper describing this research is available at www.buyoutresearch.org. Reprint F0712D

TOOLS

Selecting Management Tools Wisely

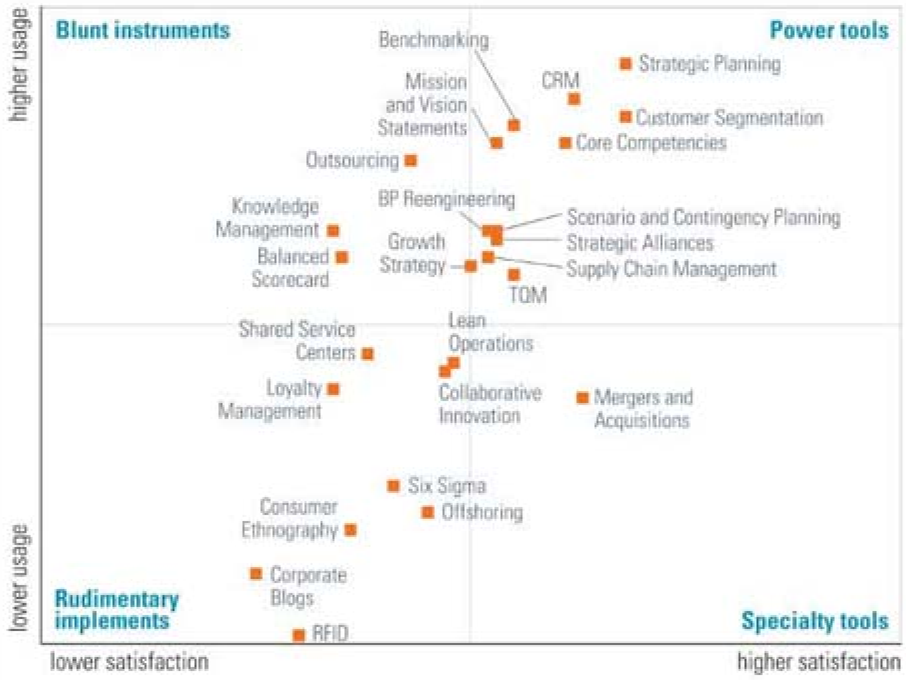
by Darrell Rigby and Barbara Bilodeau

Managers have a profusion of tools at their disposal – benchmarking, outsourcing, and customer segmentation to name a few – so it is a challenge to choose the right one for the job at hand. We set out to learn how (and how successfully) organizations are using tools, with the goal of helping executives make informed decisions about which ones to try. Every year or two since 1993, Bain & Company has culled the 25 most popular tools from a list of 50 to 100 by weighting and rating their mentions in academic and mainstream business articles. We have also asked thousands of executives worldwide how frequently and extensively they've used these tools, whether they've been satisfied with the results, and whether they intend to use the tools again. Now, with 8,504 survey responses in hand, we have a good sense of the tools' performance today and over the past 15 years. After looking at the various ways managers use the tools and comparing levels of use and satisfaction, we have grouped them into four categories. (See the chart "Top Tools in 2006.")

Rudimentary implements – though they often generate buzz – are for a number of reasons underdeveloped. Sometimes, developing them would be overly complex; other times, the problems

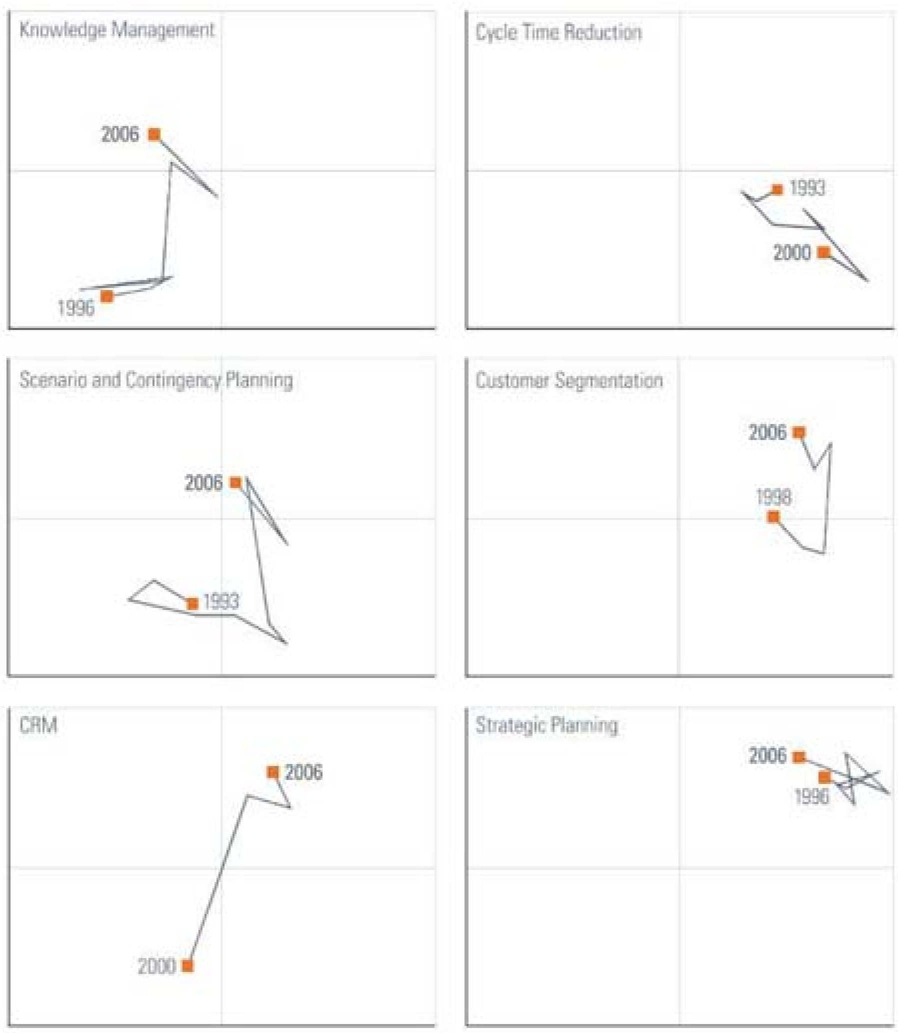
Top Tools in 2006

The executives in our survey scored the tools below according to how frequently they were used and how much satisfaction they delivered.



Six Tools Over Time

Management tools become more or less useful when their capabilities change or when there's a shift in the business environment. Here's how some of the most familiar ones have evolved since 1993.



they're meant to address are deemed not worth the investment. In this year's study, examples include RFID technology, corporate blogs, and consumer ethnography. Rudimentary implements score below average in usage frequency and satisfaction in our surveys.

Specialty tools fill niche needs and are highly effective when applied correctly. When used in the wrong situations in the wrong ways, however, they can be like crowbars in the hands of children. For instance, business process reengineering proved highly beneficial to manufacturing operations in the early 1980s, but when it later became a euphemism for mass layoffs, both satisfaction and usage plummeted (the tool has since rebounded, as the chart shows). Specialty tools are used sparingly but get high marks in satisfaction.

Blunt instruments attack pervasive problems in cumbersome ways. Often, managers trying to meet a widespread need in their organizations see the instrument as the best available (if imperfect) option. In other cases, the tool is a management fad that is being asked to do more than it can. A classic example of a blunt instrument is knowledge management. Managers realize they need to capture and share employees' knowledge, but they often fall short because the technology they use is too complex, they gather too much extraneous data, or they don't give people incentives to share knowledge. Blunt instruments score high in usage but low in satisfaction.

Power tools, which get high scores in both usage and satisfaction, can be applied with rigor in a variety of settings. They're used by many managers with success and thus incur very little risk. Strategic planning has consistently been rated as a power tool by nearly all managers in all industries and company sizes – even when management gurus and journalists have declared it dead (witness business thinker Tom Peters's 1994 review of Henry Mintzberg's book *The Rise and Fall of Strategic Planning*). In fact, practitioners usually say that strategic planning is their most frequently utilized and highly satisfying management technique. One of our survey

The Best Advice I Ever Got

Hans-Paul Bürkner
President and Chief Executive Officer
The Boston Consulting Group

Good advice often comes in the form of deeds, not words. The best advice I ever got came not by listening, but by observing one of my colleagues – by watching his behavior, coming to understand his philosophy, and then adapting it to my own style.

When I joined BCG as a consultant in 1981, Tom Lewis was a principal, and quickly became one of my role models, though he was only about five years my senior. On one of our earliest projects together, we worked for a high-technology client evaluating potential entry into new businesses. Tom was responsible for a remarkably mixed team: We had one person who was strong on organizational issues but incredibly weak with numbers, another who was a computer on legs – superb with analytics, much less so with anything else – and so on. At that time, I assumed it was better (or certainly easier) to build a team from people with similar strengths that were ideally suited to the task, so I didn't envy Tom the job of leading such a disparate group, nor did I anticipate a positive outcome with the client.

But Tom, who's a very modest man, didn't have the same philosophy. He simply went about the task of turning that diverse set of individuals into a high-performing team – methodically, gradually, and quietly. Every week or so, he would engage us one-on-one to discuss how we perceived our performance, what we liked to do, what we thought would help the project go well, all in a nonthreatening way. Rather than saying to the person weak at numbers, "You want to do economic modeling? Are you kidding?" Tom helped steer him toward tasks he excelled at, letting him use and – more important – show off his abilities to the best advantage. As a result, team members developed a deep appreciation of each individual's skills, and that increased our investment in the group effort. The client implemented our recommendations, and that project became the basis of a very long relationship with BCG.

Tom never articulated this team-building philosophy directly, but I watched him act on it many times, and it is central to how I now think about leading individuals, teams, and this firm. When we're faced with what looks at first like an unsolvable problem, a team with what I call "spikes" of different talents will come up with a better solution than a team whose members have similar strengths. One person makes an oddball suggestion, the next person misunderstands it but in a fruitful way, and together they end up devising a novel solution. The process can be slow and uncomfortable; spikiness often hurts. But it can yield spectacular results – as long as the firm or the project leader ensures that team members appreciate one another's talents.

Building teams is not about being nice. Tom is unusual; he's a natural diplomat, and people like to work with him. Yet however graceful and nonthreatening, his talks went to the heart of a subject most people would rather avoid: what they're good at and what they're not. While I've adopted Tom's philosophy, I apply it differently. Tom was subtle; I'm more direct. When putting together a team, I make sure it's spiky. And when people complain that their differences will cause problems, I'll bluntly disagree. I'll tell an unhappy manager, "It doesn't matter that he's weak in finance. Find out what he's best at, and show his strength to the team." Tom's subtlety was effective for him, but directness comes naturally to me. Acting on advice works best when you do it your way.

– Interviewed by Daisy Wademan

Reprint F0712F

participants commented, "It's so easy to get absorbed in daily operating urgencies that we need the strategy process to challenge traditional thinking and redirect where we spend our time and money."

Though some tools have remained in the same category for a long time, others have evolved in fascinating directions, because changes in their capabilities or in the business environment have made them more or less useful. (See the chart "Six Tools Over Time.") For instance, scenario and contingency planning leaped quickly from a specialty tool to a power tool after the terrorist attacks of September 11, 2001, a change we analyzed in a previous Forethought article ("A Growing Focus on Preparedness," HBR July–August 2007). Customer relationship management began as a rudimentary implement when we first studied it in 2000, but by 2002 the global economy had strengthened: Managers had shifted their attention from cost reduction to revenue growth and increased their focus on measuring and improving customer satisfaction. Meanwhile, technology improved companies' ability to track and analyze customer behavior, and CRM took off.

When evaluating a tool for potential use, managers should consider whether they have the people and skill sets to develop it to meet the company's objectives. If so, they should set realistic expectations in terms of complexity of implementation and the level of investment needed. Organizations without the capacity or patience for an involved, slow implementation may want to wait and see what others do. It's also helpful to investigate both the industries and the approaches that have met with success. Once you select a tool, make sure people understand why they are using it. If they know which needs they're trying to meet, they're more likely to make it work for the organization.

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Reprint F0712E

DECISION MAKING

Hotter Heads Prevail

The detached and impassive executive may fit the image of the ideal corporate decision maker, but people make better choices when they're experiencing intense emotions, a study suggests.

That is, experiencing emotions but not being led astray by them. The study, by Myeong-Gu Seo of the University of Maryland's business school and Lisa Feldman Barrett of Boston College's psychology department, found that the most effective decision makers were those who had strong feelings while making decisions but were able to prevent their emotions from impeding their ability to reason.

The researchers, whose work appears in a recent issue of the *Academy of Management Journal*, put about 100 people, drawn from investment clubs, through a four-week online investing simulation. Just before they "bought" or "sold" stocks each day on the basis of the latest market data, the participants recorded their emotions and the intensity of their feelings.

Controlling for participants' age and investment experience, the researchers assessed decision performance by calculating what the returns would have been if the participants had actually invested. (The participants were also rewarded – with real money – for making choices that would have yielded high returns.)

Participants who happened to be experiencing more intense emotions at the time they made their stock choices (whether related to the investment or not) did better on their investments. The findings support the view of researchers who believe that strong emotions, rather than being harmful in decision making, are beneficial to it because they boost attention and memory.

Accordingly, to improve the quality of decisions, companies should strive to rid themselves of the social constraints against intense emotions at work, the authors say. At the same time, managers and employees should try to increase their emotional self-awareness and learn to describe and differentiate their feelings – especially negative ones – during decision making. Participants with a more refined ability to perceive and describe their feelings, the study also found, were better at preventing their emotions from biasing their decisions.

– Andrew O'Connell

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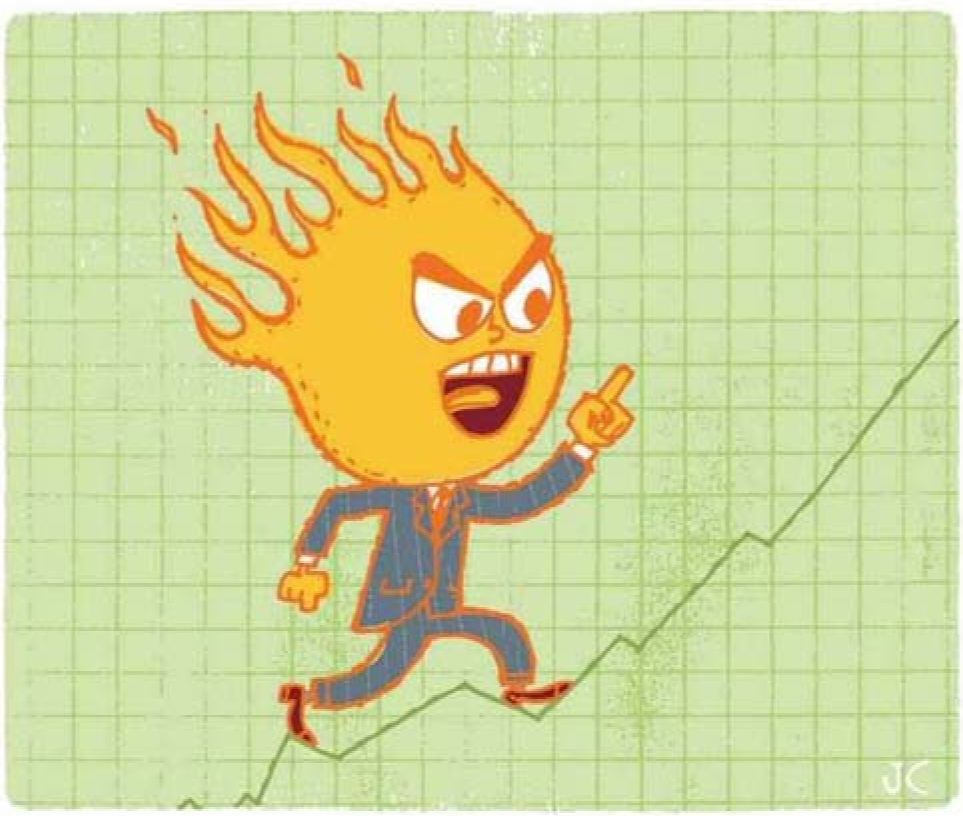
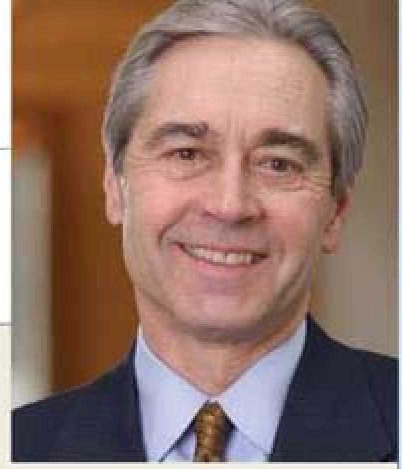


Conversation

Northwestern Mutual's **Ed Zore** on staying relevant to customers



It is relevance, not just innovation, that matters to customers, says Ed Zore, president and CEO of Northwestern Mutual, the 150-year-old insurer that is consistently ranked by *Fortune* as the most admired company in life and health insurance and is the U.S. market share leader for total individual life insurance premiums. For Northwestern Mutual, staying relevant to customers means watching the right dashboard gauges, including the one that shows "persistency" – the percentage of customers who stay with the company year after year.

So what's wrong with focusing on innovation?
There's obviously nothing wrong with innovation. Innovation is great as long as it improves your ability to provide value to the customer, but too often it doesn't. In technology industries, you have to come up with a new gizmo every month. I heard a 50-minute speech in which a CEO must have used the term "innovation" 35 times. And I'm sitting there trying to figure out what he means. I don't have a clue. He's not talking about making the stuff work. He's not talking about making it useful.

Don't innovate just for the sake of being innovative. Stay relevant. That's the name of the game, no matter what industry you're in. Being relevant means lowering costs, improving customer service, or generating business. An innovation doesn't make sense if it can't do that.

How do you know whether you're staying relevant?
We have several ways of measuring relevancy. One is *results.* You can see if you're relevant by how you're performing. Your results tell you if you understand the business. Our company is exceptionally good at managing the fundamentals: Long-term investments. Low expenses. Careful underwriting. We believe that one of our obligations as a mutual company is to provide as much value as we can to our policy owners. That's one reason we're so proud of how greatly our dividend payout exceeds even our closest competitors'. We've also stayed relevant by adding new products and services that are consistent with our initial value proposition. But, of course, any company can benefit from looking at its results and the value it provides customers.

Another measure is: *Are we gaining or losing ground?* If we're gaining on the competition, we're moving in the right direction. If we weren't growing, we'd probably be decaying, because we wouldn't be able to keep good people. Our numbers show we're doing well.

We also gauge relevance by *listening* to our customers and to our 7,500 financial reps. Our reps are our eyes and ears in meeting with clients, assessing client needs and implementing our financial security value proposition. They let us know what's working and what's not. We have committees of reps – for investment products, long-term care products, life insurance, disability insurance – zillions of committees of reps that give us focused feedback, not just random sales reports, and we take their input very seriously. And *persistency* is a number we religiously track – it's the rate at which customers stay with the company from year to year. Right now it's 96.5%, and it keeps creeping up. Alongside that, we measure the level of complaints per unit of sale and per rep. That not only saves us money, but it also provides us with information we can use to keep improving customer service.

What's the best way for a company to stay on top of its game?
To stay relevant, you've got to keep increasing the value you deliver to customers. Here's one example: Several years ago, we figured out how to restructure policies to create more value for policy owners, and we gave it to them retroactively at no increase in premium. Nobody else did that. We did it a couple of times – we do it with all our products today. We're adding some features to a long-term care policy, and we plan to add them retroactively to all the policies out there. We'll go to our policy owners and say, "Look, we just made this better for you." It's good for the customer, and it's good for the field force that sells the policies, because they don't have to apologize.

Our goal is to have customers for 40 to 50 years and to be around to pay their claims and help them achieve financial security. We want to make sure we're here when they need us. General Motors would love it if everybody came back and bought a GM car, and how do you do that? By making sure there's substance under the chrome, not just flashier chrome.

– Thomas A. Stewart

Reprint F0712H

MARKETING

The Flaw in Customer Lifetime Value

by Detlef Schoder

Have you ever watched as one of your competitors raked in profits from customers that you had decided not to bother acquiring? Perhaps this happened because your company based its decision on the traditional method of calculating customer lifetime value (CLV). That could be a costly mistake.

The standard CLV approach calculates the net present value (NPV) of all anticipated cash flows coming in (revenues) and going out (marketing dollars spent) over some time span (months, years, or even decades) for a given customer. Keep customers who show a positive NPV for the marketing investment, the rules say, and drop the ones who don't. Those are rational choices at the time of the calculation – but only then. The conventional calculation is thus rather static and actually flawed, because you are not able to factor in a company's flexibility to cut a given customer loose at any time. Flexibility means options, and options have value.

In analyzing the seller's option to abandon unprofitable customers, my colleagues and I looked at 12 years of purchasing data for more than 100,000 customers of a specialty catalog company. What we found was astonishing: The difference in CLV using the real-options approach versus the traditional approach was, in some cases, as much as 20%. More important, some negative CLVs actually turned positive when the value of the real options was considered. In other words, we found that neglecting a customer with a negative NPV – as traditionally calculated – may be exactly the wrong choice: He could turn out to be highly profitable.

Companies have been using real options for a long time to optimize their investment portfolios. It's time they applied them in the valuation and management of their investment in customers, too. Here's a five-step process for bringing real-options analysis into the NPV calculation:

❶ Estimate the future purchasing behavior (that is, the probability of purchase and dollar amount expected to be spent) for a set of customers, using the common RFM (recency, frequency, and monetary value) approach. This determines expected revenues.

❷ Calculate costs generated per customer per period.

❸ Use those two inputs to estimate the profit contribution for each customer over the time horizon under consideration, for example ten periods.

❹ For each period, determine whether the expected future profit contribution for that customer might be negative.

❺ Finally, calculate the CLV that includes the option value (the value of abandoning that customer). What would be saved by dropping him at any given period?

To give a highly simplified example of this fifth step, imagine a customer that cost \$100 to acquire and \$100 to retain for each subsequent period, thus costing \$500 to keep for five periods. If, based on data from previous customers with similar characteristics, that customer might be expected to purchase \$150 of goods in the first period, \$100 in the next, \$50 the next, and \$0 in the final two periods, a conventional CLV calculation would show that the customer would be unprofitable (he generates just \$300 of revenue at a marketing cost of \$500). But, add in the value of the option of dropping him after the second period (\$100 × 3 = \$300) and the same customer suddenly looks profitable: Over the five periods, the marketing cost is \$200 (\$500 minus the \$300 option to drop) and revenues are \$250 (\$150 for period 1 and \$100 for period 2). In an actual business scenario, this calculation can be mathematically demanding and generally can't be carried out easily using simple spreadsheet methods. More advanced option-pricing approaches are needed. (For details, see Michael Haenlein, Andreas M. Kaplan, and Detlef Schoder's "Valuing the Real Option of Abandoning Unprofitable Customers When Calculating Customer Lifetime Value" in the *Journal of Marketing*, July 2006.)

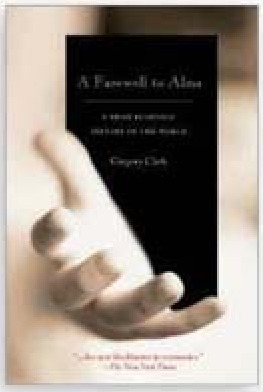
There's a saying in business: Anyone can save 50% on marketing expenses, but no one knows which 50%. Including real options in the CLV calculation can actually help direct marketing dollars to the right customers.

Detlef Schoder (schoder@wim.uni-koeln.de) is a professor and chairs the Department of Information Systems and Information Management at the University of Cologne in Germany. Reprint F0712J

Reviews

A Farewell to Alms
A Brief Economic History of the World
Gregory Clark
(Princeton University Press, 2007)

At just over 400 pages, this survey of world economic development is not exactly brief. But the author's engaging style and (relatively) jargon-free descriptions of the economic principles in play before, during, and after the Industrial Revolution in England turn this rich and detailed account into more of a sprint than a slog. Indeed, *A Farewell to Alms* reads less like a history book and more like the script of a good police procedural.



Clark, an economics professor at the University of California, Davis, aims high here. He attempts to answer questions he says have vexed economists for decades. Among them, why did the Industrial Revolution happen in late-eighteenth-century England and not at some other time or place? And what has prevented some nations from fully capitalizing on the benefits of industrialization?

Like *CSI*'s Gil Grissom in the crime lab, Clark obsessively sifts through a wealth of economic and anthropological data from the 1200s to the 1800s – fertility rates, life expectancies, labor statistics, and even physiological factors such as average height and average daily caloric intake. In the first half of the book, he describes economic life in England during the pre-industrial Malthusian era, in which advances in technology prompted a population boom that ate away at the standard of living. The average English inhabitant in the late 1700s and early 1800s was arguably working harder and longer to achieve the same level of subsistence as hunter-gatherers of previous eras, Clark contends.

In the book's second half, Clark examines the mechanisms of societies that broke out of the so-called Malthusian trap. England, he says, was ripe for industrialization not because of its large supply of coal or other resources, as others have argued. Rather, a set of cultural factors were present that helped the country evolve socially and, hence, economically: slow but steady population growth between 1300 and 1760; legal, political, and economic institutions that were established long before the technological advances of the revolution occurred; and a stable government. As abundant numbers of relatively well-off children grew up and entered society – as apprentices and tradesmen, primarily – so-called middle-class values (hard work, education, and so on) spread throughout England. In China and India, by contrast, that cascade of values was slower to materialize – and so was economic growth.

Culture and social evolution, not institutions, shape economies, Clark argues. That holds true in today's world, where outside help from institutions such as the World Bank and the International Monetary Fund have little effect in lifting up ailing nations. Instead of lining the pockets of corrupt leaders with foreign aid, the West would do better to create liberal immigration policies for people from Third World countries, offering them opportunities for advancement in the world's major cities. Whatever your reaction to this decidedly un-PC take on economic aid, the book serves as a useful explanation of how we got where we are today and a reminder that new approaches are needed to close the yawning gap between the world's richest and poorest societies. – Roberta Fusaro

Exodus to the Virtual World
Edward Castronova
(Palgrave Macmillan, 2007)

So far, online virtual worlds are arguably just a sophisticated form of electronic escapism, with economic effects roughly equivalent to the direct and ancillary spending generated by television and movies. But Castronova, an economist, contends that participating in multiplayer synthetic worlds is different from watching TV and films. The interactive and intrinsically social nature of this major entertainment medium is attracting far more market segments than the stereotypical teenage boy associated with such games. As technology advances, gaming will draw people away from other entertainment media in droves. Castronova also suggests that gamers will push public policy in a libertarian direction, as they seek in life the same freedom from rules and responsibilities that they enjoy in game environments. While much of the book is highly speculative, it is an intelligent introduction to an important industry.

The Conscience of a Liberal
Paul Krugman
(W.W. Norton, 2007)

Is inequality bad for business? Krugman, the prominent economist and columnist, argues that American wealth differentials are endangering the country's meritocracy, not to mention social fabric. Already it's harder for poor but talented kids to get ahead in the United States than in Europe, the supposed bastion of class barriers. And he points out that social parity and a booming economy often go hand in hand: The post–World War II golden age of equality in the U.S., with high taxes and strong unions, was a time of prosperity. He doesn't prove that egalitarian measures will work well today – the United States faced less international competition in those decades, after all. But he does show that inequality has arisen more from political decisions than from economic forces. This powerful manifesto for egalitarian public policy makes for provocative reading. –John T. Landry

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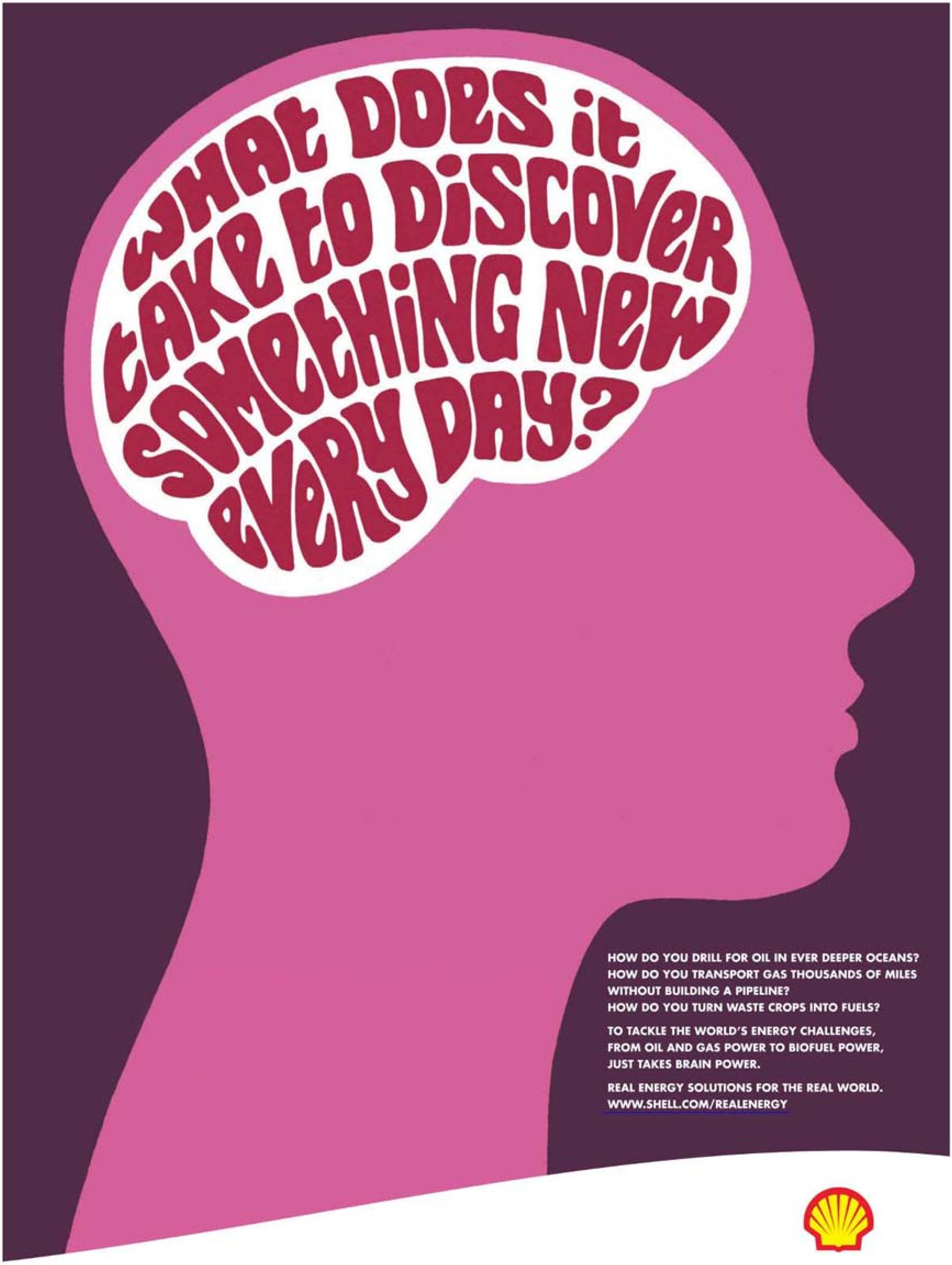
WHAT DOES IT TAKE TO DISCOVER SOMETHING NEW EVERY DAY?
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The Customers' Revenge

Atida Motors' decades-old complaint policy may be no match for unhappy customers who threaten to take their case to YouTube.

by Dan Ariely

JIM McINTIRE, vice president of customer service at Atida Motor Company, was just about to shut down for the day when he received an e-mail from his brother. "Go to Hell, Angel!" the subject line shouted.

The message linked to a YouTube video. In "A Letter for Bill Watkins, CEO, Angel Airlines," two stolid executives – "Jeff" and "Jerry" – wearing identical pinstripe suits, took turns narrating the story of their airline nightmare. In one scene, the pair sat chained to their coach seats in a stuffy, tarmac-stranded plane. Sweating women and children in prison garb begged for water from surly flight attendants dressed as guards. In the next, the two men crawled on their knees before a leather-clad gate attendant, crowned with devil horns and holding a long whip. They begged her to finally assign them their "guaranteed" seats

HBR's cases, which are fictional, present common managerial dilemmas and offer concrete solutions from experts.

Daniel Vasconcellos

on an overbooked plane. "Not a chance," she replied huffily. She snapped her whip dismissively and shouted, "Next in line!"

In the final sequence, the men took turns reeling off a series of probabilities. "Lifetime chances of dying in a bathtub: one in 10,000," said Jerry. "Chances of Earth being ejected from the solar system by the gravitational pull of a passing star: one in 2 million," said Jeff. "Chances of winning the UK's National Lottery: one in 14 million," said Jerry. "Chances of anyone from our 3,000-person company ever flying with Angel in the future: zero!" they shouted in unison. The video ended with a message to Angel's CEO: "Now, Mr. Watkins, we're letting the world know about your so-called customer service!"

For his part, Jim had expended a lot of energy trying to improve customer service at Atida. Historically, the 70-year-old automobile manufacturer had had a better reputation for innovative styling and high performance than for service. But Jim, who had turned around customer service operations at another Detroit carmaker, had been brought on board a decade ago to change all that. The company now offered a comprehensive warranty on all its new vehicles as part of its massively promoted Red Carpet program, covering everything from transaxle repairs to the paintwork. An Atida credit card rewarded customers with accessories for their cars and apparel sporting the Atida logo. Returning customers even received a free satellite radio.

"Hey, that video you sent me was hysterical. It's inspiring me to take revenge on our dental insurer. Maybe I should sic Michael Moore on them."

Jim chuckled as he forwarded the e-mail to his wife, his mother, and a few frequently flying executive friends at Atida. "You'll all enjoy this," he typed. "Sure glad we're not on the receiving end of it. Cheers, Jim."

Nor will we ever be if I can help it, Jim thought, as he snapped his laptop shut.

During the 40-minute drive home, Jim contemplated the video and recalled his last miserable, multiple-leg trip on the struggling airline, when his baggage – including an expensive digital camera, a gift from his brother – was permanently lost. He'd resolved never to fly Angel again. Another nail in their coffin, he thought. When you treat customers like animals, they snarl and bite.

As a result of Jim's efforts, Atida had finally built a state-of-the-art call center in Bangalore the previous year. In its last annual report, the company boasted that the call center would reduce costs and call-waiting times, standardizing and streamlining service for customers. Executives had high hopes that the current strong sales of the recently introduced Andromeda XL would excite Wall Street. All in all, Jim concluded, there certainly was a great deal to be proud of.

When he arrived home, his wife, Michelle, was in the kitchen, sipping a glass of pre-dinner wine and stirring the gravy for the pot roast. She gave him a quick kiss and poured him a glass of Pinot Noir. "Hey, that video you sent was hysterical," she said. "It's inspiring me to take revenge on our dental insurer. I just spent another fun-filled hour on the phone trying to get them to pay for these damn implants."

Jim pursed his lips in sympathy. "Any luck?"

"I swear, Jim, it's just been a nightmare," she said exasperatedly. "It seems like every time I call to get help, they refer me to some new idiot who doesn't know anything, and I have to explain everything all over again. And it's not my fault! Maybe I should sic Michael Moore on them. Or sneak into their offices at night and smash their computers with a sledgehammer."

A Love-Hate Relationship

"Loved that video," said Lisa Ross, Jim's head of customer communications, as she took a sip from her cola can. "After all that flying back and forth from India last year, I can certainly relate to it!" She smiled, taking in the party atmosphere. "It sure is nice to be home for a while."

The autumn afternoon was sunny but crisp. The lunchtime smell of roasting hot dogs mingled with the tinny sound of the Beach Boys drifting over the PA system. The Detroit Chaser Club's annual show was packed with hundreds of car enthusiasts who had come to pay homage to the 1950s model that had made Atida Motors famous. In their baseball caps and blue jeans, Jim and Lisa were indistinguishable from the enthusiasts. The event was an annual ritual for the two of them and sundry other Atida executives who came to spy on Chaser fans.

They sidled up to the Best in Show, a heavy, cherry-red convertible with mirrorlike chrome headlight bezels and fat, white sidewall tires. The vintage car featured a large stylized hood ornament – a silver-and-black checkered flag – and a doughnut-shaped Continental Kit on the back bumper for holding the spare tire. Little wind wings afforded a breeze for the driver and passenger in the wide front seat when the top was up.

"Wow, what a beauty," Lisa said.

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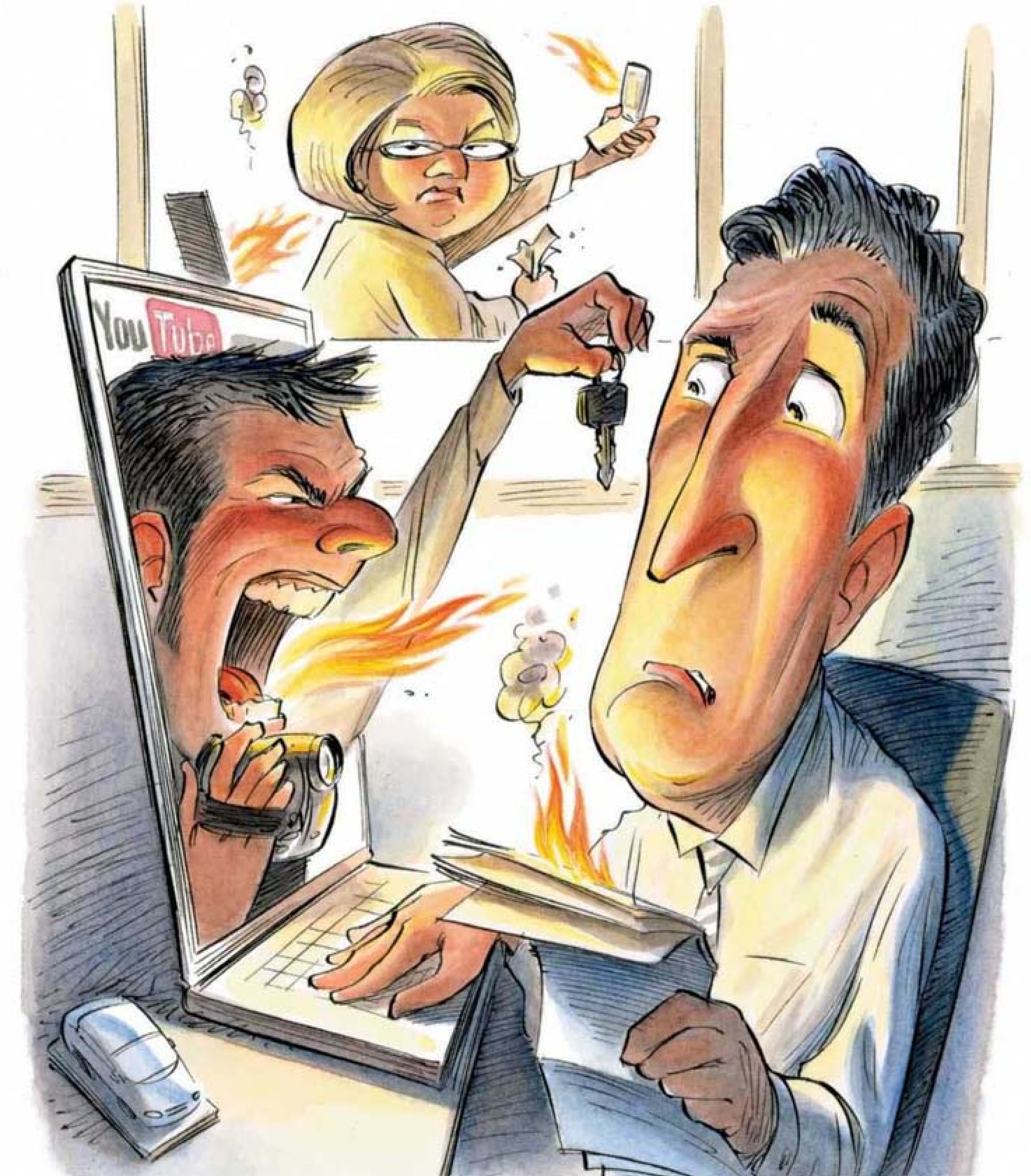

A group of fans had gathered around the car, peeking into the interior and marveling at the pristine leather. One man was pointing his video camera at the backseat. "No belts," he said to a friend at his elbow, as he focused on a slim red cord attached to the back of the front seat. "Safety sure wasn't job one in those days."

"Heck no," said his smiling friend. "But boy, that backseat sure was fun."

Soaking in the affection that surrounded the old cars, Jim thought how nice it would be if the fellow with the camera posted his video on YouTube. He remembered why he loved working for the company. "People really do love these old Atidas," he said to Lisa. "My father restored a few of them, you know. It took him 12 years to bring one back to life. Anyway, that's how I got into this in the first place. I guess this company is in my DNA."

"Kind of makes you wonder what this show will be like 30 years from now," Lisa said, sighing. "Will people be drooling over classic Andromeda XLs, I wonder?" She lowered her voice. "Which reminds me, I e-mailed you the report. We need to have a little chat about a few problem children when we get back to the office."

Later that afternoon, Jim scanned the divisional quarterly report tracking customer feedback, which logged more than 30,000 calls. In addition to noting average wait times and call duration times, the report summarized the content and disposition of all calls, e-mails, and letters. Several had been escalated. Looking them over, he saw a number of messages marked "read original text."

One of them was a letter from a customer named Jessica Long. Apparently, this person had been inundating Paul Turm, the CEO, with letters complaining about her Andromeda XL, which she had bought shortly after the car came on the market. First the air-conditioning failed, then the CD player jammed, then the catalytic converter went out, and so on. The company had repaired each problem at no expense to her – in fact, Atida had actually replaced the car – but she kept on sending in complaints about the new one, too. Her latest letter was attached to the report:

Dear Paul,

It's only been two months since I wrote you, but it seems the repairs to my Atida Andromeda XL, which you replaced three months ago, are now sadly happening more often.

This time my daughter organized a birthday party for me. We were on the way there when we started hearing a high-pitched squealing, which sounded like it was coming from the brakes.

I was worried enough to stop at a gas station and have the mechanic take a look. He said it seemed like one of the brake pads was going bad and needed to be replaced immediately. By the time I got to the birthday party, it was so late that four of the invited guests had already gone home.

I called customer service and sat on hold for an hour. Of course they were useless. The person who finally took the call could barely speak English, so I asked to speak to a supervisor. After 30 more minutes on hold, I finally spoke to someone. He told me to contact my local dealership. Now the dealership is giving me the runaround and won't reimburse me because I took the car to a mechanic instead of to them, and in a total catch-22 they are telling me to take it up with customer service!

I wonder, am I just part of some bizarre economic experiment you are conducting over there? Or is this some new business model they teach now?

I can only hope that you start making cars that actually work for real people in the real world. Thanks for ruining my birthday. I hope someone ruins yours.

Disrespectfully yours,
Jessica Long
cc: Alan's Consumer Blog

Jim stood up and carried the report over to Lisa's office. "Hey, Lisa," he said, poking his head in the doorway. "Looks like our friend Jessica is on the rampage again."

Lisa looked up at Jim and smiled. "She's a piece of work, isn't she?" She motioned him to a chair. "I remember taking a business-writing course as an undergraduate. The instructor asked us to write complaint letters. Our goal was to get a free box of chocolates after complaining that we found some hair in the candy, or whatever. A few people actually got freebies. I'm sure Ms. Long would get an A+ in that class," she added, trying to hold in her frustration. "We've already replaced her car to shut her up. She needs to get a life."

Then she pointed to the report in Jim's hand. "Did you see that other letter in the appendix? The one from the guy named Tom?"

"Looks like our friend Jessica is on the rampage again." Lisa looked up at Jim and smiled. "She's a piece of work, isn't she?"

Jim turned to the back and found the letter, which was written on letterhead from HBH Films in Los Angeles.

Dear Mr. Turm,

I am writing to you as a longtime customer and *former* Atida fan who is now close to desperation. Several months ago, I purchased my fifth (!) Atida, the new Andromeda XL. (I also hold one of your company's preferred-customer credit cards.) It was peppy, it was stylish, it handled well. I loved it.

On September 20th, I had just finished shooting a commercial in Las Vegas. My production assistant and I were driving back to Los Angeles with a trunk full of very expensive filming equipment. It was late at night, and we were driving at approximately 70 miles per hour. All of a sudden, the car stopped responding to the gas. It was as if we were driving in neutral. I tried to make my way to the right. Looking over my shoulder, I saw a big truck bearing down on us as I tried to move over. The driver barely missed us. We managed to make it onto the shoulder alive. It was one of the most frightening experiences of my life.

After sitting for more than an hour in the breakdown lane, our car was towed. We were forced to haul all the heavy equipment from it into the tow truck, spend the night in a bad motel, then move everything into a taxi and a train to get back home to Los Angeles. In the morning, I called your customer service line and described as colorfully as I could the night's ordeal to the rep. "I am sorry about the inconvenience," she said.

Inconvenience! This just made me furious. Here I was, very close to having had a serious accident (not to mention having had a five-month-old car severely break down on me) and the best description she could come up with for this was *Inconvenience!* To make matters worse, she said you wouldn't reimburse me for the motel or the train because according to your records I don't live in Nevada where the problem took place, which makes me ineligible. This is nonsense!

Over the next month, I called your customer service line two or three times a week, asking them for more information on the state of my unrepaired car, to no avail. (I taped each of the calls for future reference.)

I've always bought Atidas because I love driving them, but now I'm angry, spiteful, and I want you to share in my misery. I feel the need for revenge. I've contacted the state attorney general's office, which gave me the regulations for the Lemon Law. It appears I'm entitled to get my car repurchased or replaced. But when I called your customer service to discuss this option, they sounded surprised to hear of the Lemon Law, claiming that it was completely beyond their knowledge or jurisdiction.

I'm now talking to my lawyer, and I'm seriously thinking of making a very slick and nasty little film about your company and putting it up on YouTube. I guarantee you won't be happy with it.

Sincerely,
Tom Zacharelli

"Wow," said Jim. "Have you checked with Legal about this one?"

"It's not a legal problem," said Lisa. "Our lawyers are saying that our only obligation is to fix the car and nothing else. They say this customer can certainly hire a lawyer, but once customers understand how much pursuing the legal option will cost, they almost always see things differently. They take their loss, and they move on."

"Well, we have more to worry about here," Jim said thoughtfully. "PR would probably say the YouTube thing needs to be taken seriously because the buzz on the Andromeda is just getting started."

Lisa's shoulders began to tense. "Jim, we've got a policy for handling this stuff, one we've been following for decades. Our job is to build good cars backed by decent warranties. It's the customer's responsibility to get the car to the dealer. It's all written right there in the warranty manual they receive with the car."

"I understand, Lisa," Jim replied. His stomach churned. Whether it was the hot dog or the conversation that was backing up on him, he wasn't sure. "But this guy Tom has been a pretty loyal customer. I think Marketing would say we need to think more about the effects of positive versus negative word of mouth."

Lisa frowned. "Jim, look at that report! There are 30,000-plus calls there! We can't afford to coddle people whose complaints border on extortion." She glared at him. "I've been doing this kind of work a long time. And my job is to get those customers off the line."

A Shift in Policy?

"Heads up, Jim," began the message from Marieke Kuesters, the head of PR. "The new U.S. Customer Satisfaction Survey has just come out. Unfortunately, it looks like we've dropped down the rankings in the auto category. Might it have something to do with those call backups in Bangalore? Should we huddle about this before Paul calls us all on the carpet?"

Damn, Jim thought. The news was coming at exactly the wrong time, as the CEO would certainly point out.

He called Lisa into his office and invited Marieke to join them. The customer feedback report lay on the round table. As they sat down, he pushed it over toward Marieke. "Take a look at this," he said, showing her the appendix with the letters from Jessica and Tom.

While Marieke reviewed the report, Jim peered at Lisa. "This whole thing is really frustrating," he said.

Lisa nodded.

"Paul's going to want solutions, and pronto."

"Well, Jim," Lisa responded, "given the backlog of calls, this was inevitable. We were probably too ambitious. Nobody can set up a call center halfway around the world and expect it to operate perfectly from day one. Anyway, things are getting better. Paul will be impressed by next year's ratings."

But that doesn't help us now, Jim thought angrily.

Meanwhile, Marieke was glowering over the letters.

"What do you make of those?" Jim asked her.

"Well, there's nothing to stop an angry customer from taking their case to the internet, and this guy Tom is in advertising. He knows that bad news sticks." She paused. "Given the power of the net to spread negative word of mouth, it seems that we should be actively thinking of better ways to deal with irate customers than what we're doing now."

"Maybe we should consider a change in policy," Jim ventured, "investing enough in compensation programs so that unhappy customers don't wreak their revenge publicly."

Lisa looked glum. "Jim, I think that would set a bad precedent. It's teaching customers the wrong lesson. It might invite people to come at Atida with all kinds of claims. We don't want to treat them like spoiled children and teach them to behave that way."

How should Atida deal with its unhappy customers? Five commentators offer expert advice beginning on page 38.

Tom Farmer (tom@solidstateid.com) is a partner at Solid State Information Design, a marketing-strategy consultancy in Seattle.

A company investing only loose change in service-experience design invites hostile fire. I lobbed a grenade once myself, though the notorious results were wholly inadvertent.

WHETHER THE COMPANY knows it or not, Atida is a service organization that happens to sell cars, not a car-making organization that happens to provide service. A company investing vast sums in product marketing – but only loose change in service-experience design – invites hostile fire. I lobbed a grenade once myself, though the notorious results were wholly inadvertent.

In 2001, a coworker and I were denied our "guaranteed" reservations by a rude clerk at a sold-out Houston-area hotel. On returning home, we had a little fun assembling a "graphic complaint" for the hotel's managers. The PowerPoint, entitled "Yours Is a Very Bad Hotel," escaped into the internet slipstream (thanks, I think, to a colleague's mom), leaping from in-box to in-box in a viral wildfire. We received 5,000 e-mails from amused recipients around the world, and the mainstream media took notice. So did the hotel's brand masters.

The brass asked what we wanted. (Nothing material. We sought evidence of better employee training and got it.) We ended up on friendly terms with some execs, one of whom appeared on a webcast with us, months later, to discuss the fallout – a brave and classy thing to do. Meanwhile, the hotel that was the scene of the crime, evidently a troubled property before we rolled up, quietly changed franchise affiliations.

"Yours Is a Very Bad Hotel" showed how service brands can be affected by a new internet-age force: a decentralized, communally managed, peer-to-peer communications network that is inherently uncontrollable. At Atida, Jim, Lisa, and Marieke must accept an end to the era of rigid top-down corporate message management. Customers co-own brands and therefore co-control the image of an organization. Peer testimony (about a hotel, a washing machine, or an Atida) can carry more weight than company advertising.

The good folks at Atida should do three things. First, they should stop defining their jobs solely as controlling responses to bad news. Instead of hunkering down in the executive suite ducking incoming missiles, they should harness the power of the customer's online voice in a proactive, pulse-taking manner. That starts with making online dialogue intrinsic to the brand experience. If Atida designed a more engaging service experience with a strong diagnostic aspect – initiating dialogue with a tone and style that breeds affection for Atida people – it would nip more problems in the bud and sow far fewer enemies.

Second, mature service providers classify customers according to their historical and predicted future value, and Atida ought to start doing the same. Tom, who's purchased several expensive models and presents a serious-sounding safety issue, is Atida's equivalent of an elite customer. He represents future business. He's a key influencer. Where's his Diamond Desk?

Third, a customer classification strategy would remind Atida of a central tenet of the service world: The customer isn't always right. Some are too troublesome or expensive to satisfy. Knowing which to ignore is as important as knowing which to pamper. At Southwest Airlines, the story is told of a perpetually peeved customer who wrote to headquarters after every flight. Something was always wrong. Her seat wouldn't recline. The drink cart was out of root beer. She always ended by vowing never to fly Southwest again, but the letters kept coming. Finally, an exasperated customer communications guy brought the stack of letters upstairs to Herb Kelleher. Herb scanned them, then pulled out a sheet of company letterhead and wrote, "Dear Mrs. Jones: We'll miss you!" If Atida is "escalating" letters like Jessica Long's, it should be only to figure out how to disengage. Maybe they should send her a bus pass.

Wendy Wray

HEARD ON STEPS OF MAIN OFFICE
FRIDAY 8:15 AM

Smart guy: But how do we differentiate in a customer-centric environment?

Witty guy: Everyone else is going virtual.

Smart guy: Great. Let's do that.

Everyone's looking for innovative ways to make customers happier. Few know where to start. IBM helped Staples reshape their customer experience, resulting in a 60% increase in their online conversion rate. See how at ibm.com/do/retail

Smart guy: Great. Let's do that.

Everyone's looking for innovative ways to make customers happier. Few know where to start. IBM helped Staples reshape their customer experience, resulting in a 60% increase in their online conversion rate. See how at ibm.com/do/retail

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THE POOR PERFORMANCE of the new Andromeda is bad enough: A lousy product is always going to anger customers. But the way Atida mistreats consumers like Jessica and Tom, post-breakdown, stokes their rage enormously. Jessica and Tom are not just disgruntled; their perception of unfairness at the hands of Atida has provided them with a lot of energy. Bad-mouthing Atida over the internet allows them to create a real mess while expending it.

Our research into customer dissatisfaction expressed via the internet has demonstrated that too many companies fall into a trap when they care more about containing negative spin than about fairness. Among other things, firms like Atida fail to understand that people evaluate their experience with a company in more than one way. Beyond the frustration they encounter when a product fails to meet expectations, customers share a multidimensional sense of indignation when they feel mistreated. We have found that consumers in fact evaluate the *distributive, procedural,* and *interactional* fairness of a transaction. Companies can please or disgruntle customers along any or all of these dimensions.

Companies fall into a trap when they care more about containing negative spin than about fairness.

Distributive fairness refers to the customer's evaluation of the outcome of an exchange. Jessica's and Tom's sense of distributive fairness has been violated in the first place because the two have spent their hard-earned money on lemons. In seeking redress, Jessica feels replacement isn't enough; Tom is angered by Atida's refusal to reimburse out-of-pocket expenses associated with the breakdown. Analogously, the early adopters of Apple's iPhone felt violated by the price drop that Apple initiated barely weeks after its introduction. When they took their outrage to the internet, Steve Jobs issued a post hoc letter offering them a $100 credit in an effort to restore their sense of distributive fairness.

Procedural fairness refers to the processes used to reach a desired outcome. Here, it's particularly important for customers to believe that their voices are heard. Atida thinks it has done enough by providing an 800 number, but customers like Tom and Jessica hardly feel listened to when they call it. That's why Tom wants to use the web to settle the score.

Customers perceive interactional fairness when they believe they've been treated with respect and empathy and they've been given reasonable explanations for actions taken. When Lisa expresses the thought that her customers need to "get a life," she's violating this principle. For Tom, hearing an employee say, "I am sorry about the inconvenience" as if reading from a script fails the interactional fairness test by a good margin.

In view of all the distributive, procedural, and interactional violations Jessica and Tom have experienced at Atida, it's no wonder they are now out for revenge.

Research has consistently found that fair processes and respectful treatment mitigate the frustrations that result from distributively unfair outcomes. Had Atida delivered a customer experience high in procedural and interactional fairness, some of the wind might have been taken out of the sails of its distributively wronged customers.

Jim's team needs to create the impression that Atida is a fair dealer. To the extent that Jim can lead his staff to design and execute customer interactions that treat people fairly, he can inoculate Atida against future threats involving vengeful customers and protect the company from the public airing of customer gripes.

HEARD ON BROADWAY
MONDAY 2:29 PM

Guy with PDA: I love it. How soon can we get this into stores?

Short guy: Six months, maybe seven.

Guy with PDA: What can we do in six weeks?

Short guy: Change the color?

While other people talk about getting to market faster, we can help you get to market faster. IBM worked with Clarion Malaysia to speed product innovation, reducing design cycle time by half. See how at ibm.com/do/electronics

STOP TALKING
START DOING

IBM

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Atida's curt customer-service policy may be penny-wise, but it's more than pound-foolish. The company may be handling calls quickly and adhering to legal requirements, but that's not the same as taking care of customers. By treating service as a cleanup issue, Atida is missing the most important aspect of dealing with customer complaints in the first place – an opportunity to engage customers.

The very fact that Atida has moved the call center to Bangalore – where it can focus on reducing labor costs and processing calls as efficiently as possible – is symptomatic of the firm's misguided attitude toward its customers. Lisa assumes that eliminating the backlog of calls will improve customer satisfaction. However, getting the customer off the phone doesn't mean the customer is satisfied – or even finished complaining. Such an approach may have worked in the past, but it's clearly not consistent with Jim's desire to build a strong customer service reputation – and it's downright dangerous in the internet age, where word of mouth can spread infinitely faster than it did in the glory days of the Chaser.

Another big problem with running the call center from India is that it's too far removed from headquarters. Atida has a proud heritage, but the call center is worlds away from the cultural epicenter in Detroit. In working remotely, Lisa is removed from the day-to-day call issues, managerial hand-holding, and cultural inculcation necessary to help employees do their jobs better.

Indeed, Atida needs to rethink its service policy and shift its focus to the customer, rather than fixate on statistics. Jessica, for example, would probably appreciate a birthday present and a nice cake with an apology; Tom wants to be recognized for his loyalty. Atida should voluntarily replace his vehicle, reimburse his expenses, and probably throw in something special – such as free roadside assistance for the life of his car – to demonstrate the company's commitment to him. In adopting an attentive and individualized customer service policy, Atida could turn Jessica, Tom, and other unhappy customers from enemies into very powerful advocates for its brand.

Consider one story that has become part of Lexus lore. A call came in to our center in Southern California on a Friday at 6:00 PM, just before a long holiday weekend. A woman in Carlsbad – 80 miles away – called our free roadside assistance for help with a flat tire. While she was on the phone giving her location, a thief grabbed her purse off the trunk, taking her money, her credit cards, and her car keys. She then called our customer service center again to find out how to get another key. She needed it quickly, since she was on vacation and her two children were in the car with her.

The young man who took her call knew this woman needed him to do more than simply look up her key code so she could take it to the dealership – which, at the moment, she clearly couldn't do – so he went to his supervisor. "This poor woman needs help right now!" he declared. The supervisor agreed that they should take her a $1,000 gift check – and then he and the young man drove to Carlsbad to deliver the money and a new set of keys to the woman, who was both surprised and grateful. She went on to tell all her friends about what we had done for her, and her kids repeated the story to their friends.

This is not a unique instance. We encourage this kind of approach to customers because the stories they tell reinforce our strong reputation for customer satisfaction. And you can bet both the young man who took the call and his supervisor are telling that story too.

Getting the customer off the phone doesn't mean the customer is satisfied – or even finished complaining.

Short-term thinking is getting in the way of the real issue: "What is the value of a customer and how can we enhance it?"

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JIM IS WORRIED about Wall Street's reaction to the new model. Lisa is concerned with the large number of calls coming in to the center. Marieke may fear the potential negative effect of Tom's threatened video. Fair enough, but such short-term thinking is getting in the way of the real issue: What is the value of a customer and how can we enhance it?

Customers are valuable to a firm in two ways. The first – the *direct* lifetime value – is simply how much profit an individual is expected to generate for the company over the long run from purchasing products and services. Informed managers should be able to assess negative effects on this measure: If this customer is unhappy, what is the potential value lost?

What companies often fail to consider is the second way – the *indirect*, word-of-mouth lifetime value – how much profit customers give to, or take from, the firm because of their effect on others. Happy buyers of the Andromeda XL will tell their friends about their experience; some of these may purchase Andromedas and later influence others. My research, using both simulations and empirical analysis of sales-growth data, shows that when a product is new a customer's word-of-mouth value may be more than double his or her direct value. Conversely, unhappy customers will spread negative word of mouth, conceivably depressing sales just as much.

Most unhappy customers do not bother to publicize their experiences. Unlike Jessica and Tom, they don't even bother to complain. Instead, they stop buying and spread bad news in their social networks. These small revenges represent a great loss of lifetime value that is invisible to the firm but has substantial implications for the bottom line. A good CRM system can help managers track and estimate both direct and indirect value, and would be useful for Atida to implement.

If it did, the company might see how much value its current complaint-handling system is destroying. Customers' satisfaction with the firm, and their lifetime value, can be damaged as much by the complaint-handling process as by the original product failure. Managers are often quick to realize the possible costs of dealing with complaints; they are typically weak on the benefits. Indeed, Atida handles complaining customers as if they were enemies. Lisa doesn't understand that customers like Jessica and Tom are doing the firm a favor by providing essential feedback.

Because it has no learning process, Atida has no way to realize the positive value of customers' complaints. Tom has a very high lifetime value, not only because he is a loyal customer but also because of the potential value of his social network, especially because he buys Atidas early in their life cycles. (Research into online banking, for example, has shown that earlier adopters are worth three to four times as much as other customers because of their word-of-mouth value.) Atida should take quick action to soothe Tom's anger and rectify the situation. A personal apology from the CEO (or at least from Jim), a bouquet of flowers, and a new smart phone would be a good place to start.

Jessica's case is more complicated; she may just be a professional complainer, as Lisa surmises. Yet possibly not: Was she justified in her complaints? The pros and cons of simply writing her off should be examined under a lifetime-value approach. To be on the safe side, Atida may want to consider dropping her in a way she feels is just. Maybe send her a $2,000 gift certificate toward the purchase of a new Toyota?

Finally, as far as a change in policy goes, Atida can begin by adopting a simple, straightforward rule – the Golden one.

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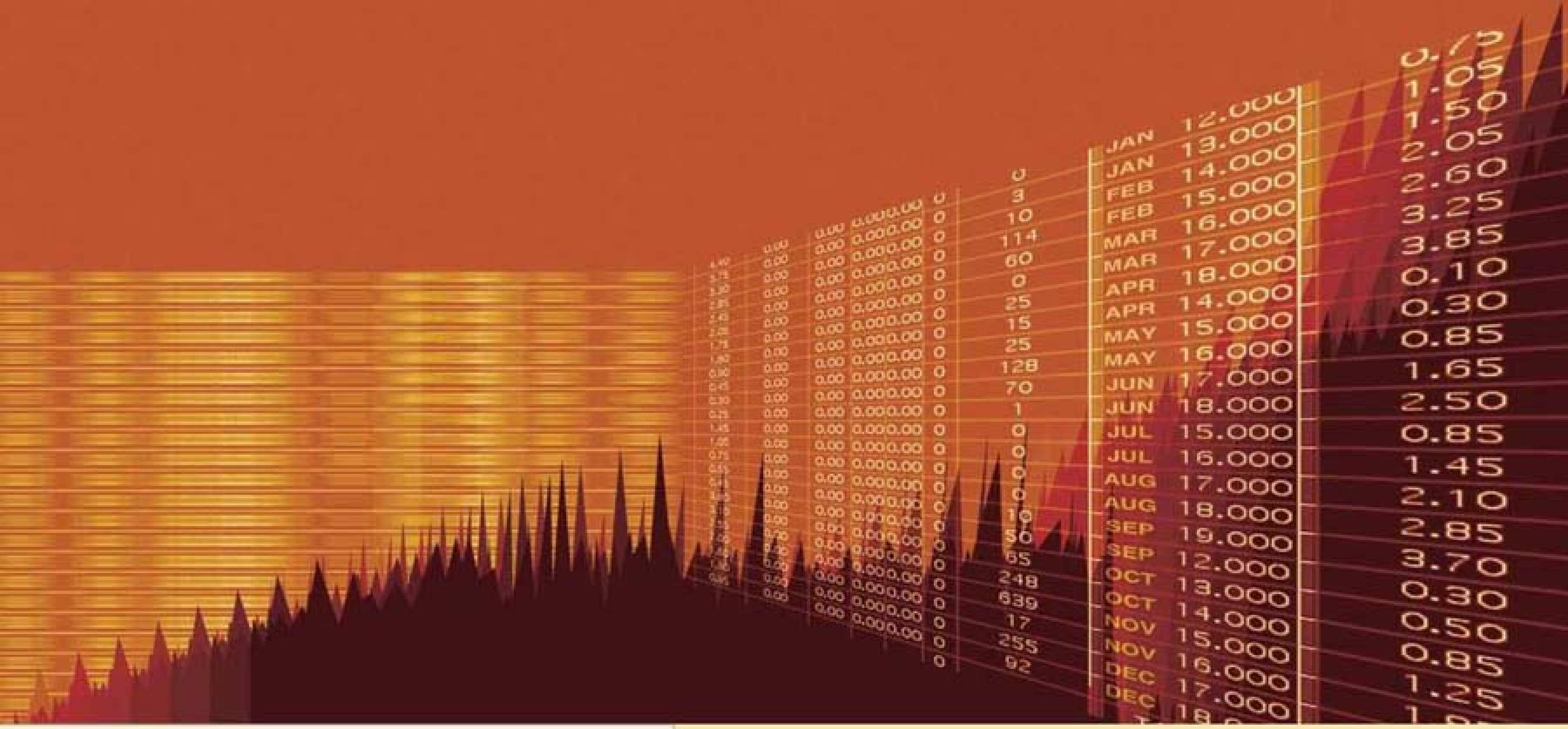
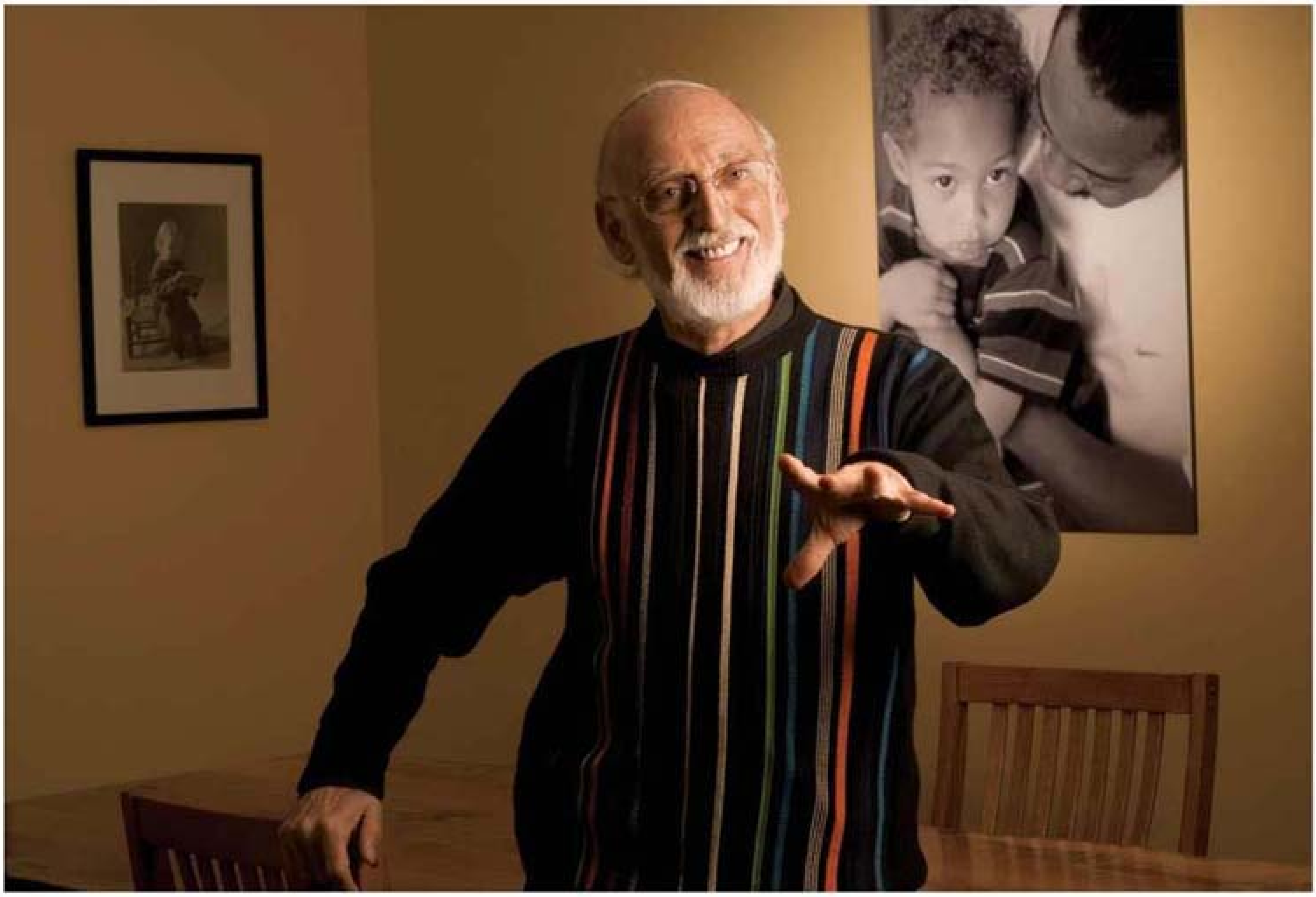
To order, see page 147.





Making Relationships Work

A Conversation with Psychologist **John M. Gottman**

The best science we have on relationships comes from the most intense relationship of all – marriage. Here's what we know about it.

IT HAS BECOME COMMON to extol the value of human relationships in the workplace. We all agree that managers need to connect deeply with followers to ensure outstanding performance, and we celebrate leaders who have the emotional intelligence to engage and inspire their people by creating bonds that are authentic and reliable. There's a large and fast-growing support industry to help us develop our "softer" relationship skills; many CEOs hire executive coaches, and libraries of self-help books detail how best to build and manage relationships on the way to the top.

Despite all the importance attached to interpersonal dynamics in the workplace, however, surprisingly little hard

Gary Benson

scientific evidence identifies what makes or breaks work relationships. We know, for instance, that the personal chemistry between a mentor and his or her protégé is critical to that relationship's success, but we don't try to work out what the magic is, at least not in any rigorous way. The absence of hard data and painstaking analysis exacts a heavy price: When relationships sour, as they easily can, there's little guidance on what you can do to patch things up. Even the best human resources officers may not know how or when to stage an intervention. If companies were more effective in helping executives handle their relationships through difficult times, they would see the company's productivity soar and find it much easier to retain leadership talent.

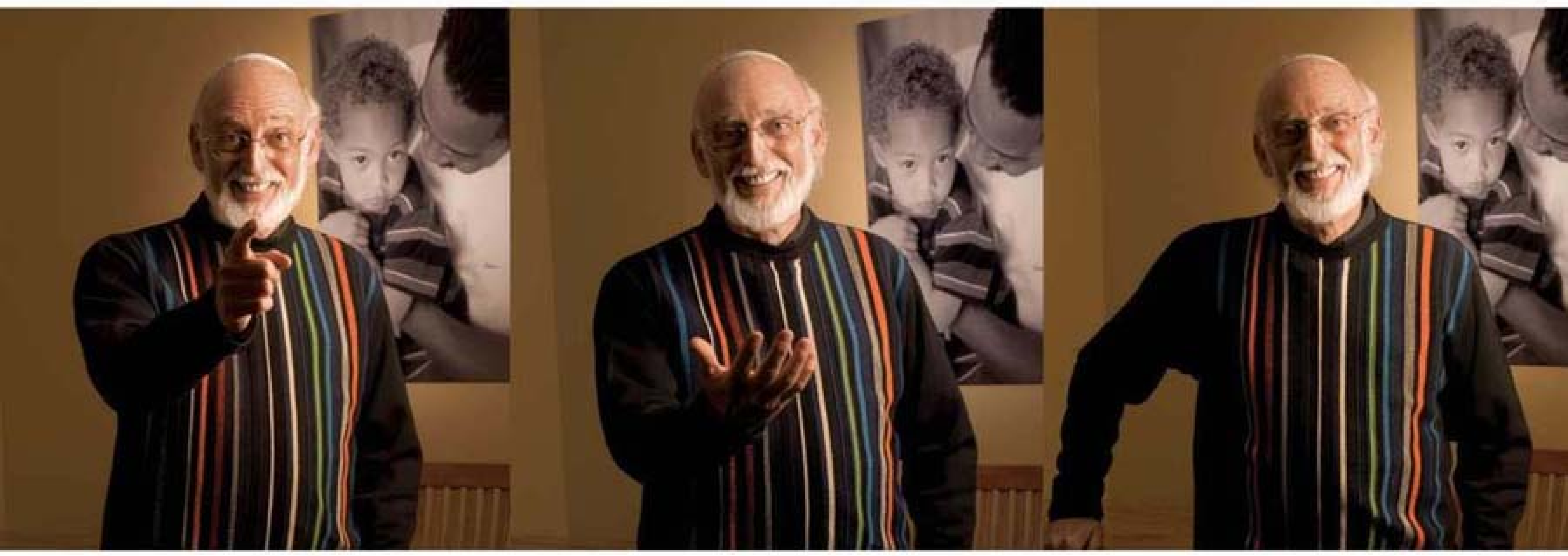
But if there's little research on relationships at work, some is beginning to emerge on relationships at home. That's good news because the way that people manage their work relationships is closely linked to the way they manage their personal ones. People who are abusive at home, for example, are likely to be abusive at work. If you believe that – as most psychologists do – then the relevance of the work of those who study relationships at home immediately becomes obvious.

Good relationships aren't about clear communication – they're about small moments of attachment and intimacy.

Few people can tell us more about how to maintain good personal relationships than John M. Gottman, the executive director of the Relationship Research Institute. At the institute's Family Research Laboratory – known as the Love Lab – Gottman has been studying marriage and divorce for the past 35 years. He has screened thousands of couples, interviewed them, and tracked their interactions over time. He and his colleagues use video cameras, heart monitors, and other biofeedback equipment to measure what goes on when couples experience moments of conflict and closeness. By mathematically analyzing the data, Gottman has generated hard scientific evidence on what makes good relationships.

HBR senior editor Diane Coutu went to the Seattle headquarters of the Relationship Research Institute to discuss that evidence with Gottman and to ask about the implications of his research for the work environment. As a scientist, he refuses to extrapolate beyond his research on couples to relationships in the workplace. The media have sensationalized his work, he says. However, he was willing to talk freely about what makes for good relationships in our personal lives.

Successful couples, he notes, look for ways to accentuate the positive. They try to say "yes" as often as possible. That doesn't mean good relationships have no room for conflict. On the contrary, individuals in thriving relationships embrace conflict over personality differences as a way to work them through. Gottman adds that good relationships aren't about clear communication – they're about small moments of attachment and intimacy. It takes time and work to make such moments part of the fabric of everyday life. Gottman discusses these and other nuances of his wisdom, acquired from experience and research, in this edited version of Coutu's conversation with him.



You're said to be able to predict, in a very short amount of time and with a high degree of accuracy, whether couples will stay together for the long term. How do you manage that?
Let me put it this way: If I had three hours with a couple, and if I could interview them and tape them interacting – in positive ways as well as in conflict – then I would say that I could predict a couple's success rate for staying together in the next three to five years with more than 90% accuracy. I've worked with 3,000 couples over 35 years, and the data support this claim, which have now been replicated by other scientists.

Could you train me to decide whether I should hire Dick or Jane?
I know this question has come up in the media, which have tried to sex up my work. But the reliability you see in my research has to do with studying relationships specifically. Just to predict whether an interviewee would be a good fit for a job – you couldn't do it. At least I know *I* couldn't do it. I rely on my research to be able to look at *couples*. And even with couples, I need to witness a sample interaction. The more emotional and the more realistic the situation is, the better I am at predicting with a high level of accuracy.

For instance, one test we've used for years is the "paper tower task." We give couples a bunch of materials, such as newspaper, scissors, Scotch tape, and string. We tell them to go build a paper tower that is freestanding, strong, and beautiful, and they have half an hour to do it. Then we watch the way the couples work. It's the very simple things that determine success. One time we had three Australian couples do the task. Beforehand, we had the couples talk on tape about each other and about a major conflict in their relationship that they were trying to resolve. So we had some data about how relatively happy or unhappy they were. When one couple who came across as happy started building their paper tower, the man said, "So, how are we going to do this?" The woman replied, "You know, we can fold the paper, we can turn the paper, we can make structures out of the paper." He said, "Really? Great." It took them something like ten seconds to build a tower. The wife in an unhappily married couple started by saying, "So how are we going to do this?" Her husband said, "Just a minute, can you be quiet while I figure out the design?" It didn't take much time to see that this couple would run into some difficulties down the line.

Your work depends heavily on your interviewing technique. How did you develop it?
My hero was Studs Terkel. I think he's by far the greatest interviewer ever. Bill Moyers is good. Barbara Walters is very good, too, but Terkel is amazing. In one interview, he went into a woman's attic and said to her, "Give me a tour, tell me what's up here." He had a big cigar in his mouth, but he was really interested. Acting as the tour guide, she said, "Well, I don't talk much about this doll." Terkel pointed out that it was not a new doll. "No," she said, "my first fiancé gave me this doll, before he was killed in a car accident. He was the only man I've ever loved." Surprised, Terkel remarked, "You're a grandmother; you must have married." She replied, "Yeah, and I love my husband, but just not like I loved Jack." The woman then launched into a great monologue, prompted by Terkel. We studied his tapes and based our interview technique on his approach.

What's your biggest discovery?
It sounds simple, but in fact you could capture all of my research findings with the metaphor of a saltshaker. Instead of filling it with salt, fill it with all the ways you can say yes, and that's what a

good relationship is. "Yes," you say, "that is a good idea." "Yes, that's a great point, I never thought of that." "Yes, let's do that if you think it's important." You sprinkle yeses throughout your interactions – that's what a good relationship is. This is particularly important for men, whose ability to accept influence from women is really one of the most critical issues in a relationship. Marriages where the men say to their partners, "Gee, that's a good point" or "Yeah, I guess we could do that" are much more likely to succeed. In contrast, in a partnership that's troubled, the saltshaker is filled with all the ways you can say no. In violent relationships, for example, we see men responding to their wives' requests by saying, "No way," "It's just not going to happen," "You're not going to control me," or simply "Shut up." When a man is not willing to share power with his wife, our research shows, there is an 81% chance that the marriage will self-destruct.

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Does that mean that there's no room for conflict in a good relationship?
Absolutely not. Having a conflict-free relationship does not mean having a happy one, and when I tell you to say yes a lot, I'm not advising simple compliance. Agreement is not the same as compliance, so if people think they're giving in all the time, then their relationships are never going to work. There are conflicts that you absolutely must have because to give in is to give up some of your personality.

Let me explain by illustrating from personal experience. My wife is very bad at just sitting still and doing nothing. A couple of years ago I gave her a book called *The Art of Doing Nothing*. She never read it. She always has to be up and about doing things. I'm not like that. I don't multitask the way she does; if I take a day off, I want it to be a day off. I want to play music; I want to have a sense of leisure. We fight about this difference all the time. She wants me to do stuff around the house, and I want her to take it easy. And it's worth fighting about this because it's an important personality difference between us. I don't want to adopt her style, and she doesn't want to adopt mine.

Another common issue in many relationships is punctuality. People have huge differences in their attitudes toward it and fight about it constantly. And they should – because unless you do, you can't arrive at an understanding of your differences, which means you can't work out how to live with them.

What else do people in relationships fight about?
I actually analyzed about 900 arguments last summer. With the help of the lab staff, I interviewed people about their fights – we saw them fighting in the lab and then outside the lab, and we talked about the issue. What we learned from measuring all these interactions is that most people fight about nothing. Their fights are not about money, or sex, or in-laws – none of that stuff. The vast majority of conflicts are about the *way* people in the relationship fight. One fight we studied was about a remote control. The couple was watching television, and the man said, "OK, let me see what's on," and started channel surfing. At one point the woman said, "Wait, leave it on that program, it's kind of interesting." He replied, "OK, but first let me see what else is on." She kept objecting until he finally said, "Fine, here!" and handed her the remote. She bristled and said, "The way you said 'fine,' that kind of hurt my feelings." He shot back with, "You've always got to have it your way." It may seem really elementary, but that's what people fight about. Unfortunately, most of these issues never get resolved at all. Most couples don't go back and say, "You know, we should really discuss that remote control issue." They don't try to repair the relationship. But repair is the sine qua non of relationships, so everybody needs to know how to process those regrettable moments.

I want to stress that good relationships are not just about knowing when to fight and how to patch things up. We also need humor, affection, playing, silliness, exploration, adventure, lust, touching – all those positive emotional things that we share with all mammals. Something that's been so hard for me to convey to the media is that trivial moments provide opportunities for profound connection. For example, if you're giving your little kid a bath and he splashes and you're impatient, you miss an opportunity to play with him. But if you splash back and you clean up later, you have some fun together and you both get really wet, laugh, and have a beautiful moment. It's ephemeral, small, even trivial – yet it builds trust and connection. In couples who divorce or who live together unhappily, such small moments of connection are rare.

We can't splash around at work. Are there equivalent ways to achieve connections there?
There are many similar things you can do in a work environment. You can go into your friend David's office and say, "How's little Harry doing?" And he might say, "You know, he really likes his new school. He's excited by it, and in fact you know what he's doing now...?" The conversation might take five or ten minutes, but you've made a connection. This goes for the boss, too. A lot of times the person who's running an organization is pretty lonely, and if somebody

walks into her office and doesn't talk about work but instead asks about her weekend, the message is, "Hey, I like you. I notice you independent of your position." Within organizations, people have to see each other as human beings or there will be no social glue.

What about intimate relationships at work – thumbs up or down?

That can be really problematic. Marriage researcher Shirley Glass did some terrific work on friendship in the workplace. She gave this wonderful example of a man who hadn't had sex for a long time. He and his wife had a new baby and were fighting a lot. Then after work one day, he and his coworkers went out to celebrate a really successful quarter at the company. Everybody had a good time. People eventually started to go home, but this man and a female coworker lingered. They were talking about the excellent fourth quarter earnings, and she said, "You know, George, this is the happiest I've seen you in months." Nothing untoward was happening, but he was enjoying the conversation in a way that he hadn't with his wife in a long time. So on the way home, he thought to himself, "You know, we laughed and shared a lot, and it was kind of intimate, and I should really go home and say, 'Nancy, I'm really kind of worried because I just had a conversation with a woman at work, and I felt closer to her than I've felt to you in months, and it scares the hell out of me, and we need to talk.'" But he knew exactly how his wife would react. She'd tell him to grow up and would say, "Hey, I have this baby sucking at my teats and now you're being a baby, too. I don't need this kind of crap from you, so just suck it up and get on with it. You're a new father, and quit having those conversations with that woman at work." So he decided not to share the experience with his wife because, he thought, "Nothing really happened anyway." But something did happen, and now he's got a secret. That's the beginning of betrayal.

Is there no difference between an emotional and a physical affair?

I honestly don't think so. I've seen this in my clinical work and in my research. Most affairs are not about sex at all; they're about friendship. They're about finding somebody who finds you interesting, attractive, fascinating. This can be on a physical or an emotional level – it all boils down to the same thing.

What contributes to a successful long-term relationship?

Look for the positive in each other. Robert Levenson, of the University of California at Berkeley, and I are in the 18th year of a 20-year longitudinal study in the San Francisco Bay area. We have two groups of couples who were first assessed when they were in their forties and sixties and are now, respectively, in their sixties and eighties. The surprising thing is that the longer people are together, the more the sense of kindness returns. Our research is starting to reveal that in later life your relationship becomes very much like it was during courtship. In courtship you find your new partner very charming and positive. It was all so new then. You de-emphasized the negative qualities and magnified the positive ones. In the long term, the same thing happens. You say, "She's a wonder woman. She can get us through anything." For instance, my wife and I have just moved out of the house we lived in for 14 years, and she orchestrated the entire thing. She was amazing. My genius was to sit back and say nothing. In good relationships, people savor the moments like this that they have together.

Is there such a thing as an ideal relationship?

I don't really know. Somebody I admired a long time ago was Harold Rausch, now retired, from the University of Massachusetts, who studied relationships and decided there was an optimal level of intimacy and friendship – and of conflict. He called couples who had achieved those levels "harmonious." He said that couples who preferred some emotional distance in their relationships were psychologically brittle and not very oriented toward insight and deep understanding. Rausch identified another type of couple – those who fought a lot and were really passionate – and he said they're messed up, too.

We studied those three groups of couples as well, and our research showed that they could all be successful. The people who wanted more distant relationships and friendships valued loyalty, commitment, and dedication but weren't so interested in intimacy. Still, they could have very happy marriages. You might think, "OK, they don't fight a lot in order to avoid conflict, and maybe that's bad for the kids." It turns out that wasn't true at all. We followed the kids' emotional and intellectual development, and a distant relationship between the parents turned out to be fine for the children. Our research showed that bickering a lot can be fine, too, provided that both people in the relationship agree to it. People have different capacities for how much intimacy and passion they want and how much togetherness they want. The problem is when there's a mismatch.

Are the short-term factors for success in relationships different from the factors that make for long-term success?

We face this question about short- and long-term success when we study adolescents and their relationships. We don't necessarily want a 14-year-old's dating relationship to last, but we'd like it to be a positive experience, and we'd like to facilitate our kids' growth and not lead them down a negative path. Whether we look at teenagers or at older couples, it turns out again and again that respect and affection are the two most important things. Whatever your age, there are so many ways you can show respect for your partner. Express interest in the story she's telling at dinner, pay him compliments, listen to her ideas, ask him to watch a *Nova* special with you so that you can discuss it later. The possibilities abound.

What other advice emerges from your study of good relationships?

I think that men need to learn how to embrace their wives' anger. This message is particularly pertinent today because women are now being educated and empowered to achieve more economically, politically, and socially. But our culture still teaches women that when they assert themselves they are being pushy or obnoxious. Women who get angry when their goals are blocked are labeled as bitchy or rude. If men want to have a good relationship with women, they have to be sensitive to the changing dimensions of power and control in the Western world. And they have to accept the asymmetry in our relationships for the time being. The good news is that embracing your wife's anger just a little bit can go a long way toward unleashing feelings of appreciation and affection.

I had this funny experience when I sold my book *The Seven Principles for Making Marriage Work* to my publisher. I met with the head of the marketing department, a young guy who leaned back in his chair as if he were not at all impressed by any of my work. He pointed his finger at me and said, "All right, tell me one thing in the next 30 seconds that I can do to improve my marriage right now!" I told him that if I were to pick just one thing it would be to honor his wife's dreams. The guy jumped up, put on his coat, and left the room. I found out months later that he had immediately hopped on the subway to Brooklyn, where he surprised his wife, who was at home with a young baby. Her mouth dropped when he asked her what her dreams were. He told me later that she said she thought he would never ask.

Within organizations, people have to see each other as human beings or there will be no social glue.

What would you suggest we be on guard against in relationships?

What I call the Four Horsemen of the Apocalypse – criticism, defensiveness, stonewalling, and contempt – are the best predictors of breakup or continued misery. Readers familiar with my work will remember that I consider contempt to be the worst: It destroys relationships because it communicates disgust. You can't resolve a conflict with your partner when you're conveying the message that you're disgusted with her. Inevitably, contempt leads to greater conflict and negativity. Our research also shows that people in contemptuous relationships are more likely to suffer from infectious illnesses – flu, colds, and so on – than other people. Contempt attacks the immune system; fondness and admiration are the antidotes.

Are you in a successful relationship?

Yes, my wife and I have just celebrated our 20th wedding anniversary, but we both had disastrous first marriages. Mine failed because my first wife and I had opposite dreams. I really love children and wanted to be a father, but she wasn't so sure and that was a deal breaker. Could a therapist have saved that relationship? I don't think so. My need to be a father was too great. And I'm so glad I became a dad. It's the most important thing I've ever done.

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The Four Truths of the Storyteller

The stories that move and captivate people are those that are true to the teller, the audience, the moment, and the mission.

BY PETER GUBER

I'm in the business of creating compelling stories.

As a filmmaker, I need to understand how stories touch audiences – why one story is an instantly appealing box office success while another fails miserably to connect. I've been fortunate enough to work with some of the world's most talented storytellers – gifted directors, novelists, screenwriters, actors, and other producers – and from them I've gleaned insights into the alchemy of great stories. Make no mistake, a hit movie is still an elusive target, and I've had my share of flops. But experience has at least provided me with a clear sense of the essential elements of a story and how to tap into its power.

The power of storytelling is also central to my work as a business executive and entrepreneur. Over the years, I've learned that the ability to

Tavis Coburn

articulate your story or that of your company is crucial in almost every phase of enterprise management. It works all along the business food chain: A great salesperson knows how to tell a story in which the product is the hero. A successful line manager can rally the team to extraordinary efforts through a story that shows how short-term sacrifice leads to long-term success. An effective CEO uses an emotional narrative about the company's mission to attract investors and partners, to set lofty goals, and to inspire employees.

Sometimes, a well-crafted story can even transform a seemingly hopeless situation into an unexpected triumph.

In the mid-1980s at PolyGram, I produced a television series called *Oceanquest,* which took a team of expert divers and scientists around the world – from Antarctica to Baja California to Micronesia – to film their aquatic adventures. The cast included former Miss Universe Shawn Weatherly, a novice who served as a stand-in for the viewers at home.

One of the planned segments critical to the success of the series was to explore the forbidden waters of Havana harbor, where galleons and pirate ships had carried treasure since the sixteenth century. There was only one problem: Neither the U.S. government nor the Communist regime of Fidel Castro wanted a team of Americans filming there.

Pleading that our mission was purely scientific and peaceful, we managed, with support from former secretaries of state Henry Kissinger and Alexander Haig, to get permission from the U.S. State Department. But the go-ahead from the Cuban government for underwater filming proved more elusive. Gambling that we could win approval, we sailed to Cuba, set up our equipment in Marina Hemingway, and filmed a few surface shots in various locations as we waited for word from the regime. Millions of dollars in sunk costs hung in the balance.

A local official finally turned up with a surprise announcement: Fidel Castro had taken a personal interest in our project and would be visiting the harbor. (Castro, we learned, was an environmental advocate and scuba enthusiast.)

"May we use this visit to ask for permission to film in the harbor?" we asked.

The official shrugged. "El Presidente will be here for ten minutes only," he replied. "But you are certainly free to tell your story. Just remember, no autographs and no gifts."

Of course, we'd already provided all sorts of information about our project to the Cuban government's Washington office. But it was soulless data with no emotion, life, or drama. No wonder our request had elicited a perfunctory "no." I was determined not to make the same mistake again.

Castro (or Cool Breeze, as we'd privately code-named him) arrived, his entourage in tow. To make his experience interactive, we'd arranged a display of our most elaborate equipment on the deck of our main ship – underwater vehicles, diving suits, high-tech cameras. Cool Breeze was suitably impressed by it all – though he seemed most taken by the friendly welcome from Ms. Weatherly, still wearing her bathing suit from that day's filming.

The ice broken, I began telling the story of Havana harbor and its centuries at the heart of world commerce, diplomacy, intrigue, and war. The central motivation for early explorers of the New World had been the quest for treasure. As the focal point of Spain's trading empire and the strategic "key to the Gulf of Mexico," Havana had been integral to this quest, its port the shipping center through which the gold of the Americas flowed on its way to the Spanish royal court. Pirates, privateers, spies, and rival imperial forces – including Britain's Royal Navy – had plied its waters, seeking booty, probing for military and economic secrets, and vying for influence. I explained how we would use the latest technology to bring Cuba's history to television viewers worldwide.

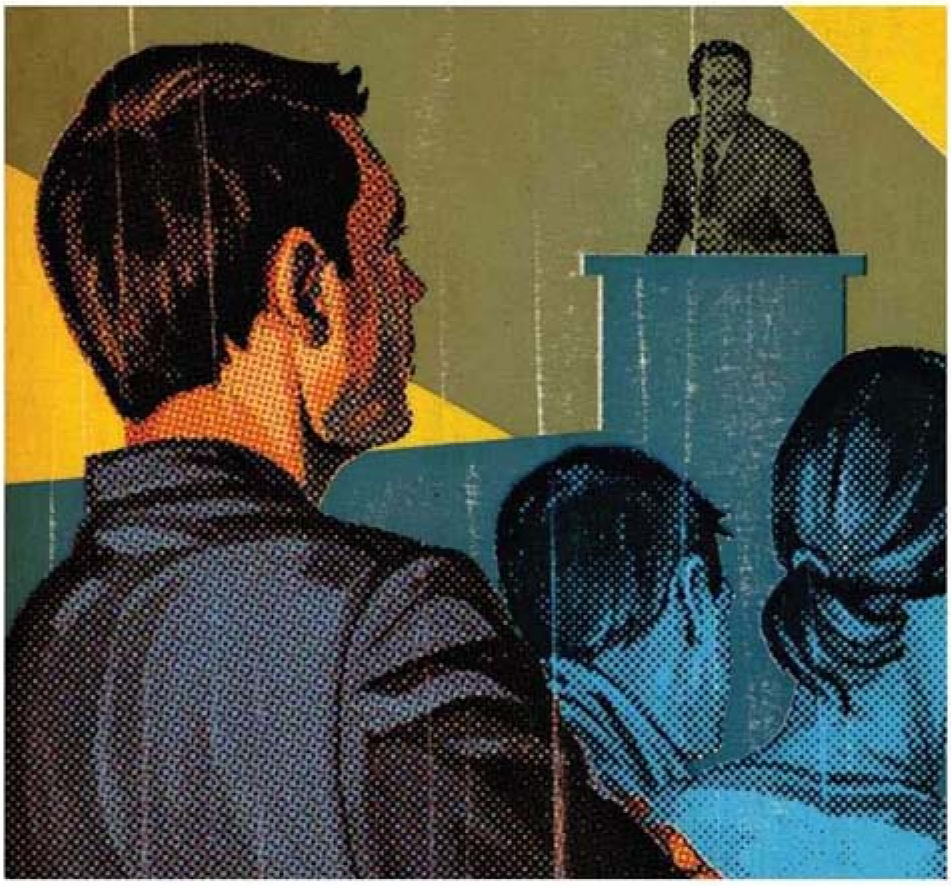
As I spoke, I watched Castro toy with the equipment and listen with growing interest to the story of Havana harbor's past. Finally, breaking the bureaucrat's rule, I presented the Cuban leader with a giant tooth (seven inches long, five inches wide) from a megalodon, a prehistoric shark that had once prowled Havana's waters.

For the leader, storytelling is action oriented – a force for turning dreams into goals and then into results.

Peter Guber (petergmandalay@gmail.com) has been the top executive at several multinational entertainment companies, including Sony Pictures, PolyGram, and Columbia Pictures, and has produced such movies as *Rain Man, Batman,* and *The Color Purple.* He is currently the chair and CEO of Mandalay Entertainment Group in Los Angeles, the host of the weekly film-industry talk show *Shootout* on AMC, and a professor at the UCLA School of Theater, Film & Television.

The upshot? Castro spent four hours visiting with our film crew, and he gave us permission to film anywhere in the harbor we wanted. We captured hours of compelling television footage. My impromptu story – and Havana's story – won the day. "The seas belong to all humankind," I reminded Castro, "and so does history. You are the steward of Havana's history, and it is up to you to share it with the world."

This experience led me – not for the first time and certainly not for the last – to try to gather some basic truths about how storytelling can be used to get people's help carrying out your goals and ultimately to inspire business success. Stories can, of course, take many forms, from old-fashioned words on a page to movies laden with digital special effects. In this article I'll restrict myself primarily to stories like the one I used with Castro: oral narratives in which a single teller addresses one or more listeners. Whether the audience is a handful of colleagues or clients at lunch or 10,000 convention-goers listening to a formal address, the secrets of a great story are largely the same.



The Leader as Storyteller

As part of my continuing effort to unlock these secrets, I recently persuaded a diverse group of leaders and storytelling experts from the worlds of business, education, and entertainment to come together over a meal and exchange their insights about storytelling. One beautiful spring evening, we gathered at my home in Los Angeles. With a feast laid out on a great low table and the city lights twinkling in the hills below us, we luxuriated in a cascade of ideas. As the wine flowed, so did the jokes, stories, and observations drawn from the centuries' worth of life experience in that room. And as varied as our backgrounds were, I found that we kept returning to one theme: the crucial importance of truth as an attribute of both the powerful story and the effective storyteller.

Before I go further, let me clear up two misconceptions about storytelling that many businesspeople have.

First, many think it is purely about entertainment. But the use of the story not only to delight but to instruct and lead has long been a part of human culture. We can trace it back thousands of years to the days of the shaman around the tribal fire. It was he who recorded the oral history of the tribe, encoding its beliefs, values, and rules in the tales of its great heroes, of its triumphs and tragedies. The life-or-death lessons necessary to perpetuate the community's survival were woven into these stories: "We don't go hunting in the Great Wood – not since that terrible day when three of our bravest were killed there by unknown beasts. Here's how it happened…"

Storytelling plays a similar role today. It is one of the world's most powerful tools for achieving astonishing results. For the leader, storytelling is action oriented – a force for turning dreams into goals and then into results.

Second, many people assume that storytelling is somehow in conflict with authenticity. The great storyteller, in this view, is a spinner of yarns that amuse without being rooted in truth. The image of Hollywood as "Tinseltown" – a land of make-believe and suspended disbelief that allows us to escape reality, even manipulates us into doing so – reinforces this notion. But great storytelling does not conflict with truth. In the business world and elsewhere, it is always built on the integrity of the story and its teller. Hence the emphasis on truth as its touchstone in our dinner symposium.

Reflecting on the lessons and ideas from our conclave, I've distilled four kinds of truth found in an effective story.

Truth to the Teller

Authenticity, as noted above, is a crucial quality of the storyteller. He must be congruent with his story – his tongue, feet, and wallet must move in the same direction. The consummate modern shaman knows his own deepest values and reveals them in his story with honesty and candor.

Jim Sinegal, cofounder and CEO of Costco, tells a business story that embodies the values he's helped build into his company. Back in 1996, he often recounts, Costco was doing a brisk business in Calvin Klein jeans priced at $29.99. When a smart buyer got a better deal on a new batch of the jeans, company guidelines calling for a strict limit on price markups dictated a lower price of $22.99. Costco could have stuck to the original price and dropped seven extra dollars a pair straight into its own pocket. But Sinegal insisted on passing the savings on to customers, because he saw the company's focus on customer value as the key to its success. The story continues to be told in Costco's hallways today. It vividly conveys a message about the company's values – one that resonates, in part, because it's aligned with the personality of its author. Sinegal answers his own phone, draws an annual salary of just $350,000 (a fraction of what most big-company CEOs earn), and has signed an employment contract that's only one page long – all of which means less cost for customers to absorb.

At the storytelling dinner I held, Oscar-winning screenwriter Ron Bass put it this way, drawing a parallel to the world of politics: "When I pitch a story, I have to sell myself – who I am. The same is true of every leader, in business or any other field. Take Barack Obama. His story is all about who he is. And everything about him is part of it, down to his physical presence: the eye contact, the hand on the shoulder, the sound of his voice."

Being true to yourself also involves showing and sharing emotion. The spirit that motivates most great storytellers is "I want you to feel what I feel," and the effective narrative is designed to make this happen. That's how the information is bound to the experience and rendered unforgettable.

But sharing emotion isn't easy. As Teri Schwartz, the dean of Loyola Marymount University's film and television school, pointed out, "It demands generosity on the part of the storyteller." Why? Because it often requires being vulnerable – a challenge for many leaders, managers, salespeople, and entrepreneurs. By willingly exposing anxieties, fears, and shortcomings, the storyteller allows the audience to identify with her and therefore brings listeners to a place of understanding and catharsis, and ultimately spurs action. When I told the story of Havana harbor to Castro – standing on the deck of a ship strewn with expensive equipment that we'd essentially brought there on spec, trusting in my ability to win the confidence of Cuba's all-powerful ruler – both my vulnerability and my enthusiastic commitment to the risky project were on full display.

Here is the challenge for the business storyteller: He must enter the hearts of his listeners, where their emotions live, even as the information he seeks to convey rents space in their brains. Our minds are relatively open, but we guard our hearts with zeal, knowing their power to move us. So although the mind may be part of your target, the heart is the bull's-eye. To reach it, the visionary manager crafting his story must first display his own open heart.

Truth to the Audience

There's always an implicit contract between the storyteller and his audience. It includes a promise that the listeners' expectations, once aroused, will be fulfilled. Listeners give the storyteller their time, with the understanding that he will spend it wisely for them. For most businesspeople, time is the scarcest resource; the storyteller who doesn't respect that will pay dearly. Fulfilling this promise is what I mean by "truth to the audience."

To meet the terms of this contract – and ideally even *over*-deliver on it – the great storyteller takes time to understand what his listeners know about, care about, and want to hear. Then he crafts the essential elements of the story so that they elegantly resonate with those needs, starting where the listeners are and bringing them along on a satisfying emotional journey.

This journey, resulting in an altered psychological state on the part of the listener, is the essence of storytelling. Listeners must remain curious and in suspense – wondering what's going to happen to them next – while trusting that it is safe to give themselves over to the journey and that the destination will be worthwhile.

Truth to the audience has a number of practical implications for the craft of storytelling.

First, you'll want to try your story out on people who aren't already converts, to get a realistic sense of how your real audience might respond. Ron Bass finds this strategy useful: "In effect," he says, "I have my own story development company. It consists of three or four young women who represent my 'marketing department.' I bounce everything off them – every new idea, scene, plot twist, character

Although the mind may be part of your target,

development, big speech. I study their reactions and then, even more important, study *my* reaction to them. I don't necessarily follow their advice. What I must follow is my own deepest instinct, and this is best revealed to me as I see how I respond to the feelings and thoughts of other people."

Business leaders too need to be in touch with their listeners – not slavish or patronizing, but receptive – in order to know how to lead them. Getting your story right for your listeners means working past a series of culs-de-sac and speed bumps to find the best path.

Second, you'll need to identify your audience's emotional needs and meet them with integrity. It's not enough to get the facts right – you've got to get the emotional arc right as well. Every storyteller is in the expectations-management business and must take responsibility for leading listeners effectively through the story experience, incorporating both surprise and fulfillment. At the end of the story, listeners should think, "We never expected *that* – but somehow, it makes perfect sense." Thus, a great story is never fully predictable through foresight – but it's projectable through hindsight.

Third, you'll want to tell your story in an interactive fashion, so people will feel they've participated in shaping the story experience. This requires a willingness to surrender ownership of the story. The storyteller must recognize that the story is bigger than she is and must enlist her audience's help.

This can mean, as screenwriter Chad Hodge pointed out during our dinner, "helping people to see themselves as the hero of the story," whether the plot involves beating the bad guys or achieving some great business objective. "Everyone wants to be a star, or at least to feel that the story is talking to or about him personally," Hodge said. Business leaders need to tap into this drive by using storytelling to place their listeners at the center of the action. As Hodge advised: "Encourage your people to join your journey, your quest, and reach the goal that lies at its end." Recall, for example, how I shone a spotlight on the chain of history of Havana's great harbor and placed Castro at the center of the story, as the harbor's current steward.

LMU's Teri Schwartz picked up on Hodge's idea: "Make the 'I' in your story become 'we,' so the whole tribe or community can come together and unite behind your experience and the idea it embodies."

the heart is the bull's-eye.

Consider how Sallie Krawcheck – formerly the CEO of Smith Barney and now, in her early forties, the youthful chair and CEO of Citigroup's Global Wealth Management division – connects with people who might be intimidated by her reputation for brilliance and her rapid rise to the top of the financial services industry. She often tells her life story in a way that anyone can identify with, recalling how she felt like an outcast at her all-girls school as a teenager – with glasses, braces, and corrective shoes – and how that prepared her for the rigors of her professional life. She has said in the business press that "there was nothing they could do to me at Salomon Brothers in the '80s that was worse than the seventh grade."

When you hear Krawcheck describe her journey in these terms, you know exactly how she feels. You can't help rooting for her – and if you're a member of her team at Citigroup, you're ready to follow her wherever she leads.

Perhaps of equal import, business leaders must recognize that how the audience physically responds to the storyteller is an integral part of the story and its telling. Communal emotional response – hoots of laughter, shrieks of fear, gasps of dismay, cries of anger – is a binding force that the storyteller must learn how to orchestrate through appeals to the senses and the emotions.

Nowhere is this more apparent than at the story's ending. Getting the audience to cheer, rise, and vocalize in response to a dramatic, rousing conclusion creates positive emotional contagion, produces a strong emotional takeaway, and fuels the call to action by the business leader. The ending of a great narrative is the first thing the audience remembers. The litmus test for a good story is not whether listeners walk away happy or sad. Rather, it's whether the ending is emotionally fulfilling, an experience worth owning, a great "aha!" – not just sticky fingers and a few uneaten kernels of popcorn.

Orchestrate emotional responses effectively, and you actually transfer proprietorship of the story to the listener, making him an advocate who will power the viral marketing of your message.

Truth to the Moment

A great storyteller never tells a story the same way twice. Instead, she sees what is unique in each storytelling experience and responds fully to what is demanded. A story involving your company should sound different each time. Whether you tell it to 2,000 customers at a convention, 500 salespeople at a marketing meeting, ten stock analysts in a conference call, or three CEOs over drinks, you should tailor it to the situation. The context of the telling is always a part of the story. In the case of my pitch to Castro, the story had to seem spontaneous, a natural response to the inspiring historic setting of Marina Hemingway (itself named after one of the twentieth century's great storytellers). And it did, though the information had been gathered in advance. Its organization and delivery were in essence the "premiere" of this particular story.

There is a paradox here. Great storytellers prepare obsessively. They think about, rethink, work, and rework their stories. As Scott Adelson, an investment banker who uses storytelling to help clients raise capital in public markets, said at our dinner: "Sheer repetition and the practice it brings is one key to great storytelling. When we help companies sell themselves to Wall Street, we often see the CEO and his team present their story 10, 20, 30 times. And usually each telling is better and more compelling than the one before."

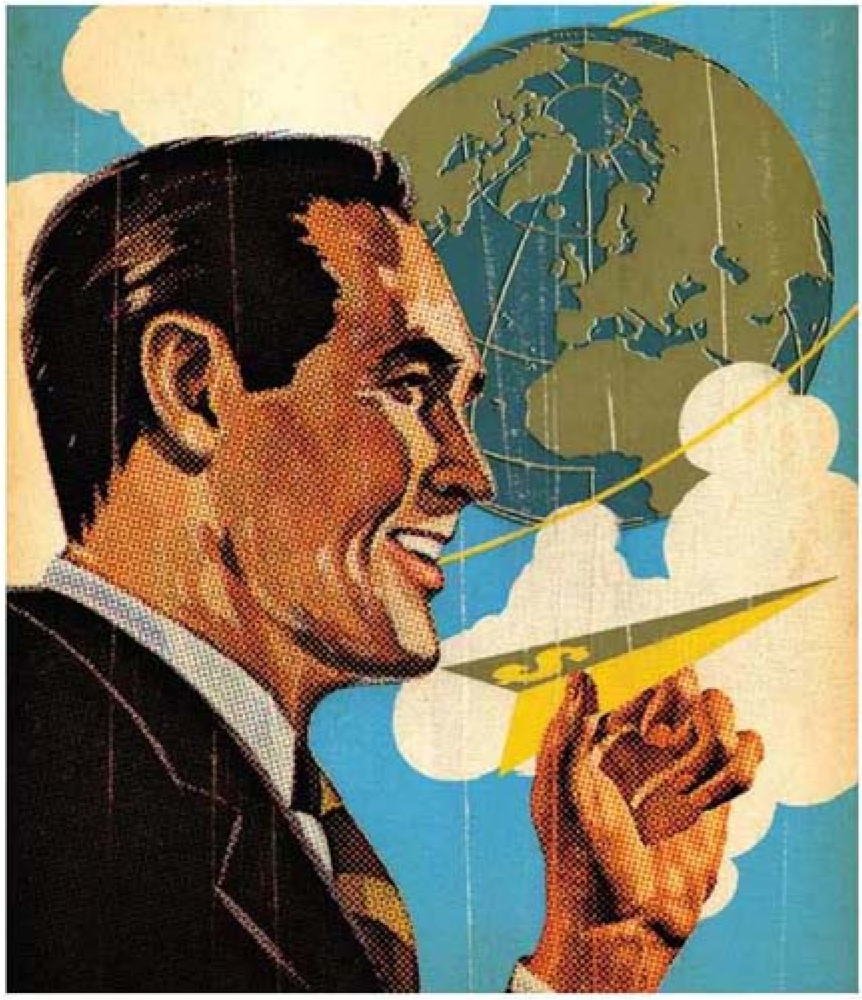
At the same time, the great storyteller is flexible enough to drop the script and improvise when the situation calls for it. Actually, intensive preparation and improvising are two sides of the same coin. If you know your story well, you can riff on it without losing the thread or the focus.

At the storytelling dinner, scientist and science fiction writer Gentry Lee told us about appearing on a public panel about alien abductions. The other three members of the panel were two people who claimed they'd been taken by aliens, and John Mack, the late Harvard psychiatrist who believed in and researched such stories. As you might expect, the two abductees had colorful, vivid, fascinating stories to tell. The listeners were literally standing on their feet, clapping and cheering. Mack poured fuel on the fire by testifying that these stories could be confirmed by many others he'd studied.

Lee had prepared, from a scientist's perspective, a detailed response to the abduction stories, showing how the power of the imagination can conjure up fantasies that look, feel, and appear compellingly real. But he could see that the frenzied audience was in no mood to absorb his lengthy presentation. Instead, he decided to avoid a war of dueling stories by simply using a single startling observation to deflate the abductees' tales. All he said was this:

"My friend Carl Sagan used to say, 'Extraordinary claims require extraordinary evidence.' Well, we've heard some wonderful stories today, and they make extraordinary claims. I would just point out the following: Hundreds of people who believe they've been abducted by aliens have told stories like the ones we've just heard. And yet, despite all these hundreds of supposed abductions, not a single souvenir has ever been brought back – not a single tool or document or drinking glass or so much as a thimble! Given the total absence of any physical evidence, can we *really* believe these extraordinary claims?"

This simple, unadorned statement – improvised on the spot to startle the audience into a fresh way of thinking – completely transformed the situation. Most of the throng



changed from true believers to thoughtful skeptics in just a few moments.

For the well-trained storyteller, spontaneity and economy can be elegant and powerful.

Truth to the Mission

A great storyteller is devoted to a cause beyond self. That mission is embodied in his stories, which capture and express values that he believes in and wants others to adopt as their own. Thus, the story itself must offer a value proposition that is worthy of its audience.

The mission may be on a national or even global scale: To land a man on the moon and return him safely to Earth. To win the Cold War and bring freedom to millions of people around the world. To reverse global warming and save the planet.

Or the cause may be more modest but still important, at least to the storyteller and his audience: To turn around a company that is floundering and save hundreds of jobs. To bring a great new service to market and improve the lives of customers.

In any case, the job of the teller is to capture his mission in a story that evokes powerful emotions and thereby wins the assent and support of his listeners. Everything he does must serve that mission.

This explains the passion that great storytellers exude. They infuse their stories with meaning because they really believe in the mission. I truly believed that our program

As a modern shaman, the visionary business leader taps into the human yearning to be part of a worthy cause.

on the history of Havana harbor was important: We had shown up to do something that was bigger than the swirl of temporary political bargaining between our countries, and we had bet the farm on the journey.

When truth to the mission conflicts with truth to the audience, truth to the mission should win out. The leader who knows his listeners is able to gain their trust and spend that currency wisely in pursuit of the mission. But this doesn't mean telling people exactly what they want to hear. That's pandering and, as Hollywood has learned, a formula for a mediocre story. Indeed, sometimes you need to do just the opposite. At our dinner party, Colin Callender, president of HBO Films, noted that several of HBO's most acclaimed productions are ones that audience pretesting marked as losers.

Even in today's cynical, self-centered age, people are desperate to believe in something bigger than themselves. The storyteller plays a vital role by providing them with a mission they can believe in and devote themselves to. As a modern shaman, the visionary business leader taps into the human yearning to be part of a worthy cause. A leader who wants to use the power of storytelling must remember this and begin with a cause that deserves devotion.

One of today's most creative business leaders is Muhammad Yunus, founder of Bangladesh's Grameen Bank and pioneer of the microcredit movement, which advocates providing small loans to the poor. When he addresses would-be partners to solicit support for microcredit, he tells some version of this story:

"It was a village woman named Sufiya Begum who taught me the true nature of poverty in Bangladesh. Like many village women, Sufiya lived with her husband and small children in a crumbling mud hut with a leaky thatched roof. To provide food for her family, Sufiya worked all day in her muddy yard making bamboo stools. Yet somehow her hard work was unable to lift her family out of poverty. Why?"

(Of course, "Why?" is a rhetorical question. But posing it to the listeners engages their curiosity and makes them eager to hear the answer, which they trust Yunus to supply.)

"Like many others in the village, Sufiya relied on the local moneylender to provide the cash she needed to buy the bamboo for her stools. But the moneylender would give her this money only on the condition that he would have the exclusive right to buy all she produced at a price he would decide. What's more, the interest rate he charged was incredibly high, ranging from 10% per week to as much as 10% *per day.*

"Sufiya was not alone. I made a list of the victims of this moneylending business in the village of Jobra. When I was done, I had the names of 42 victims who had borrowed a total of 856 taka – the equivalent of less than $27 at the time. What a lesson this was for me, an economics professor!

"I offered $27 from my own pocket to get these victims out of the moneylenders' clutches. The excitement that was created among the people by this small action got me further involved. If I could make so many people so happy with such a tiny amount of money, why not do more?

"That has been my mission ever since."

When Yunus tells this story of the origins of microcredit, his listeners – including bankers, CEOs, and high government officials – are moved. They are riding the emotional arc of Yunus's tale, which culminated in 2006 with the awarding of the Nobel Peace Prize jointly to Yunus and Grameen Bank. When he concludes his story by asking his listeners to help bring affordable credit to every poor person in the world, he almost always receives a standing ovation – along with a flood of pledges.

The Unchanging Heart of Storytelling

Story forms have evolved continually since the days of the shaman. Literary genres from epic poetry to drama to the novel use stories as political or social calls to action. Technological breakthroughs – movable type, movies, radio, television, the internet – have provided new ways of recording, presenting, and disseminating stories. But it isn't special effects or the 0's and 1's of the digital revolution that matter most – it's the oohs and aahs that the storyteller evokes from an audience. State-of-the-art technology is a great tool for capturing and transmitting words, images, and ideas, but the power of storytelling resides most fundamentally in "state-of-the-heart" technology.

At the end of the day, words and ideas presented in a way that engages listeners' emotions are what carry stories. It is this oral tradition that lies at the center of our ability to motivate, sell, inspire, engage, and lead.

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CHINA + INDIA

The Power of Two

China and India, ancient allies and modern competitors, are rebuilding economic ties after almost five decades. Consequently, multinational companies face the most challenging – and potentially rewarding – business landscape ever.

BY TARUN KHANNA

Jon Krause

A historic event, largely unnoticed by the rest of the world, took place on the border between China and India on July 6, 2006. After 44 years, the Asian neighbors reopened Nathu La, a mountain pass perched 14,140 feet up in the eastern Himalayas, connecting Tibet in China to Sikkim in India. Braving heavy wind and rain, several dignitaries – including China's ambassador to India, the Tibet Autonomous Region's chairperson, and Sikkim's chief minister – watched as soldiers removed a barbed wire fence between the two nations.

Companies all over the world would do well to hear the winds of change roaring through Nathu La (which in Tibetan means "Listening Ears Pass"). The decision to reopen the world's highest customs post marked the culmination of a slow but steady process of rapprochement between China and India. The friends turned foes in 1962, when they fought a short but bloody war. After that, the two nations' armies glared at each other, weapons at the ready, until their governments decided to fight poverty rather than each other. In the past few years, China (under President Hu Jintao and Premier Wen Jiabao) and India (led by Prime Minister Manmohan Singh) have forged links anew. China now supports India's bid for a permanent seat on the United Nations Security Council; their armies have held joint military exercises; and at World Trade Organization negotiations, the countries have adopted similar positions on international trade in agricultural products and intellectual property rights.

The two nations are also reviving their old cultural and religious ties. Beginning in 2012, they will allow tourists to use Nathu La, which will increase the number of cross-border pilgrimages. The pass makes it easy for China's Buddhists to offer prayers at monasteries in Sikkim, such as Rumtek, and for India's Hindus and Jains to visit sacred Mount Kailash and Manasarovar Lake in Tibet. The bonds between China and India run deep. Four out of five Chinese, from a broad cross-section of society, told me in an informal survey that Bollywood movies come immediately to mind when they think about India. That's despite the fact that it has been more than a decade since Indian movies were the only foreign films shown in China. Ignoring these facts would be a mistake; several scholars, such as Baruch College's Tansen Sen, have argued that religion and culture lubricate the wheels of commerce.

China and India are also rebuilding their business bridges. Although Nathu La's reopening may be largely symbolic – the two countries allow the trade of only a few products, such as raw silk, horses, and tea, across the pass – it indicates a fresh camaraderie between the planet's fastest-growing economies. Their desire to strike a partnership is evident: High-level official visits often take place between them; businesspeople from each country participate in conferences held in the other; and forecasts of the flow of goods and services between them keep rising. Sino–Indian trade stagnated at around $250 million a year in the 1990s, but it touched $13 billion in 2006, will cross the $20 billion mark in 2007, and may exceed $30 billion in 2008 – a growth rate of more than 50% a year.

Yet most enterprises and experts gloss over this budding business axis. I hear the naysayers all the time. China and India can't collaborate; they can only compete, say many Western (and not a few Chinese and Indian) academics and consultants. Both nations are vying to be Asia's undisputed superpower, and they are suspicious about each other's intentions. China and India have nuclear weapons; they have created the world's biggest armies; and they are trying to dominate the seas in the region. China continues to support Pakistan, which India isn't happy about, and India still lets in Tibetan refugees, which China resents. The United States, meanwhile, plays India against China. In addition, since most adult Chinese and Indians grew up seeing each other as aggressors, it's tough for them to trust each other.

Moreover, the argument runs, China and India are business rivals at heart. The former's remarkable economic rise threatens India, which trails its neighbor on almost every conventional socioeconomic indicator. China may be strong in manufacturing and infrastructure and India in services and information technology, but the latter's manufacturing industry is becoming globally competitive, while China's technology sector threatens to match India's in a decade. Both have a growing appetite for natural resources such as oil, coal, and iron ore, for which they compete fiercely. They also fight for capital, especially for investments by multinational companies from North America, Europe, and Japan. All this makes it difficult to believe that China and India can ever cooperate. Few people think to ask, "Can China and

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INDIA

- Area **3,287,590 sq km (2007)**
- Population **1.13 billion (2007)**
- GDP real growth rate **9.4%**
- GDP per capita (ppp)* **$3,800**
- Unemployment **7.8% (2006)**
- Population below poverty line **25% (2002)**
- Exports **$112 billion**
- Imports **$187.9 billion**
- Exchange rate **39.80 rupees per $ (2007)**
- Imports from **China, U.S., Germany, Singapore**
- Exports to **U.S., UAE, China, UK**
- Literacy rate **61% (2001)**
- Life expectancy **68.59 years (2007)**

*purchasing power parity

Sources: CIA World Factbook; www.xe.com. Data are based on 2006 estimates, except where otherwise specified.

CHINA

- Area **9,596,960 sq km (2007)**
- Population **1.32 billion (2007)**
- GDP real growth rate **11.1%**
- GDP per capita (ppp)* **$7,800**
- Unemployment **4.2% (2005)**
- Population below poverty line **10% (2004)**
- Exports **$974 billion**
- Imports **$777.9 billion**
- Exchange rate **7.52 RMB per $ (2007)**
- Imports from **Japan, S. Korea, U.S., Germany**
- Exports to **U.S., Japan, S. Korea, Germany**
- Literacy rate **90.9% (2000)**
- Life expectancy **72.88 years (2007)**

*purchasing power parity

Sources: CIA World Factbook; www.xe.com. Data are based on 2006 estimates, except where otherwise specified.

India work together?" Instead, a big question debated in boardrooms is whether India can catch up with China.

This perspective is incomplete. China is home to 1.3 billion people; India has a population of 1.1 billion. In the next decade, they will become the largest and third-largest economies in terms of purchasing power. By 2016 they will account for around 40% of world trade, compared with 15% in 2006. That's roughly the position they occupied about 200 years ago. Economist Angus Maddison has calculated that in the 1800s, China and India together accounted for 50% of global trade. It is impossible to make predictions about the integration of these countries into the global economy, because past events, such as Germany's reunification and the fall of the Iron Curtain, don't compare. After those occurrences in 1990, a large number of people entered the global economy, but the numbers pale in significance when compared with the China–India double whammy. Like it or not, the world's future is tied to China and India.

Both countries have put feeding their millions ahead of border disputes, and they can't turn the clock back on liberalization. They have too much to lose by not working together. This doesn't suggest that a lovefest will ensue; it only implies less hostility and suspicion between two fast-maturing nations.

China and India have taken different routes to enter the world economy, and that has resulted in their gaining complementary strengths. Some business leaders have learned to make use of both countries' resources and capabilities, as I shall show in the following pages. In the process, they have become globally competitive. Multinational companies will only lose if they don't take advantage of the complementarities between the two economies. If they embrace both countries, however, they can tap into diverse strengths almost as easily as Chinese and Indian companies will.

Fathoming the Depth of Their Relationship

The tensions between China and India are real, but they will eventually prove to be aberrant. There are three good reasons for believing that: one historic, one economic, and one strategic.

First, China and India sealed their borders in modern times, but in the 2,000 years preceding the conflict of 1962, the two countries enjoyed strong economic, religious, and cultural ties. By the second century BC, the southern branch of the Silk Road – an interconnected series of ancient trade routes on land and sea – linked the cities of Xi'an in China and Pataliputra in India. Trade on the Tea and Horse Road, as the Chinese called it, was a significant factor in the growth of the Chinese and Indian civilizations. Seen in that light, the closing of the Sino-Indian border – not the border's reopening – is the anomaly.

In fact, Buddhism traveled from India to China in 67 AD along the Silk Road. In those days, the relationship between China and India was one of mutual respect and admiration. The monk Fa-hsien (337 to 422 AD), who traveled from China to India to study Buddhism, referred to the latter as *Madhyadesa* (Sanskrit for "Middle Kingdom"), which is similar in meaning to *Zhongguo,* the word the Chinese used to describe China. In the 1930s, no less a scholar than Beijing University's Hu Shih said that the sixth century AD marked the "Indianization of China." Even today, visits by Chinese and Indian leaders include a trip to a Buddhist shrine in the host nation.

There was also much goodwill after the birth of the two modern states, India in 1947 and China in 1949. During the 1930s, India's future prime minister Jawaharlal Nehru frequently wrote about how India supported the struggles of fellow Asians under the foreign yoke. He organized marches in India in support of China's freedom, organized a boycott of Japanese goods, and in 1937 sent a medical mission to help the Chinese. India was the second non-Communist country, after Burma, to recognize the People's Republic of China, in 1950. Five years later, India supported the idea that China should attend the Bandung Conference, in Indonesia, which led to the creation of the Non-Aligned Move-

How China and India Have Developed Differently

	CHINA
FOUNDATIONS	**GOVERNMENT** A single party rules China. Those at the top control the reforms process, although bureaucrats located far from Beijing don't always do its bidding. Officials who deliver economic growth can move up the ladder.
FOUNDATIONS	**INFORMATION AND TRANSPARENCY** Economic information is increasingly available, but political information is not. The state's efforts to curtail news compete with technology-based efforts to disseminate information.
FOUNDATIONS	**PROPERTY RIGHTS** The state respects the individual's rights to property more than it used to, but it still sacrifices them on the altar of public interest when the two come in conflict. The state can therefore make huge investments in public goods.
IMPLICATIONS	**LOCAL BUSINESS** The country has millions of would-be entrepreneurs, but their potential is constrained unless they partner with the state or with foreigners. The government is often the entrepreneur.
IMPLICATIONS	**MULTINATIONAL COMPANIES** Foreign companies get red-carpet treatment from the state. Since they usually rely on their home bases for capital and senior talent, they aren't affected much by China's poor markets.
IMPLICATIONS	**DIASPORA** Overseas Chinese played a catalytic role in starting China's economic miracle two decades ago. They are still a source of capital, while Chinese returning home contribute brainpower.
IMPLICATIONS	**RURAL ECONOMY** The physical infrastructure in the villages is often superb. But the relative decline in the rural standard of living, compared with that in coastal areas, has fueled protest and resentment.
IMPLICATIONS	**EDUCATION AND HEALTH** The resource-rich state has made large investments in education. Basic literacy levels are very high. The quality of health care is bad, partly because China moved away from a centralized system to a private model after 1978.
IMPLICATIONS	**EXTERNAL RELATIONS** A fiat-driven approach characterizes China's relations with the world. The country leads with its wallet. China is stronger than India in their common hinterland in Asia and is gaining prominence in Africa and central Asia.

China and India are large, populous Asian neighbors, but the similarities end there. The differences between them make the whole greater than the sum of the parts.

INDIA	
GOVERNMENT Coalitions of political parties jockey for power in a raucous democracy. Positions of power aren't dominated by traditional economic or social elites. Individual rights are respected, but the presence of many interest groups often renders the system dysfunctional.	FOUNDATIONS
INFORMATION AND TRANSPARENCY There's a cacophony of voices that are rarely deliberately inaccurate. The media debate everything; nothing is off-limits. In fact, they are increasingly exposing corruption in high places.	FOUNDATIONS
PROPERTY RIGHTS The individual's rights to property are sacrosanct. Public interest is often sacrificed for the individual's sake. The government can make only small investments in public goods, which has led to poor infrastructure.	FOUNDATIONS
LOCAL BUSINESS Indigenous enterprise has flowered in the past 15 years. It is aided by effective capital markets, good information flows, and respect for property rights.	IMPLICATIONS
MULTINATIONAL COMPANIES The government continues to exhibit a distaste for foreign investment, although less so than in the past. That's partly for good reasons, like supporting indigenous entrepreneurs, and partly for bad ones, such as protectionism.	IMPLICATIONS
DIASPORA Once shunned, nonresident Indians are more accepted than they used to be. Capital flows from overseas Indians come in the form of remittances, not investments.	IMPLICATIONS
RURAL ECONOMY The state's utter neglect of rural India has left villagers impoverished. The infrastructure is usually in terrible shape. The efforts made by the private sector and civil society to help villagers are laudable but inadequate.	IMPLICATIONS
EDUCATION AND HEALTH The state has made woefully inadequate investments in education. The quality of health care, especially for the masses, is terrible. Private-sector investments help compensate, but they aren't large enough to make an impact.	IMPLICATIONS
EXTERNAL RELATIONS The state's inefficiency extends to projecting India's influence. India's best brand ambassadors are its companies, executives, academics, and film stars. India is incapable of using hard power but is a masterful exponent of soft power.	IMPLICATIONS

ment, an alliance of developing countries that supported neither the United States nor the Soviet Union. In those heady years, one slogan heard in India was *Hindi Chini Bhai Bhai* ("Indians and Chinese are Brothers"). The slogan hasn't been forgotten; China's premier, Wen Jiabao, repeated it in 2006 when he visited the Indian Institute of Technology in Delhi.

Second, economists tell us that neighbors tend to trade more than other nations do. An official committee set up to encourage commerce between China and India recently suggested that bilateral trade could touch $50 billion by 2010. Even the official numbers understate the potential, according to economists who use gravity models to estimate what the trade between two countries should be. Such models calculate potential bilateral trade as a function of the size of the nations, the physical distance between them, and other factors such as whether they share a language, a colonial past, a border, membership of a free-trade zone, and so on. Sino–Indian trade today is up to 40% less than it could be, according to those models. Moreover, Sino–Indian trade is more balanced than China's trade with the United States and Europe; the latter countries' large deficits cause political friction.

Third, China and India, after they cut themselves off from each other, evolved in complementary ways that reduced the competitiveness between them. What China is good at, India is not – and vice versa. China instituted sweeping economic reforms in 1978 and has steadily opened up thereafter. A balance-of-payments crisis forced India's reforms in 1991, but because of political factors, liberalization has been slow and piecemeal there ever since. China uses top-down authority to channel entrepreneurship; in fact, the government is the entrepreneur in many cases. India revels in a private sector–led frenzy, and its government is incapable of efficiency. China struggles to control fixed asset investment, while India is constrained by scarce capital. China welcomes foreigners, shunning only those who are not part of its power structure. India shuns foreigners and mollycoddles its own. China's capital markets are nonexistent; India's are among the best in the emerging markets. And so on. There are no two countries more yin and yang than China and India.

As a result, the kinds of companies that flourish in China and India are very different. As my HBS colleague Krishna Palepu and I argued in an earlier HBR article ("Emerging Giants: Building World-Class Companies in Developing Countries," October 2006), companies are usually reflections of the institutional contexts in their home countries. In China, where protection of intellectual property rights is nascent and the government curtails some forms of expression, entrepreneurs don't push the creative envelope. Instead, it makes sense for them to build manufacturing plants that leverage the superb infrastructure. In India, companies that depend on highway systems and reliable power find it hard to thrive. Those that train and deploy tens of thousands of technically sophisticated, English-speaking university graduates, in contrast, flourish. Both China and India are witnessing an explosion of entrepreneurship, but in ways that make their companies more complementary than the world realizes.

Getting the Best of Both Worlds

These complementarities pose both an opportunity and a threat. It's easy to spot the advantages of treating China and India synergistically and getting the best of both worlds. Companies can use China to make almost anything cheaply. They can turn to India to design and develop products cost-effectively; they can also hire Indian talent to market and service products. For instance, China's Lenovo, which purchased IBM's PC business in 2005, recently moved its global ad-management function from Shanghai to Bangalore. That's because India has a highly creative and sophisticated advertising industry.

To be sure, Chinese and Indian companies will compete intensely with each other. That doesn't mean that the rise of one will necessarily be at the expense of the other. For instance, as the Chinese government tries to develop a software industry, Indian companies such as Infosys, Tata Consultancy Services, and Satyam have been among the first to recruit Chinese engineers. Does that mean they are sowing the seeds of their own destruction? Not really. Most Indian companies have gone into China to provide software services to their multinational clients. Chinese firms will try to compete for those contracts, even as Indian companies fight for a share of the local Chinese market. China will gain from having a software industry, but the benefits may not come at the expense of India's software industry.

The coming together of China and India puts at a disadvantage many companies, especially from the West, that refuse to react to this trend. They will not be able to generate the synergies that their Chinese and Indian rivals can. If they lose share in those two markets, they are – given China's and India's size – unlikely to remain market leaders for very long. Thus, Sino–Indian emerging giants pose a stiffer threat to multinational incumbents than the latter have so far assumed.

Cooperating with Each Other

Already, some Chinese and Indian companies are beginning to view the two countries symbiotically. They are driven not by political factors but by hardheaded self-interest.

India comes to China. Three years ago, Mahindra & Mahindra, the Indian tractor and automobile maker, reckoned that it would be cheaper to manufacture tractors in China than in India. Besides, the Indian company could gain access to the fast-growing Chinese market only by producing tractors locally. M&M set up a joint venture, Mahindra (China) Tractor, with the Nanchang city government. The partners could not be more different: M&M is a private company led by the third-generation scion of an Indian business family – a far cry from the Chinese government. The Sino–Indian entity purchased Jiangling Tractor, whose plant is located halfway between Shanghai and Guangzhou and has a production capacity of 8,000 tractors per annum.

M&M's low-powered tractors are ideal to till India's fragmented farmland. In 2006 the company held a 30% share of the Indian market, while its closest rival had a 23% share. These tractors also suit China, where the size of the average landholding is now akin to India's. When China's communes broke up and the number of farmers mushroomed, the demand for tractors boomed. The Chinese government also offered financial incentives so farmers would switch from power tillers to tractors, which would reduce the demand for petrol. M&M entered the Chinese market with Jiangling Tractor's FengShou brand. The company has cleverly designed and engineered the model at its facilities in India, while its Chinese company manufactures it.

Mahindra (China) Tractor makes the compact FengShou tractors in the 18-to-35 horsepower (hp) range for the Chinese and foreign markets. It also imports M&M's more powerful 45 hp to 70 hp tractors from India and sells them in China. In February 2005, when I spoke to Anand Mahindra, M&M's CEO, he had nothing but praise for the Chinese company. "We are breaking the myth that it is hard to make money in China or that cultural assimilation is difficult," he told me. "The local disco in Nanchang now plays *bhangra* (a genre of Indian folk music), and the ex-chairman of the Chinese company sang songs from Indian movies at our first banquet." Mahindra said that he had faced no problems in getting Chinese and Indian executives to work together. M&M has posted 15 Indians to the Chinese facility, all of whom report to Chinese supervisors. According to Mahindra, the Indians are none the worse for the experience.

That's not all. M&M realized that it could enter some niche markets in the United States. Many baby boomers have retired from stressful urban lives to places like Flagstaff, Arizona, where for the price of a San Francisco apartment they have bought several acres of land. These hobby farmers need only a small tractor to till the soil. From 2000 to 2005, M&M wrested a 6% share of the U.S. under-70 hp tractor market from companies such as John Deere, New Holland, Agco, and Kubota Tractor. In some southern states such as Texas, M&M's market share is as high as 20%. M&M is giving John Deere in particular a run for its money. In 2004 a Deere dealer advertisement promised a $1,500 rebate to every consumer who traded an M&M for a John Deere. According to M&M executives, when they tracked down tractor owners who had seen the ad, 97% said that they were satisfied with their Made in China and India tractors and did not go for the rebate.

China comes to India. Just as Mahindra & Mahindra is using China's hard infrastructure, China's Huawei is leveraging India's soft infrastructure to sustain its global edge against Western giants like Cisco. In 1999 the Chinese telecommunications equipment manufacturer set up an Indian company that currently employs around 1,500 engineers. This facility, which is based in Bangalore, develops software solutions in areas such as data communications, network management, operations support systems, and intelligent networks. In 2006 the company opened a second facility in Bangalore, where 180 software engineers develop optical network products and wireless local-area-network solutions.

Huawei has announced that it will invest an additional $100 million to create a single 25-acre campus in Bangalore for 2,000 people. This will enable Huawei India to enter new areas such as optical-transmission networking and sharpen its focus on third-generation networking. While Huawei's development center in Shenzhen is its most important facility, the Bangalore center (which accounts for about 7% of the company's R&D efforts) is emerging as the second most important. That's partly because of its capabilities. In August 2003, the Indian facility earned the coveted Capability Maturity Model Level 5 certification – the highest quality level for software producers.

Huawei's strategy is noteworthy because India's bureaucracy and polity did everything it could to prevent the company from setting up base. The company persisted, realizing that employing engineers, rather than outsourcing software development to Indian companies, would give it better footing. Jack Lu, who oversees human resources, headed the Bangalore office for three years after setting it up. He says that the main challenge is to overcome each country's stereotypes of the other. For instance, the Indian media portray the Chinese as opportunists set on stealing India's security, software, and telecommunication secrets, and vice versa.

State-owned companies cooperate. Public-sector corporations, the direct arms of two supposedly hostile governments, are also learning to work together. China and India are incredibly energy-deficient, with China importing almost 50% of its oil needs and India more than 70%. Energy companies in both nations have made it a priority to search for "equity" oil. They invest in several countries' petroleum industries to protect themselves against the possibility that one day, political instability in the Middle East will choke off their supplies. This strategy turned China and India into intense rivals in the international energy industry. Between January and October 2005, China's Sinopec and China National Petroleum Corporation (CNPC) and India's Oil and Natural Gas Corporation (ONGC) clashed over purchases of oil assets in Angola, Ecuador, Kazakhstan, Myanmar, Nigeria, and Russia. Although the Chinese companies won several contracts, they paid more because of the Indian company's aggressive bidding.

In April 2005, Wen Jiabao suggested that China and India think about cooperating in the energy sector. After several meetings of executives from the countries' oil companies, the Chinese and Indian governments signed an agreement in January 2006 about working together on bids for energy resources, and the oil companies signed memorandums of understanding. Incidentally, China teamed up with India partly because it hoped that its companies would get preferential treatment when they bid for infrastructure-related contracts in India.

The Sino–Indian oil hunt has delivered results. In December 2005, CNPC and ONGC won a bid for a 37% stake in Syria's Al Furat Petroleum. Another joint venture between Sinopec and ONGC won a 50% stake in the Colombian oil company Omimex de Colombia in August 2006. In April 2007, ONGC and CNPC agreed to team up to acquire oil assets in Angola and Venezuela. They may also offer each other stakes in other companies they have invested in. Thus, enterprises that everyone thought would bid up the prices of oil assets dramatically are working together in the best interests of China and India.

Viewing the Two as One

It's not surprising that multinational companies find it tough to develop a joint strategy for China and India. Three years ago, I studied the Chinese and Indian subsidiaries of 20 Asian companies such as Japan's Asahi Glass, Hitachi, Honda, Mitsui, and Toshiba; South Korea's Samsung, Hyundai, and LG Electronics; and Singapore's DBS Bank and Singapore Telecommunications. Many had operations in both countries, although I included some enterprises that operated in only one of them.

These companies have customized their business models to the local institutional context, which makes it tough for them to generate synergies from their subsidiaries in the two countries. For instance, the Chinese subsidiaries are less transparent than the Indian ones because capital allocation does not occur through the financial markets in the former as it does in the latter. The opacity has made it harder for Indian subsidiaries to collaborate with their Chinese counterparts. The Indian ventures also depend on local suppliers more than the Chinese ones do, since they have operated for 39 years, on average, in India and only 18 years in China, having been forced out of the country in the aftermath of the Cultural Revolution. However, even in corporations that have entered both countries in the past five years, the reliance on local suppliers is 60% in India and 10% in China. Thus, the Chinese and Indian subsidiaries use different business models and generate few synergies. Moreover, 31 of the 33 Chinese subsidiaries I studied viewed themselves as independent of their Indian counterparts, which precluded the chances of cooperation. Relatively few China and India country managers report through their hierarchies to a common decision maker, and companies reward them on the basis of their performance in each country. These organizational factors make it almost impossible for companies to identify opportunities in both China and India that would benefit their strategies.

A final barrier to developing a China–India strategy arises from success. For instance, at Motorola, one of the most successful investors in China, it's easy to imagine a hotline snaking from the China headquarters to Schaumburg, Illinois. Because Motorola has not focused on India nearly as long, that market is starved for attention. The converse is true of Unilever. The company's success in India means that the Indian subsidiary has a direct line to London and Rotterdam, while the China operation doesn't enjoy the same privileges. China shines in Motorola's world; India sparkles in Unilever's. The companies have neglected one of the two markets – and both have achieved less than they could have.

Succeeding from the Outside

It may be difficult for multinational companies to make the best use of China and India, but it isn't impossible. In fact, as GE and Microsoft show, you can skin the proverbial cat in many ways.

GE's approach. The simplest, and most powerful, way of combining China and India is to focus on hardware in China and on software in India. As is now well known, that's exactly what GE Healthcare does. For instance, it developed the 719 parts of a high-end Proteus radiology system in a dozen countries. It created the software algorithms and the scanner's generator in Bangalore and allocated part of the hardware manufacturing and assembly to Beijing. The ability to set up parallel groups of highly skilled engineering talent in both countries raises the efficiency of product development and fits in with GE's competitive culture, a senior executive told me.

The idea that these countries' ascent can occur only at everyone else's expense defies economic logic.

It's tempting to attribute GE's success to a well-run country manager system. But most companies have similar matrix structures, so that is not the full story. GE did well in China and India because it tailored its business model to the realities of each market. Its early forays into China and India didn't work: GE's business units were unable to profitably sell or develop products locally. Nor could they produce the equipment in other countries at a low enough cost to cater to the low-income populations in the two markets. Experimentation led GE to develop in China and in India parts of what it needed. That process also allowed the company to find ways in which the two subsidiaries could work together. Chinese managers in GE felt that it was in their interest to collaborate with their Indian counterparts, and vice versa. This process took the better part of two decades to come to fruition.

GE also succeeded because it became a good corporate citizen in both countries. Its aircraft engines business has transferred several technologies to China, and its medical diagnostics business is engaged in the debate about health care there. In India, GE was one of the pioneers of business process outsourcing, the practice that put the country on the world's business map. In a vote of confidence in both countries, GE has opened cutting-edge R&D centers in Shanghai and Bangalore. In both China and India, several companies owe their existence to GE. Some were set up by former GE executives; others became world-class by supplying raw materials or components to GE.

Microsoft's approach. While GE has split the value chain between China and India, Microsoft takes a different tack. It develops innovations that are best suited to China and India respectively.

For example, the company decided to develop mobile-phone-based computing in China, since the country had more than 450 million cellular telephones in 2006 and only 120 million PCs. India had a smaller base of only 166 million mobile phones in 2006. Microsoft created a mobile phone that doubles as a computer when the user attaches it to a device mounted on the side of a TV. You can access the device, FonePlus, with a keyboard, and use the TV screen as a PC monitor. If this experiment succeeds in China, Microsoft will find ways of using FonePlus globally.

In India, Microsoft conducted experiments that would have been much harder to pull off in China. In 2004 the company launched the Windows XP Starter Edition at \$25–\$30 apiece in India, compared with the pricey full-functionality product. Microsoft decided not to launch the Starter Edition in China, where the top four PC manufacturers control close to two-thirds of the market. The local companies were reluctant to push a low-priced product, since they earn more from the higher-priced version. Because Indian consumers didn't buy the full-functionality Windows, the risks of offering the Starter Edition there were lower than in China. Microsoft's trials in India suggest that the Starter Edition either targets first-time users or induces nonadopters to try out the full-functionality product, so Microsoft China might be willing to market it in the future.

At the same time, Microsoft's China subsidiary is trying to leverage India by forming a three-way venture with the Chinese government and India's largest software company, Tata Consultancy Services (TCS). After entering China in 2002 by setting up a fully owned enterprise in the Hangzhou Special Economic Zone, TCS received the go-ahead in 2007 to expand its presence there. The National Development and Reform Commission authorized the technology parks in Shenzhen and Beijing to buy into TCS's Chinese operations. Incidentally, TCS has gone through three phases in China: It entered China because its global clients were setting up shop there; it then used the country as a base to cater to Asian companies; and, finally, TCS is now going after the Chinese market.

Meanwhile, Microsoft is trying to help the Chinese government build a globally competitive software industry. In keeping with that strategy, Microsoft plans to buy a stake in TCS China, creating an entity that will be 65% owned by TCS, 25% owned by the Chinese software parks, and 10% owned by Microsoft. The Chinese government likes this idea because Microsoft's technologies will spread along with those of TCS. The new venture will develop banking applications for the Beijing and Tianjin city governments. TCS will develop the applications, and Microsoft will use its 17 centers across China to roll them out to the banks. The largest banking applications project TCS has so far undertaken is at the State Bank of India, which has 10,000 branches and 100 million accounts, compared with Bank of China's 22,000 branches and 360 million accounts. That's one more reason China and India are often relevant to each other; no other country has such sprawling networks. It's likely that TCS and Microsoft will one day apply in India the experience they gain in China.

To ensure that China and India don't lack attention, Microsoft has elevated the two country heads to the rank of corporate vice president. They report directly to the person who oversees Microsoft's international operations. They meet frequently to learn from each other. Since there are laboratories and development centers in Beijing and Hyderabad, the heads of R&D in China and India both report to the head of Microsoft's worldwide R&D. The company has also extended the scope of its Redmond, Washington–based Unlimited Potential division, which seeks to bring computer skills and jobs to communities that don't already have them. The division looks at how products that Chinese consumers are using can be sold in India and vice versa, and looks at products that can be sold in other emerging markets worldwide.

...

It is strange that many people perceive the rise of China and India only as a threat. The idea that these countries' ascent is a zero-sum game – it can occur only at everyone else's expense – defies economic logic. For instance, the United States' job losses in recent times as companies relocated manufacturing facilities and services to China and India are smaller than the unemployment in past decades attributable to structural changes in the U.S. economy. Instead of balking at the inevitable expansion of economic power beyond New York and London, companies will do well to recognize the complementarities between Beijing and New Delhi and, in a fast-changing world, try to wrest competitive advantage from them.

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To order, see page 147.

A semistructured approach can generate great ideas even in familiar settings – and works better than unfettered brainstorming or strict quantitative analysis.

Breakthrough Thinking from Inside the Box

by Kevin P. Coyne, Patricia Gorman Clifford, and Renée Dye

IMAGINE THAT WE ASKED YOU to invent an idea for a new business in the next 20 minutes. The task is so broad and vague that you would probably think you couldn't do it. We have often seen people give up without really trying when confronted with such an amorphous challenge.

Instead, let us pose a narrower question: What do Rollerblades, Häagen-Dazs ice cream, and Spider-Man movies have in common? The answer is they are all based on the same business concept. In each case, a firm has taken something children love and reproduced it in an extreme, more expensive form for adults. The same notion has led to over 25 new product categories, including gourmet jelly beans, baseball

Fernanda Cohen

fantasy camps, \$200 sneakers, 20-foot-high sand castles for corporate parties, paintball, space tourism, and Disney collectibles. Now that you see this, we are confident you could think of how to reproduce something that was emotionally powerful to you as a child in an expensive form for adults. That's because we have conducted this exercise as a warm-up to our workshops with hundreds of managers, and they have always generated interesting ideas.

What did we just do, and why did it work? In our quest for breakthrough ideas, we didn't ask you to think outside the box. Nor did we ask you to think more intently inside your usual box. We gave you a new box and asked you to think inside that.

Most managers and professionals are quite capable of thinking effectively inside a box. They live with constraints all the time and automatically explore alternatives, combinations, and permutations within their confined space. We have found that if you systematically constrain the scope of their thinking (but not too much), people are adept at fully exploring the possibilities, and they can regularly generate lots of good ideas – and occasionally some great ones. Setting the right constraints is a matter of asking the right kinds of questions: ones that create boxes that are useful, but different, from the boxes your people currently think in.

Ten years ago, as part of a larger project for McKinsey's strategy practice, we led a team of consultants who developed such an approach to brainstorming. It involves posing concrete questions and orchestrating the process for answering those questions. Since then we have successfully used this method with more than 150 clients engaged in everything from major product innovations and industry-shaping moves to simple process improvements. Our technique helped a consumer goods company identify an opportunity for a chilled beverage that captured 20% of the market in the first six months after its launch. A print media company used it to come up with ways to triple the firm's penetration of the Hispanic market. A plastic pipe manufacturer uncovered an immediately exploitable opportunity to reduce costs by 75%. A regional bank came up with a process that more than doubled the sales productivity of the branches involved in the pilot. Even those whose job it is to be creative have benefited from the methodology: The editors of a group of prominent magazines who had been stuck in a rut in their efforts to come up with story angles have begun using the approach to develop fresh new articles for every issue.

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Now that it has been road tested, we'd like to share our approach. A good place to begin is to examine what's wrong with conventional approaches to brainstorming.

Why Brainstorming Doesn't Work

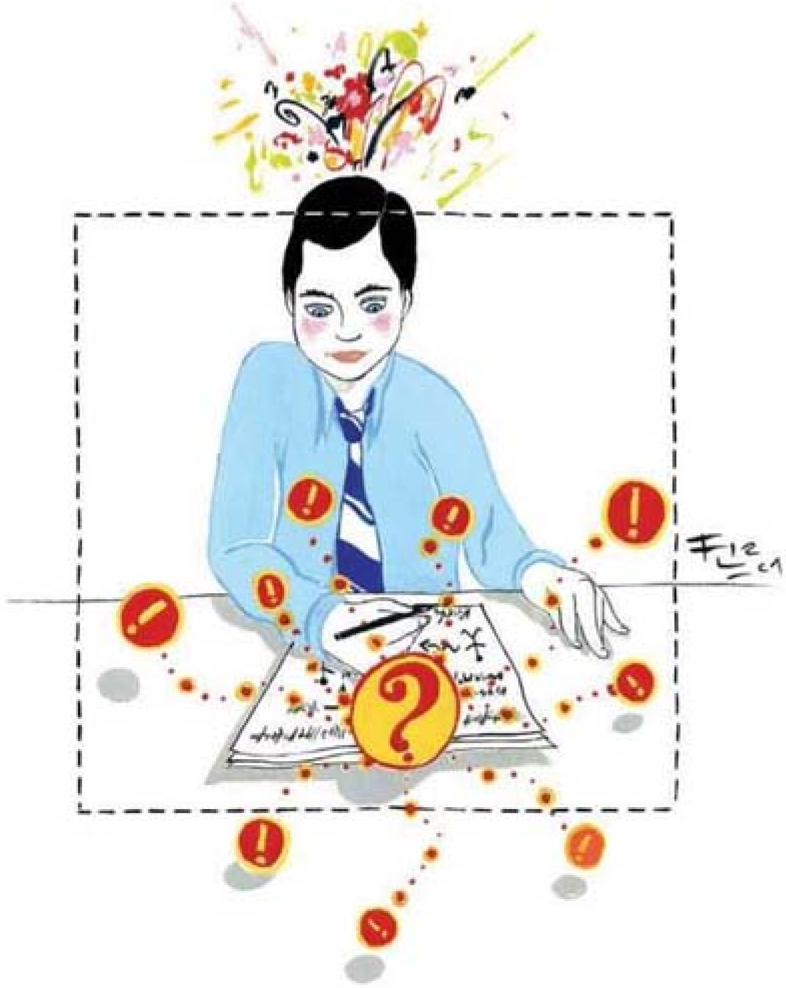
Many managers fail to generate a stream of solid ideas because they employ two common techniques: They encourage their people to go wild and think outside the box or they assign them the task of slicing and dicing the old boxes (in the form of existing market and financial data or specially commissioned market research) in new ways.

The problem with the first method is that most people are not very good at unstructured, abstract brainstorming. Imagine a random product you are trying to improve in a typical facilitated brainstorming session. Outside-the-box possibilities could include making the product bigger or smaller, lighter or heavier, prettier or more rugged (or changing its appearance in any of a hundred ways). Further ideas could involve making the product more expensive or less, or maybe breaking it into parts or bundling it with other products. They could involve changing the product's functionality, durability, ease of use, or the way it fits with other products. Or its availability, affordability, or repairability. How do you know which dimensions are fruitful to explore? More often than not, the facilitator will say, "There are no bad ideas," which only compounds the confusion. Without some guidance, people cannot judge whether they should continue in the direction of their first notion or change course altogether. They cannot handle the uncertainty, and they shut down.

The second method – slicing the data in new ways – almost always produces only small to middling insights, for different reasons. The contents of every database are structured to correspond to insights that are already recognized, not ones that aren't. (Why are sales data often organized by region? Because someone already knows that the contrasts from region to region are meaningful.) Moreover, any insights produced by recrunching publicly available numbers will probably be discovered quickly by competitors' armies of MBAs, who are most likely using the same techniques and the same data as your people.

Market research suffers from another sort of limitation. Whenever an organization embarks on a journey to come up with a big, new idea, someone inevitably declares, "We should ask the customer, because customers aren't stupid, you know." True, customers aren't stupid, and they can tell you if they perceive your product to be inferior to competitors' offerings in some particular way. However, they can rarely tell you whether they need or want a product that they have never seen or imagined. Market surveys famously said the ultimate demand for computers was five units. That people didn't need Xeroxes because they would never need more than three copies of anything and carbon paper could handle it. That cellular phone demand was limited. That the Sony Walkman would be a flop. Market research can be invaluable in getting reactions to an idea once it is fully formed and tangibly demonstrated to the customer. It rarely, however, finds the latent need.

Our approach takes a middle path between the two extremes of boundless speculation and quantitative data analysis. When you ask questions that create new boxes to think inside, you can prevent people from getting lost in the cosmos and give them a basis for making and comparing choices and for knowing whether they're making progress. But posing the right questions is only half the battle. How you organize and conduct brainstorming sessions also matters enormously. You must redesign your ideation processes so that they remove obstacles that interfere with the flow of ideas – such as most people's aversion to speaking in groups of more than ten. We'll talk about the process of structuring an effective brainstorming session in a moment. But first, let's examine more closely where great questions come from.



The most fertile questions focus the mind on valuable overlooked corners of the universe of possible improvements.

Asking the Right Questions

In conducting its research ten years ago, the McKinsey team learned of a study by Mihaly Csikszentmihalyi, then a psychology professor at the University of Chicago. In its descriptions of how Nobel laureates and other creative people achieved their breakthroughs, an interesting insight emerged: Once they asked themselves the right question, their ideas flowed rapidly. This revelation prompted us to examine how the most successful companies in recent history had achieved their positions. We looked at two groups: The first were already large companies that became industry-shaping enterprises in a relatively short time. The second grew from garage-based start-ups into firms with more than $1 billion in (profitable) sales in less than six years. In every case, their successes were built on breakthrough ideas that redefined the products and services in their markets.

We found that a number of their innovations sprang from responses to particular questions. But, subsequently, we realized that it didn't matter whether they had actually asked a question or not. What mattered was whether there was a question that *could* have uncovered the kind of extraordinary opportunities that CNN, Google, USA Today, eBay, and Amazon identified and exploited.

We then zeroed in on 50 breakthrough ideas from a spectrum of industries and reverse engineered them to find the focused questions that could have led any intelligent manager to the same epiphany. Obviously, some of the questions were specific to their industries. However, we found many that are universally applicable, including those featured in the exhibit "21 Great Questions for Developing New Products."

One question that can generate insights in any business is, "What is the biggest hassle about using or buying our product or service that people unnecessarily tolerate without knowing it?" Entrepreneurs who focused on eliminating such hassles gave us Jiffy Lube (on demand, fast turnaround oil changes), CarMax (used cars with warranties purchased in a pleasant environment at reasonable, fixed prices), prepaid cell phones that can be bought off-the-shelf (thus avoiding the 20-minute setup process and the risk of racking up unexpectedly high phone bills), and something as low-tech as single-use packages of real fire logs (for those who have no place to store a cord of wood).

The world is still full of such opportunities. Take gasoline retailing. What's the biggest "invisible" hassle? Having to go to a gas station. The average car is driven only about 500 hours a year and sits somewhere – often in a large parking lot – for the remaining 95% of the time. What if a small tanker truck could visit that parking lot and fill up any subscriber's vehicle displaying a "please fill this car" flag? Would it work? Operational issues would have to be overcome, of

21 Great Questions

for Developing New Products

"De-average" buyers and users

Which customers use or purchase our product in the most unusual way?

Do any customers need vastly more or less sales and service attention than most?

For which customers are the support costs (order entry, tracking, customer-specific design) either unusually high or unusually low?

Could we still meet the needs of a significant subset of customers if we stripped 25% of the hard or soft costs out of our product?

Who spends at least 50% of what our product costs to adapt it to their specific needs?

Explore unexpected successes

Who uses our product in ways we never expected or intended?

Who uses our product in surprisingly large quantities?

Look beyond the boundaries of our business

Who else is dealing with the same generic problem as we are but for an entirely different reason? How have they addressed it?

What major breakthroughs in efficiency or effectiveness have we made in our business that could be applied in another industry?

What information about customers and product use is created as a by-product of our business that could be the key to radically improving the economics of another business?

Examine binding constraints

What is the biggest hassle of purchasing or using our product?

What are some examples of ad hoc modifications that customers have made to our product?

For which current customers is our product least suited?

For what particular usage occasions is our product least suited?

Which customers does the industry prefer not to serve, and why?

Which customers could be major users, if only we could remove one specific barrier we've never previously considered?

Imagine perfection

How would we do things differently if we had perfect information about our buyers, usage, distribution channels, and so on?

How would our product change if it were tailored for every customer?

Revisit the premises underlying our processes and products

Which technologies embedded in our product have changed the most since the product was last redesigned?

Which technologies underlying our production processes have changed the most since we last rebuilt our manufacturing and distribution systems?

Which customers' needs are shifting most rapidly? What will they be in five years?

course. But just ask any motorist pumping gas at a self-service station on a cold, rainy day how he or she likes the idea.

The same questions can, of course, lead to different ideas. Consider the opportunities that different divisions of a bank might generate by pondering the question, "For which subset of users are the procedures associated with our product least suited?" This exercise could prompt the lending department to focus on marginally profitable loans to small businesses for which the paperwork is burdensome to both sides. One possible remedy the bank might offer: industrial pawn shops, which, like their consumer counterparts, would allow a business to secure a loan by parking an asset in exchange, minimizing the need for documentation. The same question could spark the bank's credit card division to think about which potential customers might not be well represented in the credit-history databases owned by external credit bureaus. This line of questioning could lead to a business initiative aimed at marketing credit cards to immigrants who have good credit histories in their home countries but no credit history in the United States. Similarly, asking, "Who does not use my product for one particular reason?" has already led to the creation of several museums for the blind, where information is delivered through aural, tactile, and olfactory sensations.

The most fertile questions focus the mind on a subset of possibilities that differ markedly from those explored before, guiding people to valuable overlooked corners of the universe of possible improvements. To develop your own list, ask yourself every time you come across a new business idea that you think is really clever, "What question would have caused me to see this opportunity first?" In other words, reverse engineer every great idea or innovation you see. That's what we did to invent the question about the ice cream, Rollerblades, and Spider-Man that we use in our warm-up exercise. Using this approach, we have built and tested an arsenal of more than 250 questions.

Should you want to be more systematic about the search for new questions, you can employ a simple logic tree that starts with a high-level question and successively breaks it down into more tightly defined probes. This rigor has proven useful even in unusual settings. For example, imagine you are the editor of a trendy mass-market magazine that covers popular music. Your articles consist mainly of interviews with and profiles of new bands, singers, and occasionally a venerable star. But the formula is getting tired. A simple tool like the exhibit "A Music Magazine's Logic Tree for Generating Fresh Article Ideas" could assist you in pursuing a much wider range of story angles on the same trends and keep readers engaged.

We have found that the right level of abstraction tends to occur about three to six levels down the tree. If you stop at the first level, the question would be too broad; if you were to continue too far down, the questions would start becoming too specific to generate useful answers. In addition to aiding you in coming up with novel ideas, such trees can also help you see when you are stuck in a rut and are producing conceptually similar ideas. If all your ideas originate from the same few questions, you'll profit substantially from exploring the other branches of the tree.

We once had the top six executives of a $100 billion company working full tilt because each had bet $20 that his team could come up with the best idea.

Better Orchestrating the Process

The fact is, virtually all brainstorming sessions violate the fundamentals of how human beings actually think and work together. Consider the following all-too-familiar situation.

About 20 people – most of them chosen for political reasons – gather in a room. The leader is either their boss, whose presence makes some people reluctant to offer what may be perceived as a silly idea, or a "creativity moderator," who neither understands the business nor thinks he should have to. Three pushy people dominate the session with their pet ideas, while the others sit in silence. After the group is instructed to think outside the box, ideas pop up randomly: "Let's paint it blue!" "We can sell it in Germany." "How about an upscale version?" "The problem is the sales force." Since "there are no bad ideas," preposterous dreams consume much of the time and energy. ("If we could invent a cheap pill that could substitute for gasoline....") Finally, because everyone knows you cannot force people to come up with good ideas, participants think it's okay to produce nothing – or to not follow up on anything the workshop did create.

Now let's adjust the process, aligning each step with what we know about how people work best in groups:

Bound the range of acceptable ideas, then select and tailor the questions accordingly. How often have you heard someone say after a brainstorming session, "I had thought of that but didn't say it because I didn't think it was the kind of idea you were looking for"? How often have you been presented with ideas that were patently infeasible given your budget, staffing, or time constraints? How often have people offered up incremental steps when you were looking for a big idea? All of these problems are easily avoided if you take the time, before the meeting, to clarify what constitutes the criteria for, and boundaries of, a good idea in your particular case. Do you want big ideas or safe, surefire winners? How much money can the company afford to spend? What level of staffing is the company willing to commit? How soon do you need a payback?

Then consider the particular requirements of the problem you're trying to solve. That will help you avoid asking questions that will lead to the same insight. For example, if all customers can use your product in only one way (like large cranes used inside industrial plants), it doesn't pay to ask, "For which current customers are our products least suited?" and also, "For what particular usage occasions is our product least suited?" since in this case, those questions will result in the same answer. However, those two questions might produce excellent and distinct insights in situations where each customer uses the product in several ways and the customers are themselves quite different from one another (which is the case for automobiles, for example). When choosing among possible questions, go for those that approach the problem from angles that are as far as possible from the ways you have approached it in the past. As a whole, think of the series of questions as a portfolio, each one creating a distinct box that comes at your situation from a different point of view.

Once you've settled these parameters, you will be able to tailor the language of your questions to best fit your specific goals and constraints. The wording of questions that will generate radical ideas differs substantially from that which will generate moderate, low-risk ideas. On the one hand, for example, a leader of a computer vendor who asked his senior managers in the late 1980s, "How can I reduce costs?" would probably have elicited solid but incremental ideas like "consolidate shipments" or "reduce store staffing." On the other hand, asking them, "What element of our business would we have to eliminate to cut costs 50%, and are there customers who do not need that element?" could have led the vendor to beat Michael Dell in pioneering the mail-order distribution model that so successfully challenged the retail store approach to selling personal computers.

The number of questions in your portfolio will depend on the size of your brainstorming group and the time available. For reasons that will become obvious below, you will need one question for every four or five participants every 30 minutes. However, you might consider giving your best question or two to more than one group if you can't think of enough excellent questions to go around. Finally, test each question on yourself. Which ones make you think of the most ideas?

Select participants who can produce original insights. Sure, you always have to invite some people for political reasons who will not contribute much. But make sure there are enough other people who *can* contribute. If, for instance, you intend to ask, "Who is using our product in ways we did not expect or intend?" or "Who is using our product in enormous amounts?" you should plan to include participants who are in a position to know firsthand. There's a very good chance these people will not be on your own staff and may be found in unexpected places. For example, the surprising potential for a line of foods aimed at elderly consumers was discovered a number of years ago by a sales manager who found that one of his reps in Florida sold much more baby food than his territory's demographics suggested should be possible. Eventually, the salesman revealed his secret: People in nursing homes were eating the baby food. Similarly, mountain bikes were the result of bicycle manufacturers learning about a subset of customers who, having subjected their bikes to extreme abuse, kept replacing them very frequently.

Ensure that everyone is fully engaged. You must accept that under normal brainstorming circumstances most of your attendees will care less about the success of the meeting than you do. Therefore, don't be shy about resorting

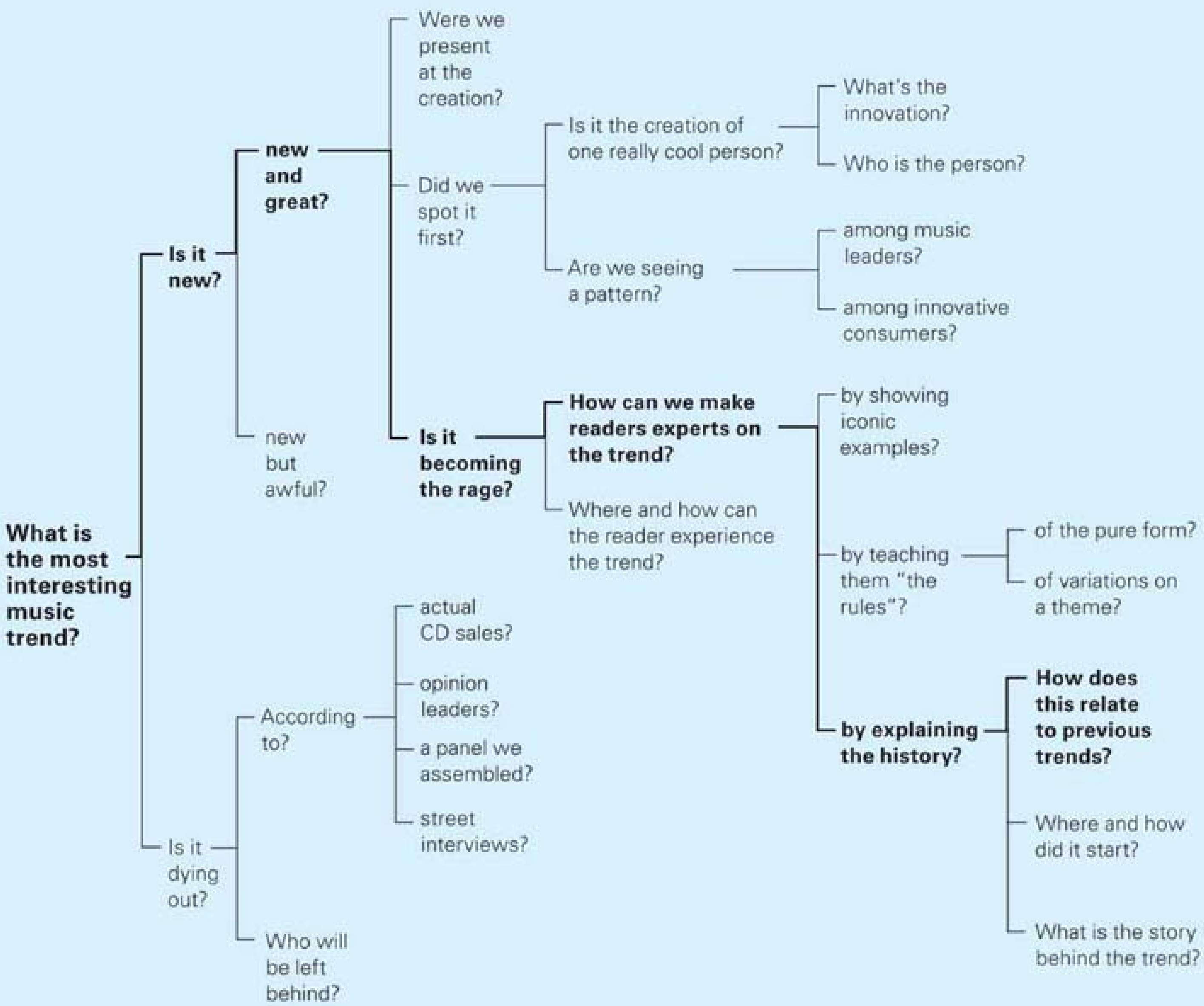
Put all those pushy people who feel compelled to dominate the discussion in the same group. That will prevent them from silencing the 16 people in the other groups.

A Music Magazine's Logic Tree for Generating Fresh Article Ideas

One tool for systematically generating effective brainstorming questions is a logic tree. It begins with a high-level question that is broken down into increasingly specific queries. Often the questions five or six levels down are most fruitful.

Such is the case in this example of a music magazine trying to rethink the way it generates story ideas. The questions on the first few branches are quite general – probably the ones the editors would ask every day. But say we move down a branch (as we have here along one particular one in bold), we can see that the questions get more specific and perhaps more original.

For example, the question, "How can we make readers experts on the trend?" yields three intriguing possibilities that, in turn, lead to further questions that are still sufficiently abstract yet focused enough to work. Following the other branches leads to equally stimulating possibilities.



to parlor tricks. We once had the top six executives of a \$100 billion company working full tilt because each had bet \$20 that his team could come up with the best idea. If a small trick could inspire those multimillionaires, imagine what you could do with your participants. Perhaps you could let the winning team pick the color of the logo on the final product or appear as extras in a television ad. Whatever the incentive, its purpose is clear: getting 100% of the participants to work at 100% of their capacity 100% of the session.

Structure the meeting to ensure social norms work for you, not against you. In almost all meetings of ten or more people, the social norm is to keep quiet or to speak only a minimum amount. A few pushy people break this rule, and the others let them fill the airtime. In contrast, observe what happens when a manager breaks a 20-person session into groups of four. First, in any group of four, the social norm is for everyone to participate, so no one can hide without seeming uncooperative. Second, if there are five subgroups instead of one combined group, five people rather than just one are offering their ideas at any given time. Finally, put all those pushy people who feel compelled to dominate the discussion in the same group. That will prevent them from silencing the 16 people in the other groups.

Don't push off the task of sorting the ideas to later. Do it right then and there.

Focus every discussion using your preselected questions. At the outset of the meeting, explicitly state the ground rules you've decided on – whether you want big ideas or incremental improvements, what the budget is, and so on. Don't worry about stifling creativity. It is precisely such boundaries – the outline of your new box – that will channel their creativity.

Then, once you've divided people up into their small groups, give each a single highly focused task. Have them spend 20 to 30 minutes discussing one question and report back to everyone the best ideas that came from just that question. Here's what typically happens: The first five minutes of each session sound like any other brainstorming meeting. But then the participants return to the better ideas and refine them. Thoughtful variants emerge. The interplay results in complex, multilayered notions that have a higher likelihood of growing into a true killer idea.

Do not rely solely on one brainstorming session. It is surprising how many managers limit the participation of others in their ideation effort to one workshop. That, again, ignores how people actually think and work together. Some individuals don't work well in a workshop format, no matter how well structured the session is. What's more, the legitimate answer to some questions is "I don't know, but we could find out if this workshop weren't ending at 5:00." And sometimes the ideas keep improving over time. For all these reasons, brainstorming should be a multifaceted process, not a single event. You might, for instance, assign someone before the workshop to gather data; you might need to schedule a follow-up meeting or two; or you might just need to provide a way to gather additional information from individuals after the session.

Narrow the list of ideas to the ones you will seriously investigate right away. Nothing is more deflating to the participants of a brainstorming session than leaving at the end with no confidence that anything will happen as a result of their efforts. So don't push off the task of sorting the ideas to later. Do it right then and there. For most ideation sessions, the selection process does not have to be complex. If you wait until some later point to sort the ideas, the odds are overwhelming that nothing will come from the effort.

In sharp contrast to traditional brainstorming, our process typically generates a surfeit of constructive ideas. A 20-person workshop produces about 20 ideas an hour, on average. Thus, the eight hours of idea generation that normally occurs in a two-day workshop generates more than 150 ideas! True, usually about a quarter are awful, and only about half of the others will be worthy of serious consideration. However, that still leaves some 50 ideas to choose from. Many managers are reluctant to pick winners out of fear of disappointing those whose ideas are not selected. This is a mistake. Most people prefer the choice to be made in front of them so they can learn from your thought process and produce better ideas next time.

...

When you introduce our think-inside-the-box approach in your organization, keep in mind one other basic law of human dynamics: People are nervous about change. It could take time and effort to coax all those quiet, thoughtful souls who have hated traditional brainstorming sessions dominated by blowhards to emerge from the shadows and open up. They may come mentally unprepared to participate the first time and may not have done their homework. After all, they never had to be on their toes before in quite this way. However, most, if not all, of them eventually will see and appreciate the change. Within the safe confines of new boxes, they will shower you with good, and great, ideas. Then it will be your job to turn those ideas into profitable reality.

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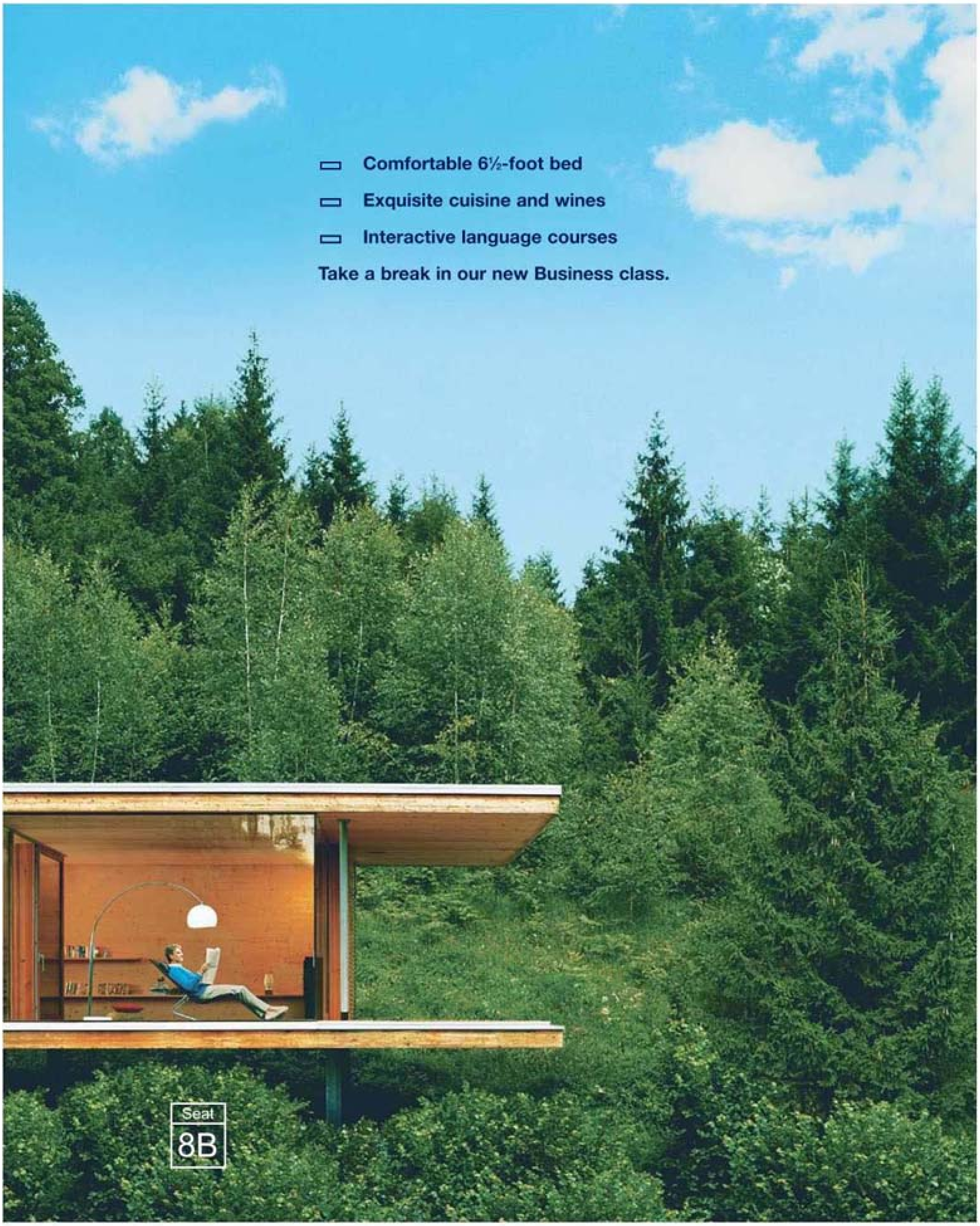

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Harvard Business Review
February 2004

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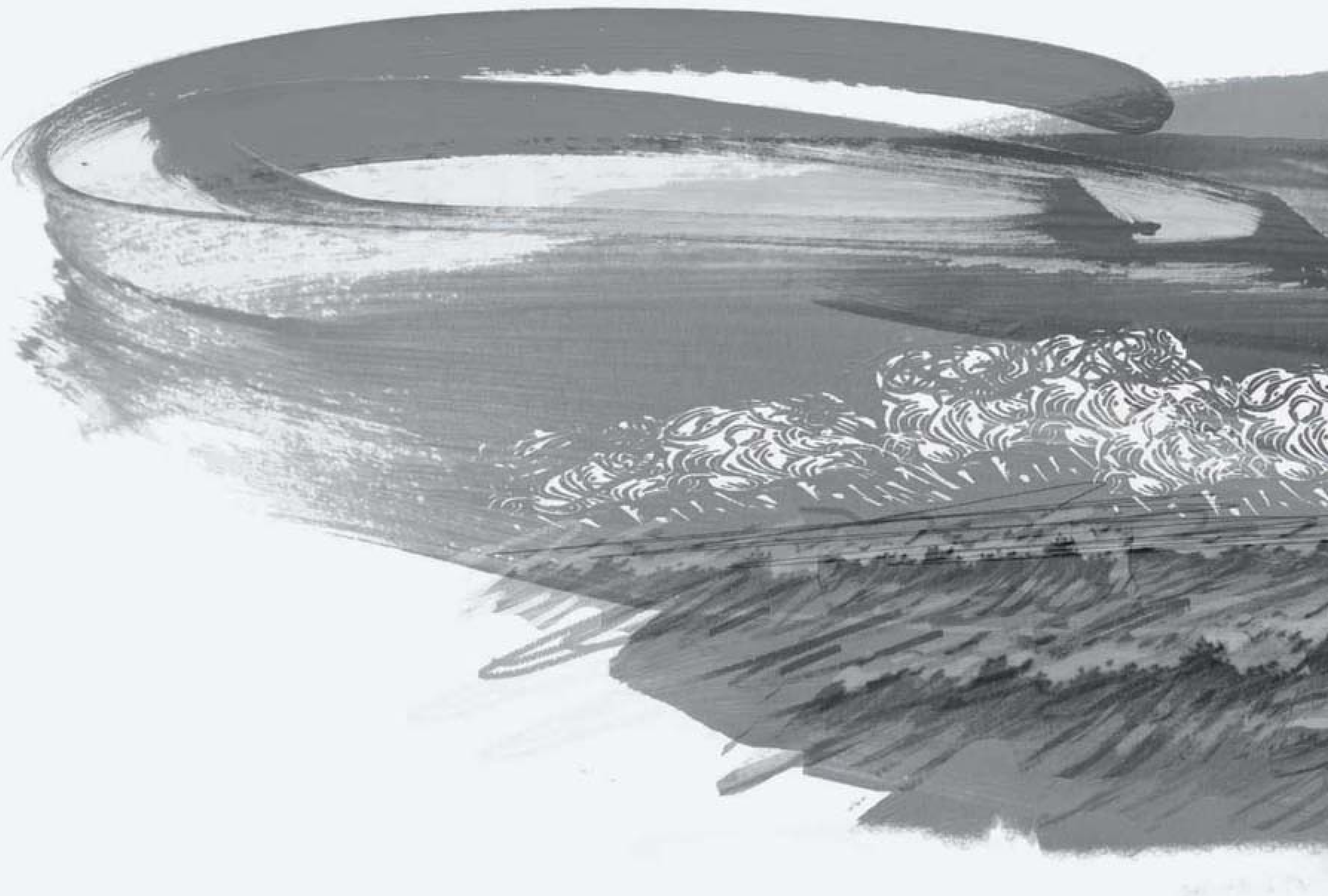
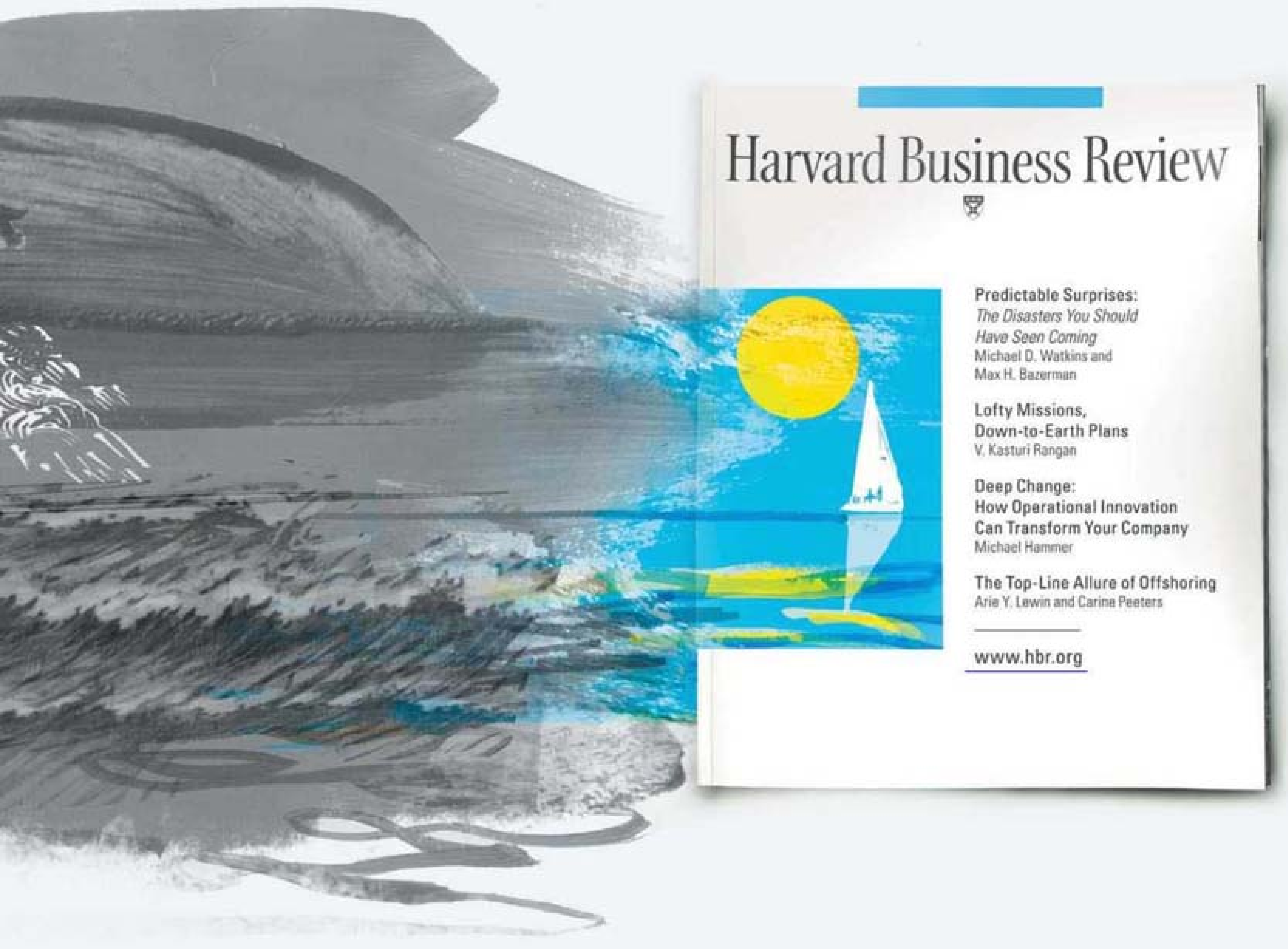
George Abbott, Dave Carpenter, Todd Condron, Roy Delgado, and P.C. Vey

"Sorry, Humford, but you've been outvoted by the little voices in my head."

"The golden eggs are great...but I need you to lay a golden parachute."

"The leg is from the merger of '98. The eye is from the merger of '04."

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What Every Leader Needs to Know About Followers

The distinctions among followers are every bit as consequential as those among leaders – and have critical implications for how managers should manage.

by Barbara Kellerman

There is no leader without at least one follower – that's obvious. Yet the modern leadership industry, now a quarter-century old, is built on the proposition that leaders matter a great deal and followers hardly at all.

Good leadership is the stuff of countless courses, workshops, books, and articles. Everyone wants to understand just what makes leaders tick – the charismatic ones, the retiring ones, and even the crooked ones. Good followership, by contrast, is the stuff of nearly nothing. Most of the limited research and writing on subordinates has tended to either explain their behavior in the context of leaders' development rather than followers' or mistakenly assume that followers are amorphous, all one and the same. As a result, we hardly notice, for example, that followers who tag along mindlessly are altogether different from those who are deeply devoted.

In reality, the distinctions among followers in groups and organizations are every bit as consequential as those among

Jill Calder

leaders. This is particularly true in business: In an era of flatter, networked organizations and cross-cutting teams of knowledge workers, it's not always obvious who exactly is following (or, for that matter, who exactly is leading) and how they are going about it. Reporting relationships are shifting, and new talent-management tools and approaches are constantly emerging. A confluence of changes – cultural and technological ones in particular – have influenced what subordinates want and how they behave, especially in relation to their ostensible bosses.

It's long overdue for leaders to acknowledge the importance of understanding their followers better. In these next pages, I explore the evolving dynamic between leaders and followers and offer a new typology for determining and appreciating the differences among subordinates. These distinctions have critical implications for how leaders should lead and managers should manage.

A Level Playing Field

Followers can be defined by their behavior – doing what others want them to do. But for the purposes of this article, and to avoid confusing what followers do with who they are, I define followers according to their rank: They are low in the hierarchy and have less power, authority, and influence than their superiors. They generally go along to get along, particularly with those in higher positions. In the workplace, they may comply so as not to put money or stature at risk. In the community, they may comply to preserve collective stability and security – or simply because it's the easiest thing to do.

History tells us, however, that subordinates do not follow all the time. As the ideas of the Enlightenment took hold in the eighteenth century, for instance, ordinary people (in industrialized societies especially) became less dependent on kings, landowners, and the like, and their expectations changed accordingly – as did their sense of empowerment. The trend continues. Increasingly, followers think of themselves as free agents, not as dependent underlings. And they act accordingly, often withholding support from bad leaders, throwing their weight behind good ones, and sometimes claiming commanding voices for those lower down in the social or organizational hierarchy.

Witness the gradual demise of communism (and totalitarianism) in the former Soviet Union, Eastern Europe, and now China. And consider the social and political upheavals, all of them antiauthority, in the United States and elsewhere during the 1960s and 1970s. Similarly, there has been a dispersion of power at the highest levels of American business, partly because of changes in the cultures and structures of corporations as well as the advance of new technologies. CEOs share power and influence with a range of players, including boards, regulators, and shareholder activists. Executives at global companies must monitor the activities of subordinates situated thousands of miles away. And knowledge workers can choose independently to use collaborative technologies to connect with colleagues and partners in other companies and countries in order to get things done. The result is reminiscent of what management sage Peter Drucker suggested in his 1967 book *The Effective Executive:* In an era dominated by knowledge workers rather than manual workers, expertise can – and often does – trump position as an indicator of who is really leading and who is really following.

Types of Followers

Over the years, only a handful of researchers have attempted to study, segment, and speak to followers in some depth. To various degrees, Harvard Business School professor Abraham Zaleznik, Carnegie Mellon adjunct professor Robert Kelley, and executive coach Ira Chaleff have all argued that leaders with even some understanding of what drives their subordinates can be a great help to themselves, their followers, and their organizations. Each researcher further recognized the need to classify subordinates into different types. (See the sidebar "Distinguishing Marks: Three Other Follower Typologies.")

Zaleznik classified subordinates into one of four types according to two sets of variables – dominance versus submission and activity versus passivity. His research findings intended to inform corporate leaders in particular. By contrast, Kelley and Chaleff were more interested in the welfare of those lower down the corporate ladder. Their work was designed to challenge and counteract what Kelley called the "leadership myth" – the idea that leaders are all-powerful and all-important.

Kelley classified subordinates into five types according to their levels of independence and activity, but his special interest was in fostering "exemplary" followers – those who acted with "intelligence, independence, courage, and a strong sense of ethics." These individuals are critical to the success of all groups and organizations, he argued. Meanwhile, Chaleff placed subordinates into one of four categories based on the degree to which the follower supports the leader and the degree to which the follower challenges the leader.

All three did pioneering work – and yet, as indicated, it seems to have had little impact on how current leader-follower relationships are perceived. In part, this is because of cultural, organizational, and technological changes that

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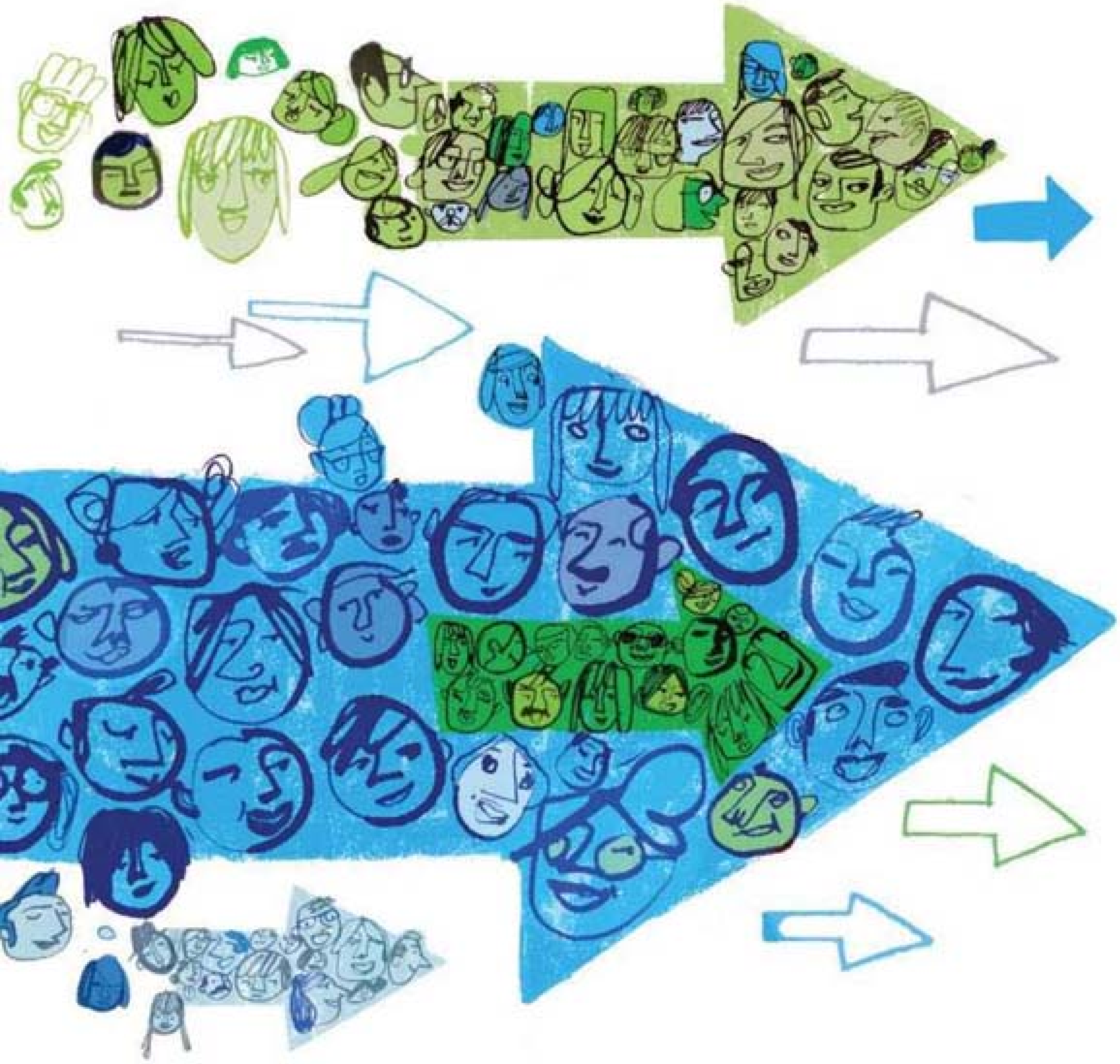

ment that largely determines the nature of the superior-subordinate relationship. This is especially true today: Because of the aforementioned changes in the cultures and structures of organizations, for instance, knowledge workers often care as much if not more about intrinsic factors – the quality of their interpersonal relationships with their superiors, for instance, or their passion for the organization's mission – than about extrinsic rewards such as salary, titles, and other benefits.

A typology based on a single, simple metric – as opposed to the multiple rating factors used by the creators of previous segmenting tools – offers leaders immediate information on whether and to what degree their followers are buying what they're selling: Do your followers participate actively in meetings and proceedings? Do they demonstrate engagement by pursuing dialogues, asking good questions, and generating new ideas? Or have they checked out – pecking away at their BlackBerries or keeping a close eye on the clock? I categorize followers as *isolates, bystanders, participants, activists,* and *diehards.* Let's look at each type.

Isolates are completely detached. These followers are scarcely aware of what's going on around them. Moreover, they do not care about their leaders, know anything about them, or respond to them in any obvious way. Their alienation is, nevertheless, of consequence. By knowing and doing nothing, these types of followers passively support the status quo and further strengthen leaders who already have the upper hand. As a result, isolates can drag down their groups or organizations.

Isolates are most likely to be found in large companies, where they can easily disappear in the maze of cubicles, offices, departments, and divisions. Their attitudes and behaviors attract little or no notice from those at the top levels of the organization as long as they do their jobs, even if only marginally well and with zero enthusiasm. Consider the member of the design team at a large consumer goods company who dutifully completes his individual assignments but couldn't care less about the rest of the company's products and processes – he just needs to pay the bills. Or witness the typical American voter – or, more accurately, nonvoter.

have taken place in just the past few years. Manual laborers, for instance, have been replaced by younger, tech-savvy knowledge workers, who are generally less disposed to be, in Zaleznik's parlance, "masochistic" or "withdrawn."

The most important point of all these typologies, however, is that leader-follower relationships, no matter the situation, culture, or era in which they are embedded, are more similar than they are different. Underlying them is some sort of dominance and some sort of deference. Segmenting followers, then, serves at least two broad purposes: In theory, it enables us all to impose an order on groups and organizations that up to now has been largely lacking. In practice, it allows superiors and subordinates alike to discern who in the group or organization is doing what – and why.

A New Typology

The typology I've developed after years of study and observation aligns followers on one, all-important metric – level of engagement. I categorize all followers according to where they fall along a continuum that ranges from "feeling and doing absolutely nothing" to "being passionately committed and deeply involved." I chose level of engagement because, regardless of context, it's the follower's degree of involve-

In 2004, no fewer than 15 million Americans said they had not gone to the polls because they were "not interested in the election" or were "not involved in politics." Groups or organizations rarely profit from isolates, especially if their numbers are high. Unwittingly, they impede improvement and slow change.

To mitigate the isolates' negative effect on companies, leaders and managers first need to ask themselves the following questions: Do we have any isolates among us, and, if so, how many? Where are they? Why are they so detached? Answering these questions won't be easy given that isolates by their very nature are invisible to the top team. Senior management will need to acquire information from those at other levels of the organization by having informal and formal conversations about managers and employees who seem lethargic or indifferent about their work, the group, or both.

The next step, of course, is to take action. Depending on the reasons for alienation, there may be ways to engage isolates in the workplace. If it's a matter of job satisfaction, a training and development plan might be drawn up. If it's a matter of job stress, a new schedule that allows for several days of work from home might be considered. In any case, leaders and managers will need to consider the return from making such investments in isolates: If it will be low or nonexistent, managers may ultimately decide to part ways with these followers. Employers that are satisfied with those who do an adequate job and no more might choose to keep these types of followers.

Bystanders observe but do not participate. These free riders deliberately stand aside and disengage, both from their leaders and from their groups or organizations. They may go along passively when it is in their self-interest to do so, but they are not internally motivated to engage in an active way. Their withdrawal also amounts to tacit support for whoever and whatever constitutes the status quo.

Like isolates, bystanders can drag down the rest of the group or organization. But unlike isolates, they are perfectly aware of what is going on around them; they just choose not to take the time, the trouble, or, to be fair, sometimes the risk to get involved. A notorious example from the public sector is people who refuse to intervene when a crime is being committed – commonly referred to as the Genovese syndrome or the bystander effect. A corporate counterpart might be the account representative at a financial services company who goes along with the new CEO's recently mandated process changes, even as some of her colleagues are being demoted or fired for pointing out inefficiencies in the new system. To speak up or get involved would be to put her own career and reputation on the line at a time when the CEO is still weeding out "loyal" employees from "problem" ones.

There are bystanders everywhere – and, like isolates, they tend to go unnoticed, especially in large organizations, because they consciously choose to fly under the radar. In the workplace, silent but productive bystander followers can be useful to managers who just want people to do as they are told – but they will inevitably disappoint those bosses who want people to actually care about the organization's mission. There are ways to bring bystanders along, however. As with isolates, the key is to determine the root causes of their alienation and offer appropriate intrinsic or extrinsic rewards that may increase their levels of engagement, and, ultimately, their productivity. Bystanders, perhaps much more than isolates, may be swayed by such incentives.

Participants are engaged in some way. Regardless of whether these followers clearly support their leaders and organizations or clearly oppose them, they care enough to invest some of what they have (time or money, for example)

Distinguishing Marks: Three Other Follower Typologies

While there is a landslide of materials out there dissecting and explaining the intricacies of leaders, very few people have devoted time and attention to the study of followers. Here are the exceptions.

1 **Abraham Zaleznik.** In 1965, this Harvard Business School professor argued in these pages that "individuals on both sides of the vertical authority relationship" matter to how organizations perform (see "The Dynamics of Subordinacy," HBR May–June 1965). To distinguish among the different kinds of subordinates, he placed them along two axes: dominance and submission (from those who want to control their superiors to those who want to be controlled by them), and activity and passivity (from those who initiate and intrude to those who do little or nothing). Zaleznik further segmented followers into four groups, two of which reflected his Freudian perspective on relationships: Impulsive (rebellious, sometimes spontaneous and courageous), compulsive (controlling but passive, in part because they feel guilty about privately wanting to dominate), masochistic (want to submit to the control of the authority figure), and withdrawn (care little or not at all about what happens at work and behave accordingly).

Ten years later, Zaleznik coauthored *Power and the Corporate Mind* with Manfred F. R. Kets de Vries and argued that leaders who know more about what makes their followers tick put themselves, their followers, and their organizations in an advantageous position.

to try to make an impact. Consider the physicians and scientists who developed the painkiller Vioxx: They felt personally invested in producing a best-selling drug for Merck, bringing it to market – and defending it even in the face of later revelations that the drug could create very serious side effects in some users. They were driven by their own passions (ambition, innovation, creation, helping people) – not necessarily by senior managers.

When participants support their leaders and managers, they are highly coveted. They are the fuel that drives the engine. In the workplace, for instance, they can make effective junior partners. When they disapprove of their leaders and managers, however, or when they act as independent agents, the situation gets more complicated. Former Merck CEO Raymond Gilmartin, for instance, was not trained as either a physician or a scientist. So it was easy enough for the people who on paper were his subordinates – the physicians and researchers championing Vioxx – to get ahead of him with a drug that brought the company a whole lot of trouble. (Vioxx was pulled from the market in 2004.)

Gilmartin could have done a much better job of communicating with and learning from these participant followers, perhaps bringing in experts from the outside to consult with him and his knowledge workers as Vioxx was being produced and marketed – and especially as it was being questioned. Indeed, if Gilmartin had understood the leader-follower dynamic even a bit better, he might have been able to help his company avert public relations and legal disasters.

Although Gilmartin's subordinates acted as free agents, they supported him nonetheless – which highlights an important point about followers' attitudes and opinions. When it comes to participant followers, and to the other engaged follower types described later in this article, leaders need to watch them overall and pay particularly close attention to whether their subordinates are for or against them. (The for-or-against question does not even come up for disengaged isolates and bystanders.)

When it comes to engaged follower types, leaders need to watch them overall and pay particularly close attention to whether their subordinates are for or against them.

Activists feel strongly one way or another about their leaders and organizations, and they act accordingly. These followers are eager, energetic, and engaged. They are heavily invested in people and processes, so they work hard either on behalf of their leaders or to undermine and even unseat them.

When Paul Wolfowitz ran into trouble as president of the World Bank, for instance, it was the activists among his staffers who led the charge against him. As soon as the news broke that Wolfowitz had intervened in a professional situation on behalf of a woman with whom he was having a personal relationship, members of the World Bank Group Staff Association promptly issued a statement: "The

2 **Robert Kelley.** In 1992, Kelley, now an adjunct professor at Carnegie Mellon, published *The Power of Followership*, which essentially urged followers to follow not blindly but with deliberate forethought. He distinguished followers from one another according to factors such as motivation and behavior in the workplace and ended up with five different followership styles: Alienated followers think critically and independently but do not willingly participate in the groups of which they are members. Passive followers do not think critically and do not actively participate; they let their leaders do their thinking for them. Conformist followers do participate in their groups and organizations but are content simply to take orders. Exemplary followers are nearly perfect, or at least they perform well across the board. And pragmatic followers play both sides of the fence, ranking in the middle in terms of independent thinking and level of activity.

3 **Ira Chaleff.** The author of the 1995 book *The Courageous Follower* was, like Robert Kelley, primarily focused on empowering subordinates, encouraging them to actively support leaders they deemed good and to actively oppose those they deemed bad. He classified subordinates according to the degree to which they supported leaders and the degree to which they challenged them. He came up with four different types of subordinates: implementers, partners, individualists, and resources. Implementers are the most common, and leaders depend on them above all to get the work done. Partners are even better: They strongly support their leaders, but they are also ready and willing to challenge them as necessary. Individualists can be a bit of a problem to leaders, because they tend to withhold support from people in positions of authority. And resources "do an honest day's work for a few days' pay but don't go beyond the minimum expected of them."

President must acknowledge that his conduct has compromised the integrity and effectiveness of the World Bank Group and has destroyed the staff's trust in his leadership. He must act honorably and resign."

Activists who strongly support their leaders and managers can be important allies, whether they are direct or indirect reports. Activists are not necessarily high in number, though, if only because their level of commitment demands an expense of time and energy that most people find difficult to sustain. Of course, this same passion also means they can and often do have a considerable impact on a group or organization. Those activists who are as loyal as they are competent and committed are frequently in the leader or manager's inner circle – simply because they can be counted on to dedicate their (usually long) working hours to the mission as their superiors see it.

Some activist followers are effectively encouraged by their superiors to take matters into their own hands. This was the case at Best Buy. CEO Brad Anderson had consistently encouraged "bottom-up, stealth innovation" at the retail organization, and human resource managers Jody Thompson and Cali Ressler were bold – and smart – enough to take him up on it. They wanted to create policies that would enable a workplace without any fixed schedules – a "results-oriented work environment," or ROWE. Best Buy employees at all levels of the organization – in the stores and at headquarters – would be free to set their own hours and come and go as they pleased, as long as their work got done. On their own, Thompson and Ressler considered how to make such a policy work, how exactly to measure results in the absence of set hours, how to implement the new processes that might be required, and so forth. In 2003, they presented their ideas to several unit managers who were struggling with complaints from top performers about undesirable and unsustainable levels of stress in the workplace. The managers were open to hearing about ROWE – more important, they were willing to test it in their units. Word gradually spread about the grassroots experiment, building strong support and acceptance in various departments, until it finally reached management's ears – after some parts of the company had already implemented the new policy. The HR managers' program eventually was rolled out companywide.

Diehards are prepared to go down for their cause – whether it's an individual, an idea, or both. These followers may be deeply devoted to their leaders, or they may be strongly motivated to oust their leaders by any means necessary. They exhibit an all-consuming dedication to someone or something they deem worthy.

Diehard followers are rare; their all-encompassing commitment means they emerge only in those situations that are dire or close to it. They can be either a strong asset to their leaders or managers or a dangerous liability. Hitler's most ardent disciple from the start was, arguably, Nazi propagandist Josef Goebbels. As conditions in Germany began deteriorating, with the Allies closing in, Goebbels remained close to the leader – straight through to the end: Shortly after the führer committed suicide, Goebbels took the most radical diehard-type step when he and his wife took their lives along with those of their six children. Without Hitler, they considered life not worth living.

Of course, not all diehard followers are so extreme in their devotion. But they are willing, by definition, to endanger their own health and welfare in the service of their cause. Soldiers the world over, for instance, risk life and limb in their commitment to protect and defend. They are trained and willing to follow nearly blindly the orders of their superiors, who depend on them absolutely to get the job done.

Sometimes diehards can be found in more ordinary circumstances, even in traditional organizations in which they are motivated to act in ways judged by others to be extreme. Whistleblowers are a case in point. Usually we think them heroes and heroines. In fact, these diehards can and often do pay a high price for their unconventional behavior. Bunnatine H. Greenhouse, a U.S. Army contracting official who criticized a large, noncompetitive government contract with Halliburton for work being done in Iraq, was punished for being so outspoken. She had initially registered her complaint only to those inside the Army. When this had no effect, she testified in 2005 before the Senate Democratic Policy Committee and described the contract as "the most blatant and improper contract abuse I have witnessed." Incensed by her remark, and citing poor performance, the Army removed Greenhouse from her elite Senior Executive Service position and reassigned her to a lesser job.

As I mentioned earlier, attitudes and opinions do not matter much when we are talking about isolates and bystanders, if only because they do little or even nothing. They matter a great deal, however, when we are talking about participants, activists, and diehards. Do these followers support their leader? Or, rank notwithstanding, are they using their available resources to resist people in positions of power, authority, and influence? My typology suggests that good leaders should pay special attention to those who demonstrate their strong support or their vehement opposition. It's not difficult to see the signs – participants and especially activists and diehards wear their hearts on their sleeves.

Good and Bad Followers

Certain character and personality traits are nearly always associated with being a good leader (integrity, intelligence, and wise judgment, for instance), as are particular skills and capacities (effective communication and decision making, for example). But given the different roles played by leaders and followers, what can reasonably be said about what constitutes a good follower? More to the point, what distinguishes a good follower from a bad one? Here my typology can again be of help.

First and foremost, there is this: Followers who do something are nearly always preferred to followers who do nothing. In other words, isolates and bystanders (little or no engagement, little or no action) don't have much to recommend them. Then again, doing something is not, in and of itself, sufficient, especially in cases of bad leadership. On the one hand, the story of "Chainsaw Al" Dunlap, former CEO of Scott Paper and Sunbeam, is one of a powerful leader with a mean streak, an intimidating executive who cultivated a culture of tyranny and misery while realizing success at Scott Paper and failure at Sunbeam. On the other hand, it's the story of isolates and bystanders who were unwilling or unable to stop him from leading so poorly. It's also a tale of participants and activists who did something; trouble was they supported rather than opposed a leader who did not deserve it.

Good followers invest time and energy in making informed judgments about who their leaders are and what they espouse. Then they take the appropriate action.

Or consider the extreme case of Darfur, which *New York Times* columnist Nicholas Kristof has long described as a situation in which there is enough blame to go around, including to those among us who have known about the genocide for years but have done nothing to stop it. Kristof praises certain kinds of followers, however – participants and activists who, despite being without power, authority, and influence, did what they reasonably could to stop the murder and mayhem. One such follower was the 12-year-old from a small town in Oregon who, after seeing the film *Hotel Rwanda*, formed a Sudan Club and raised money by selling eggs and washing cars. Another was the doctoral student who in his spare time became the foremost expert on how investments by foreign companies "underwrite the Sudanese genocide."

Good followers will actively support a leader who is good (effective and ethical) and will actively oppose a leader who is bad (ineffective and unethical). Good followers invest time and energy in making informed judgments about who their leaders are and what they espouse. Then they take the appropriate action. The senior editors and other newsroom staffers at the *New York Times*, for instance, certainly may have had problems with the way Howell Raines, then the executive editor, was trying to remake the venerable publication and may have chafed at his arrogant leadership style. The tipping point for them, however, was Raines's mismanagement of the scandal involving wayward reporter Jayson Blair – an incident they believed could create lasting damage to an institution to which they were deeply committed and where credibility is everything.

Conversely, bad followers will do nothing whatsoever to contribute to the group or organization. Or they will actively oppose a leader who is good. Or they will actively support a leader who is bad. Clearly Chainsaw Al's lapdogs fall into this last category. Most of the subordinates in his inner circle – those who were closest to him and who arguably could have afforded, professionally and financially, to oppose his ultimately destructive behavior – did nothing to try to shorten his miserable reign.

...

Contrary to what the leadership industry would have you believe, the relationship between superiors and their subordinates is not one-sided. Nor are followers all one and the same – and they should not be treated as such. Insofar as they can, followers act in their own self-interests, just as leaders do. And while they may lack authority, at least in comparison with their superiors, followers do not lack power and influence.

Spurred by cultural and technological advances, more and more followers are either challenging their leaders or, in many cases, simply circumventing them altogether. Participant, activist, and diehard followers invested in animal rights can, for instance, on their own now mass-send messages via e-mail, collect data using concealed cameras, and post their galvanizing images on various websites. Their work has motivated chains like McDonald's and Burger King to ask their meat and egg suppliers to follow guidelines that include providing extra water, more wing room, and fresh air for egg-laying hens. In 2007, Burger King went a step further and announced that it would buy eggs and pork only from suppliers that did not confine their animals in crates or cages.

As this example and countless others confirm, it's long overdue for academics and practitioners to adopt a more expansive view of leadership – one that sees leaders and followers as inseparable, indivisible, and impossible to conceive the one without the other.

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Your mind can play tricks on you when you're pursuing an acquisition. Learn to identify and avoid the assumptions that can damage a deal.

Deals Without Delusions

by Dan Lovallo, Patrick Viguerie, Robert Uhlaner, and John Horn

IF YOUR FIRM IS LOOKING TO ACQUIRE, how can you tell whether a given deal is advantageous? Unfortunately, you can never be sure that any large organic or acquisition investment will pay off, which may explain why many firms shy away from purchases that might otherwise afford them important growth opportunities. The good news is that you can stack the odds in your favor by examining a psychological phenomenon that most executives never consider when making deals – the degree to which their own biases influence decisions.

Before we disentangle the biases, let's consider some facts about M&A nowadays. A typical large corporation derives 30% of its revenue growth through acquisitions. For a $10 billion company growing by 10% annually, that's $300 million in revenues a year. Our work has shown that companies that aggressively leverage acquisitions for growth are at least as successful in the eyes of the capital markets as those that focus on purely organic ways to grow. Nevertheless, recent research from McKinsey & Company reveals that approximately half of acquiring companies continue to pay more for

Asaf Hanuka

acquisitions than they're worth. Certainly, firms are getting better at M&A – 2006 was almost a ten-year high in the percentage of shareholder value created through takeovers – but there's still plenty of room for improvement.

Many scholars have attributed the largest M&A mistakes to executive hubris in decision making, but having studied the psychology of the deal for over a decade, we believe this is only a small piece of the problem. Our insights have been confirmed by a recent McKinsey survey of executives responsible for M&A at 19 top U.S. firms. Each firm had derived at least 30% of its market value from acquisitions; the market rewarded some of these companies (their returns to shareholders exceeded those of peer firms) but did not reward others. Our analysis of responses from executives at these firms demonstrates how a variety of cognitive biases – systematic errors in processing information and making choices – can affect each step of the M&A process.

As we will show, when executives take a *targeted debiasing* approach to M&A, deals can be more successful. The approach requires executives first to identify the cognitive mechanisms at play during various decision-making steps and then to use a set of techniques to reduce bias at specific decision points, thereby leading to sounder judgments. (See the exhibit "How to Overcome Biases That Undermine the M&A Process.")

Preliminary Due Diligence: Five Biases

The preliminary due diligence stage of the M&A process is when biases are most likely to cause damage. They can, for example, lead a potential acquirer to overestimate enhancements to stand-alone values as well as revenue and cost synergies between the acquirer and the target. In addition, they can cause a deal maker to underestimate the challenge of integrating two corporate cultures. In this section, we explore five biases that tend to surface during preliminary due diligence. We also provide strategies for overcoming them and thereby avoiding their potentially costly consequences.

Confirmation bias. People have an overwhelming tendency to seek out information that validates an initial hypothesis. This bias is particularly pernicious during M&A preliminary due diligence, because the main outcome is a letter of intent (LOI) with a price range that's enticing enough to move a deal forward. The need to provide an acceptable initial bid often biases all analyses upward. Instead of synergy estimates guiding the price, as would be appropriate, the LOI often guides the synergy estimates. In effect, this seeds the entire due diligence process with a biased estimate, even before much factual information has been exchanged.

Most companies examine potential pitfalls at some point during the M&A process, but often not with the same degree of insight and strategic rigor that they build into their initial case for a deal.

During the price-setting stage, deal makers also sometimes use current market multiples as evidence to confirm the wisdom of a deal, in lieu of a compelling business case. In 2003, for example, Career Education Corporation (CEC) paid $245 million – 14 times its annual operating earnings – for Whitman Education Group. (The historical multiple in this industry is six to eight times earnings.) CEC executives justified the high price by arguing that the sector was undergoing a period in which high prices were the norm. This convenient logic – in no way an independent test of the appropriate price – may explain why the executives opted to pay a high price, but it doesn't show whether that price *should* have been paid. Subsequently, stock prices for the industry receded to historical norms.

The best way to counteract confirmation bias is to tackle it head on – by actively seeking disconfirming evidence. Consider one company that did not do that. The firm sought to acquire a sizable firm that had a complementary technology. The acquirer hoped that the combined technology platform would enable significant new product development and fuel revenue growth. Since the quality of the technology was the driving force behind much of the due diligence, the acquirer

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How to Overcome Biases That Undermine the M&A Process

At each step of the M&A process, executives can be vulnerable to a variety of cognitive biases. By identifying these biases and then taking specific steps to address them, deal makers can feel more comfortable with the process.

Process step	Bias	Debiasing prescriptions
Preliminary due diligence Estimate stand-alone enhancement, revenue synergies, and cost synergies; decide how much to bid; estimate the time, money, and other resources needed for integration.	**Confirmation bias**	Seek out disconfirming evidence.
	Overconfidence	Use a reference class of comparable prior deals to estimate synergies.
	Underestimation of cultural differences	Do human due diligence.
	Planning fallacy	Use reference-class forecasting to estimate the time and money needed for integration. Establish and update best practices.
	Conflict of interest	Seek advice from objective experts.
Bidding phase Submit bids until the seller agrees on a price.	**Winner's curse**	Set a limit price and avoid bidding wars. Have a dedicated M&A function.
Final phase Obtain greater access to the target's books; determine final payment terms and closing details.	**Anchoring**	Seek the fresh eyes of independent analysts.
	Sunk cost fallacy	Have backup plans and alternative options.

didn't take into account the target's slowing growth rates, which should have signaled the deteriorating attractiveness of the target's markets. A harder look might have raised red flags earlier. Of course, most companies examine potential pitfalls at some point during the M&A process, but often not with the same degree of insight and strategic rigor that they build into their initial case for a deal.

Overconfidence. The ubiquitous problem of overconfidence is especially insidious when it comes to identifying revenue and cost synergies. Since revenue synergies are less likely to be realized than cost synergies are, heavy reliance on the former may signal a problem. For revenue synergies to work, there must be a specific integration plan that involves new investment in growth initiatives. This plan should complement a balanced assessment of the entire competitive environment. One way to avoid overconfident synergy estimates is to use reference-class forecasting, which involves examining numerous similar deals that your firm and others have done, to see where the current deal falls within that distribution. It provides a top-down sanity check of typical bottom-up synergy estimates (see "Delusions of Success: How Optimism Undermines Executives' Decisions," HBR July 2003).

Leading serial acquirers, such as GE, Johnson & Johnson, and Cisco, draw from past experience when contemplating mergers. Companies that don't have rich M&A histories can often use analogous situations in other companies as benchmarks. To estimate synergies, firms look at a detailed business case from the bottom up; they also make top-down estimates on the basis of comparable deals. Recently, a banking firm examined more than a dozen comparable deals on three continents to make an accurate assessment of realized synergies. It is not necessary to calculate the exact value of the synergies in comparable deals; grouping them into a few performance categories – good, bad, or disastrous, for example – often suffices. Watch out if your firm's expected synergies are skewed toward the high end of, or beyond, what comparable deals have yielded and your performance with your current assets is not similarly skewed (see the sidebar "Eight Red Flags in M&A").

Underestimation of cultural differences. Unanticipated cultural conflicts are well known to cause merger problems; less well known is the idea that conflict can arise even in the most anodyne situations. In a simulation experiment performed in 2003, Roberto Weber and Colin Camerer showed how conflict between merging firms' cultural conventions (the codes, symbols, anecdotes, and rules that bind cultures together) can substantially diminish performance. Participants were assigned to either an acquiring or an acquired firm and given time to develop, within each group, a common language for describing generic photos of employees doing various kinds of work. When the firms were "merged," participants from the acquiring company who role-played as managers were able to communicate much more effectively with subordinate participants from their own firm than with those from the other firm. Sometimes, the person in the manager role grew impatient with the subordinate from the acquired company. The researchers concluded that "the more deeply ingrained firm-specific language is, and the more efficient the firm, the harder the integration may be." They also noted that employees of both the target and the acquirer tended to overestimate the performance of the combined firm and to attribute any diminished collective performance to members of the other firm – outcomes that are often evident in real-world mergers.

One way to prevent cultural conflicts is to perform cultural due diligence (see "Human Due Diligence," HBR April 2007). According to the previously discussed McKinsey survey, companies that had been rewarded by the market were 40% more likely than unrewarded companies to perform this due diligence at least "most of the time." We have also found that network analysis maps, which describe the connections among people in an organization, provide some insight about the similarities between company cultures and can help identify the key people to be retained during integration. (See "A Practical Guide to Social Networks," HBR March 2005, and "How to Build Your Network," HBR December 2005.) For one pharmaceutical client, McKinsey used network analysis to identify whether the target's scientists really were world-class research leaders in the area where the acquirer wanted to build capabilities. The results showed that the target's scientists were not essential for doing cutting-edge research on a key chemical, so the client decided to build the skills organically.

We believe that network analysis holds huge promise for refining the work of cultural due diligence. In the future, companies will be able to use this method to help identify which types of networks are easiest to integrate. The analysis should highlight places where the target's network is dependent on too few key capabilities and may even shed light on the target's quality of work.

The planning fallacy. People have a tendency to underestimate the time, money, and other resources needed to complete major projects, including mergers and acquisitions. We believe that reference-class forecasting, mentioned in our discussion of the overconfidence bias, has great promise as a tool for anticipating how much time and money will be needed for M&A integration. The American Planning Association, a nonprofit organization that helps communities plan infrastructure projects, routinely recommends this type of forecasting, and it is used to plan infrastructure development throughout the UK and Switzerland.

Firms that are successful at integration also formally identify best practices and use them to improve future integration efforts. For example, GE Capital applies the principles of Six Sigma to drive continuous improvement in its inte-

Eight Red Flags in M&A

Companies should be vigilant for red flags during the M&A process. The presence of one flag does not necessarily signal certain danger, but spotting several probably means that peril is just around the corner.

- The CEO is the only one who believes in the deal.
- The synergies analysis focuses on revenue enhancement (without an investment plan) rather than cost savings.
- Preliminary cultural due diligence is done in a perfunctory manner.
- The acquirer has done few deals and hasn't sought outside expertise.
- The limit price changes during the bidding.
- There are numerous bidders for the target.
- At any stage of the process, someone emphasizes how much time, money, or reputation has already been sunk into the deal.
- You consider the deal to be one that you must close no matter what.

gration practices, just as it does for its other core business processes. Started more than 20 years ago, this approach has developed as the company has faced challenges in its various acquisitions. The firm's executives discovered that mergers go more smoothly if integration begins early in the deal-making process and if detailed written plans include clear objectives that are to be met immediately after the deal closes. GE Capital also surveys its own employees and those of the other company to compare cultures, sets up structured meetings to address cultural integration, and works to solve actual business problems based on shared new understanding. Most important, the firm has put in place a

process for learning from deal-making experience. It also sponsors conferences to foster idea sharing and improvement of best practices, and it constantly updates materials for leaders in the newly acquired company to use. This commitment to learning, codification, and continuous improvement has helped make GE Capital a world-class integrator across the globe.

Conflict of interest. Although advisers generally earn more business if deals they work on actually go through, the good advisers understand that the best way to secure a reputation is to provide objective recommendations that stand the test of time. Firms that do deals infrequently should be especially careful to stay clear of people who are driven by one-shot profit motives. Building a network of trusted advisers who are interested in the long haul goes far toward avoiding the conflict-of-interest bias.

Conflict of interest is an even bigger concern when a deal sponsor in charge of due diligence evaluates a merger or acquisition without obtaining any external input. Recent research by Don Moore and colleagues indicates that the judgment of internal partisans, and even of external advisers, is unconsciously influenced by the roles they play. Accordingly, they are likely to reach the same conclusions as their sponsor, unintentional as that outcome may be.

Private equity firm partners have proved very successful at reviewing one another's deals to ensure analytically rigorous due diligence. Even more important, they practice humility – that is, they approach each deal as if they didn't know anything about the relevant industry, even though they may buy multiple companies within it. They ask for expert advice; they question anyone who's willing to talk; they listen genuinely to the answers they receive. Corporate buyers, on the other hand, usually evaluate deals episodically, and certainly less often than private equity firms' investment committees, which tend to have weekly rhythms. As a result, corporate boards and management teams do not develop the skills they need to critically evaluate deals. This results in a conservative bias either to kill most deals or to take management's word and provide a rubber stamp. If your firm does deals infrequently, consider seeking out objective external expertise beyond that of the advisers assisting on the deal. (Also see the sidebar "Aversion to M&A: Two Biases.")

The Bidding Phase: Avoiding the Winner's Curse

If there are multiple bidders for an M&A target, a well-documented phenomenon called the *winner's curse* can come into play. Someone bids above an item's true value and thus is "cursed" by acquiring it. Bidding wars often lead to above-value offers.

One bidding war broke out recently over Guidant, which makes heart devices such as defibrillators, pacemakers, and stents. Johnson & Johnson offered Guidant shareholders $68 a share in late 2004, which wasn't much of a premium over the stock's trading price. In early 2005, though, reports of problems with some of Guidant's defibrillators began reaching the public. When J&J subsequently dropped its offer to $63 a share, Boston Scientific offered $72 a share in late 2005. The bids increased over a couple of days in January 2006, until Boston Scientific decided to make a bid so strong that it ended the contest: $80 a share (with a collar) and an agreement not to walk even if the government objected or further recalls came to light. Soon after the deal closed, however, additional product recalls were issued and the value of Boston Scientific's stock fell by about half, although this deal may have not been the only cause of the drop. Boston Scientific's failure to protect itself from future changes and its rushed offer to end the bidding war made it fall prey to

Aversion to M&A: Two Biases

This article focuses on the dangers of undertaking mergers and acquisitions, but we don't mean to imply that organic growth is a surer bet. Many executives feel reluctant to pursue M&A because they incorrectly believe it is riskier than organic growth, even though the probability of success with internal ventures is objectively the same as with external ones. Accordingly, too many firms never avail themselves of M&A growth possibilities. Indeed, the tendency to do too few deals seems at least as prevalent as the tendency to pursue value-destroying ones. Aversion to M&A springs from two key biases: *loss aversion* and *comparative ignorance*. Loss aversion refers to fearing losses more acutely than desiring equivalent gains. In many experiments, Daniel Kahneman and Amos Tversky have shown that the psychological impact of a loss is about 2 to 2.5 times that of a gain. This means that to accept an even chance of losing $10, most people require an upside of $20 to $25. Often, the net effect of loss aversion is inaction.

In a clever experiment undertaken in 1995 in Berkeley, California, Craig R. Fox and Amos Tversky demonstrated comparative ignorance by showing that given a pair of betting options, people prefer the gamble that is comparatively less uncertain. Participants were asked to price bets on whether the temperature at a given time in San Francisco (a familiar city) or Istanbul (an unfamiliar one) was greater or less than 60 degrees Fahrenheit. Some priced bets on only one city; others priced bets on both. When comparing the two bets, participants were willing to pay over 50% more for the San Francisco gamble than for the Istanbul gamble. But when different groups were asked to price bets on only one city, they priced the gambles equally. Thus, comparative ignorance led them to value the familiar-city gamble more highly, even though it had an identical risk profile.

Loss aversion and comparative ignorance played a role in a potentially lucrative merger contemplated by a large pharmaceutical company. The target was a smaller biotech firm whose key research asset was a drug intended to enhance cognitive function, which was midway through clinical trials. The executive committee didn't feel it understood the potential outcomes of the drug as well as those of some internal prospects, so it asked the senior executive and the line manager leading the merger venture whether they'd be willing to bet their careers on the drug's market outcome. When the two very reasonably said no, the executive committee interpreted this as a lack of commitment to the merger and rejected the acquisition, even though the internal prospects were not subject to the same degree of risk evaluation.

The best way to overcome loss aversion is to aggregate a particular M&A decision within the larger portfolio of strategic choices and thereby mitigate the loss associated with a single poor outcome. To understand the power of aggregation, consider the following thought experiment. Imagine you will flip a coin: If it lands tails up, you lose $10,000. What is the lowest amount you would have to receive if the coin lands heads up to accept the gamble? Now imagine you own 20 of these gambles. What is the lowest amount you would have to receive for each heads-up to accept the bet? Did the value drop? If so, you understand the power of aggregation: The chance of overall loss becomes vanishingly small as the number of gambles rises. Over a significant time horizon, firms can undertake numerous investments. So long as the acquisition investments don't threaten the firm's viability, they should be considered a small part of a continuing gamble. A culture that fires someone (or threatens to do so) for one relatively small deal that doesn't pan out is a culture where even good deals don't get done, as in the pharmaceutical example above.

You can overcome comparative ignorance by taking a look at the actual returns your company has achieved on internal projects and the returns you and others have achieved on acquisitions. This baseline, objective measure of the two types of returns can be formulated using a reference class of at least eight similar deals that you or others have done. Reviewing ventures in this way will help reduce uncertainty about an acquisition's potential range of outcomes, minimizing the ambiguity inherent in an unfamiliar gamble.

the winner's curse. Of course, this doesn't mean the company won't derive value from the deal in the long term.

The previously discussed McKinsey survey suggested that successful acquirers are much more likely to exit when competitors initiate a bidding war: 83% of the rewarded companies withdrew at least sometimes, compared with only 29% of the unrewarded companies. Staying in a bidding war doesn't necessarily lead to a poor acquisition, but if your company doesn't evaluate whether to drop out when others enter the bidding, that's a red flag.

One technique for avoiding the winner's curse is to tie the compensation of the person responsible for the deal's price to the success of the deal – for example, to the percentage of estimated synergies realized. An even better strategy is to have a dedicated M&A function that actively generates alternatives to the deal under consideration and sets a limit price for each deal. (Companies that don't proactively maintain a deal pipeline are often forced to overpay for what seems to be their only alternative.) This method isn't a guarantee against the curse, since your maximum price still might be greater than the target's true value, but it can prevent you, in a fit of auction fever, from increasing your bid above the level you initially deem prudent.

If the acquiring firm's limit price changes during the bidding, someone in the firm should wave a warning flag and stop the negotiations. If the acquiring firm doesn't have a limit when it starts bidding, the bidder should be struck with the flagstaff.

The Final Phase: The Perils of Clinging Tightly

Once an initial bid is accepted, the acquirer has an important opportunity for additional due diligence, since it now has much greater access to the target's books. The final negotiation phase also encompasses the deal's legal structuring (for example, the exact composition of payment cash or stock). In this final phase of due diligence, the goal is to honestly evaluate the investment case in light of the more detailed information now available from the target. Two biases can come into play.

The first stems from a tendency to underreact to surprising news. A simplifying heuristic called *anchoring* is operative here. Specifically, people tend to anchor onto an initial number and then insufficiently adjust away from it, even if the initial number is meaningless. In a classic article in *Science* magazine from 1974, Amos Tversky and Daniel Kahneman described how anchoring works. In one experiment, subjects witnessed the spinning of a roulette-type wheel emblazoned with numbers from 1 to 100. Then the subjects were asked what percentage of African countries were members of the United Nations. The random numbers generated by the wheel biased the subjects' answers. For example, when the spun number was 10, the median answer was 25%; when the spun number was 65, the median answer was 45%.

Initial valuations, such as the price range in the LOI, can also act as anchors. Many acquirers fail to adjust sufficiently from a price, even in the face of surprising new evidence. For example, one energy company pursued a deal in part because the target had a futures contract with Enron. Even when Enron collapsed soon afterward, the would-be acquirer remained anchored to its original estimates of the deal's value. After the deal went through, it spent an additional $30 million – beyond an initial price of approximately $75 million – to keep the deal in play. The deal never succeeded because the acquirer eventually ran into its own problems with regulators. Likewise, anchoring can occur in the process of bidding. Confronted with unfavorable information, the acquirer may not lower the price sufficiently. It's rare to be able to bargain down the LOI price, so stepping away is almost always the only way to avoid paying too much.

When people feel that they've sunk a lot of time, money, effort, and reputation into making a deal happen, they aren't willing to surrender, even if the costs are unrecoverable. The *sunk cost fallacy* can cause an acquirer to continue pursuing the target even when it shouldn't. This phenomenon probably was operative in Boston Scientific's pursuit of Guidant.

The best way to free your firm from both final-phase biases is to hire fresh, dispassionate experts to examine the relevant aspects of the deal without divulging the initial estimate. Some private equity firms use this technique. The independent team simply is asked to make its evaluation of the new information uncovered during the detailed due diligence – data that were not available before the initial bid was accepted.

Just as important, your firm should always entertain multiple M&A possibilities as part of a broader backup plan, and should know when to stop bargaining and walk away. When you have multiple offers in play, you aren't emotionally attached to one deal. Having a few options on the table also allows you to shift to another deal with a better price-value ratio as the bargaining continues. Of course, the ability to juggle several options at once requires a disciplined, ongoing M&A process and the attention of a much larger M&A team.

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M&A is a vital component of any company's growth options, but doing it well means identifying the red flags. Taking a targeted debiasing approach can help the acquiring team make better, more accurate value estimates and can help mitigate the influence of cognitive biases. By improving the decision-making process in this way, companies increase the chances that their acquisitions will lead to success rather than to post-merger disaster.

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To order, see page 147.

Simplicity-Minded Management

A practical guide to stripping complexity out of your organization

by Ron Ashkenas

Chris Sharp

LARGE ORGANIZATIONS ARE by nature complex, but over the years circumstances have conspired to add layer upon layer of complexity to how businesses are structured and managed. Well-intended responses to new business challenges – globalization, emerging technologies, and regulations like Sarbanes-Oxley, to name a few – have left us with companies that are increasingly ungovernable, unwieldy, and underperforming. In many, more energy is devoted to navigating the labyrinth than to achieving results. Accountability is unclear, decision rights are muddy, and data are sliced and diced time and again, frequently with no clear idea of how the information will be used.

Imagine a $14 billion company with more than 100 consumer and commercial brands, a food services business, and a commodity trading operation, but no common method for tracking, reporting, or analyzing results. How would you assess relative brand or business unit performance? How would you evaluate individual performance? How would you know where to place your bets – or what to report to investors and analysts? That is exactly the situation that Gary Rodkin confronted when he became CEO of ConAgra Foods, one of the largest packaged food companies in North America, in October 2005. ConAgra's lack of cohesion was the unintended consequence of an enormously successful growth strategy, launched in the 1970s, which involved acquiring well-known brands like Reddi-wip, Egg Beaters, Chef Boyardee, and Hebrew National, and then allowing the acquired organizations to operate relatively autonomously.

That strategy was no longer viable by the time Rodkin came on board. The company's growth had hit a wall. Customers wanted a single face to the company, employees were frustrated with poor communication and competition among units, analysts wanted clearer numbers, and investors were unhappy with the wide duplication of functions. The fragmented organization's lack of common systems, data, and processes made it impossible to respond to those demands. So Rodkin made simplicity one of his first priorities, declaring it a hard business objective. He then invested in a series of initiatives to combat complexity, which made life easier for customers and employees – and produced millions of dollars in savings.

Over the past 20 years our firm has worked with dozens of companies and hundreds of executives to improve operational effectiveness, and my colleagues and I have repeatedly seen the frustrations and inefficiencies caused by complexity. By looking carefully at the sources of complexity, we've identified four areas of opportunity that managers can exploit to gain greater control over their organizations – and improve business results at the same time. To successfully counter complexity, managers need to address all four in a multidimensional, ongoing strategy.

In these pages I'll describe this strategy, citing the steps taken by Rodkin and other executives. But first, let's take a quick look at the factors that contribute to convoluted constructions in the first place.

The Causes of Complexity

Complexity is the cumulative byproduct of organizational changes, big and small, that over the years weave complications (often invisibly) into the ways that work is done. The causes tend to fall into one of four categories: structural mitosis, product proliferation, process evolution, and managerial habits.

Structural mitosis. In most large organizations, structural shifts are happening all over the enterprise, all the time. They may range from subtle changes in reporting relationships, to job moves accommodating personal preferences, to the establishment of a new unit or shared service centers. The steady accumulation of structural changes drives up complexity over time, in ways that sometimes go unrecognized.

At a major pharmaceutical company, the CEO realized that too many layers separated him from the frontline employees. When he challenged the leadership team to flatten the organization, many of the divisions were surprised to discover that there were more layers than they had realized – as many as 14 in one case. The organizational structure had taken on a life of its own. They all agreed to consolidate down to eight or fewer.

Product proliferation. Companies refresh their offerings continually, with changes as modest as tweaks to package design or the addition of new product features, or as involved as the launch of entirely new lines of products or services. Each innovation has a ripple effect throughout the enterprise, requiring changes in manufacturing and the supply chain, pricing, marketing materials, sales and service training, and so forth. What's more, most large organizations are better at adding new products and

Simplicity Checklist

Ready to cut complexity out of your company? Use this list to craft your approach.

Make simplification a goal, not a virtue
- Include simplicity as a theme of the organization's strategy
- Set specific targets for reducing complexity
- Create performance incentives that reward simplicity

Simplify the organizational structure
- Reduce levels and layers
- Increase spans of control
- Consolidate similar functions

Prune and simplify products and services
- Employ product portfolio strategy
- Eliminate, phase out, or sell low-value products
- Counter feature creep

Discipline business and governance processes
- Create well-defined decision structures (councils, committees)
- Streamline operating processes (planning, budgeting, and so on)
- Involve employees at the grassroots level

Simplify personal patterns
- Counter communication overload
- Manage meeting time
- Facilitate collaboration across organizational boundaries

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services than they are at pruning, so the SKUs mount. The resulting complexity is difficult to manage – and can be troublesome for customers, too. At one meeting of a major technology company's customer advisory board, executives and product engineers were surprised to hear that customers wanted fewer new features on some of the company's core equipment. Their assumption had always been the opposite, and they'd made it a priority to deliver. But it turned out that customers found that the steady influx of new features and capabilities from their various suppliers was making it difficult for customers to maintain network stability, because of the ripple effects of constant adjustments.

Process evolution. In recent years, corporations have put their manufacturing, accounting, and information technology processes through rigorous scrutiny, with Six Sigma, lean manufacturing, and reengineering efforts. While those processes tend to be relatively well laid out and controlled, many others haven't benefited from disciplined improvement techniques. Consider budgeting and planning, performance management, customer relationship management, sales forecasting, and innovation. All those processes evolve over time – as companies respond to new regulations, for instance, or accommodate a new leadership team – and they often become battlegrounds between corporate staff and line business units. That results in compromises that introduce too much variability and make processes inefficient. ConAgra's multiple operating units, for example, each had their own ways of doing business, making it very difficult for the newly centralized functions to evaluate relative performance.

Managerial habits. While evolving structures, products, and processes lie at the roots of complexity, managers frequently behave in a way that exacerbates the problem, though usually they have the best of intentions. Senior executives, for instance, understandably want information, but they may not realize that a request can set off a cascade of reporting work, which often keeps being added to over time. What seems like a simple question to a CEO can turn into a major exercise for hundreds of other people. When Patrick O'Sullivan became group finance director (the CFO) of Zurich Financial Services, in 2002, he discovered that business units around the world reported on dozens of different performance metrics they'd accumulated in response to questions raised over the years. Things had evolved to the point that no two units reported on the same basis. O'Sullivan launched an effort to standardize the monthly and quarterly reporting requirements, so that all units focused on the measures that were most critical both for corporate executives and for their unique business. That move eliminated thousands of hours of work for numerous managers. In March 2007, O'Sullivan became the company's chief growth officer.

Other managerial habits that inhibit simplicity include "reply all" e-mail responses and poor meeting management. Very few people recognize how their own actions contribute to complexity; the sidebar "The Hidden Cause of Complexity: You" discusses in more detail some of the psychological blind spots, many of which involve breaking the most basic and well-known management rules.

To be fair, these behaviors often actually begin as mechanisms for coping with complexities in structures, products, and processes. When a company introduces new layers of management, for instance, an executive may naturally ask for more reports and e-mail updates. The undesired result is a vicious cycle of additional complexity. (For a quick assessment of your own company, take the quiz "What's Your Organization's Complexity Quotient?")

Simplification as Strategy

While none of the elements of simplification are particularly surprising by themselves, countering complexity requires integrating them into a mul-

What's Your Organization's Complexity Quotient?

The quiz below can help you gauge your own organization's complexity. If your score looks alarmingly high, start developing your own strategy of simplicity. If your score suggests that you have complexity under control, give yourself a pat on the back – but don't rest for long. The forces of complexity are constantly at work, and their effects could creep into your business at any time.

How easily can you draw a picture of your organization's structure – the major business units, functions, and geographies?

- [ ] A It's simple and straightforward
- [ ] B It takes a little explanation
- [ ] C I would need a computer-aided-design program

How many organizational layers are there between the CEO and first-line workers?

- [ ] A Seven or fewer
- [ ] B Eight to ten
- [ ] C More than ten

How many committees or councils do you have that either review or make significant business decisions?

- [ ] A Five or fewer
- [ ] B Six to ten
- [ ] C More than ten

How many products and services does your organization offer?

- [ ] A A manageable number
- [ ] B A few more than we need
- [ ] C Way too many

If you could streamline your company's product or service lines without reducing profitability, how many SKUs (or equivalents) would you eliminate?

- [ ] A Just a few
- [ ] B About 15%
- [ ] C About 25%

How many months does it take for your organization to create its budget for the next fiscal year?

- [ ] A Less than two months
- [ ] B Two to four months
- [ ] C A good part of the year

How long does it take for your finance department to officially "close" the books at the end of each reporting period?

- [ ] A Less than one week
- [ ] B One to three weeks
- [ ] C Three weeks to forever

How many people do potential senior hires need to meet in your organization before offers are extended?

- [ ] A Just a few
- [ ] B Four to eight
- [ ] C Almost everyone

To what extent can employees clearly and accurately describe the strategy of your firm?

- [ ] A Everyone can do it
- [ ] B Many can describe the strategy
- [ ] C Not too many can describe it well

To what extent do you retire old products or features when new products or features are introduced?

- [ ] A This is our regular practice
- [ ] B We do it some of the time
- [ ] C We rarely think about doing this

How much time do your senior managers spend in meetings?

- [ ] A Less than 25% of their time
- [ ] B About half their time
- [ ] C Most of their time

If you personally were given the power to reorganize your company (or your part of it) and you had an incentive to improve productivity at the same time, what is the minimum number of people you would need compared with what you have now?

- [ ] A 100% of the current head count
- [ ] B About 85% of the current staff
- [ ] C 75% or less of the current staff

Whenever you need to get approval for a capital expense or policy modification, how clear are you about how to make it happen?

- [ ] A I know exactly how to make it happen
- [ ] B I have a reasonable idea of what to do
- [ ] C I'm not really sure how to go about it

When a dispute arises between functions or departments, or with a customer, how quickly is it resolved?

- [ ] A Right away
- [ ] B Within a week
- [ ] C Seems as if it drags on forever

If the unnecessary complexity in your company were eliminated, how much of an increase in productivity might be possible?

- [ ] A None
- [ ] B Some
- [ ] C A great deal

Scoring: Give yourself one point for every A answer, two points for every B, and three points for every C, and total them up. Then see where you fall on the scale below.

15–25: Normal complexity: You're in good shape – maintain vigilance.
26–35: Creeping complexity: You're heading for trouble – start working on simplification.
36–45: Too much complexity: Your productivity is suffering – focus hard on simplification.

tidimensional strategy. Though the elements each directly address one source of complexity, applying them separately may actually worsen the problem. For example, many companies have found that simplifying processes through large-scale enterprise systems – without addressing organizational structure, product offerings, and work behaviors – often leads to diminished rather than enhanced productivity. One-off efforts may interrupt established relationships, introduce unanticipated roadblocks, and create confusion over decision rights.

A simplification strategy must also be treated as a business imperative – not a soft, "nice to have" virtue but a key contributor to bottom-line success. With that in mind, let's look at how each of the elements of simplification plays out, paying particular attention to ConAgra, along with a few other notable examples.

Streamline the organizational structure. Once they've clearly framed simplification as a business imperative and connected it to measurable goals and incentives, managers can begin an ongoing attack on structural mitosis. That means periodically adjusting the structure to make sure it serves the business strategy and market needs and is as simple as possible.

Rodkin started by transforming ConAgra from a company with multiple autonomous business units into an integrated operating company. Previously, each business unit contained all its own support functions. Rodkin combined the functions into enterprise units, including product supply, sales, finance, human resources, information technology, research and development, and legal. He then consolidated the commodities trading, food services, and ingredients businesses into a commercial sector; and the consumer brands into a consumer sector, subdivided into four portfolio operating groups – snacks, dairy, grocery, and frozen. Each sector (as well as brands within each operating group) had its own P&L and received services and expertise from the enterprise functions. The functions were held accountable for reducing costs and supporting the brands. This new structure was put into place quickly, just a few months into Rodkin's tenure.

Whether you're centralizing functions or shifting reporting relationships, the point is to think of organizational design as a dynamic, ongoing, and organic process instead of a one-time exercise in engineering. ConAgra's historical strategy of leaving the units as independent companies had led to tremendous success – the organization had grown from a couple hundred million dollars in revenue in the early 1970s to a peak of over $27 billion in 2002. But by the time Rodkin came on board, the structure had outlived its relevance, something that was easy for people working inside it to overlook.

ConAgra continues to monitor and modify its organizational design. Eighteen months after the initial reorganization, Rodkin and his team realized that the supply chain directors that supported each of the consumer operating groups did not have enough direct access to the people who worked in manufacturing, engineering, procurement, and quality control, who had all been centralized in the enterprise units. So whenever there was a supply chain issue, it took too long for these directors to pull together a response team. That led Rodkin's team to further tweak the design by creating small supply chain support teams dedicated to each consumer group. Similarly, at the pharmaceutical company mentioned earlier, one of the company's periodic organizational-health reviews led to the elimination of an additional layer in the sales organization a year after the first streamlining initiative.

Prune products, services, and features. Once the right structure is in place, simplicity-minded managers take a hard look at the products and services the company offers. Are there too many of them? Which are profitable and have the greatest growth potential? Which have run their course? One way to get some answers is to periodically do a classic portfolio review. That's how Rodkin dealt with the brand structure at ConAgra. Previously, the company's 100-plus brands were assumed to be equal and competed for marketing and investment dollars, which made planning and allocation processes free-for-alls. To inject some rationality, in early 2006 the company sorted the brands into three categories: "growth brands," which would have priority for investment; "manage for cash" brands, which would be maintained; and "potential for divestment" brands, which could be put up for sale. ConAgra then immediately put the business units containing brands designated for divestiture, such as meats (including Butterball and Armour), on the market. It sold them that year.

Take a hard look at the products and services the company offers. Are there too many of them? Which are profitable and have the greatest growth potential?

Another way of addressing proliferation is to set up processes for evaluating how well the company's offerings match customers' needs. The review should focus both on the overall portfolio and on the simplicity of individual products, and usually demands a large dose of customer feedback. At Cisco Systems, for example, a number of customer advisory boards meet regularly to review the company's pipeline of products and services and give input on decisions that involve technology investments, timing, and bundling of

The Hidden Cause of Complexity: You

Many managers are blind to the way their own actions unnecessarily increase complexity. Complexity-inducing behaviors can be hard to identify and to change, so it's a good idea to enlist the help of a trusted associate or an external coach who can provide a more objective perspective. Senior executives should also discuss their patterns of behavior with their management team, not just to get their input and support but also to model the process for their subordinates.

Micromanagement. Managers naturally want to feel in control and want to know what is going on in their organizations, but many insist upon an excessive level of detail, generating needless hours of work for their subordinates. At one consumer products company, the CEO held monthly operating reviews with senior leaders. When his successor dispensed with those meetings, it eliminated thousands of hours of work without compromising the corporation's ability to execute.

Ask *What review processes do you have in place? Do they focus on the right topics, at the right frequency? Can you simplify without reducing control?*

Poor meeting management. Most people know the rules: Have a clear purpose for a meeting, carefully select the attendees, send out an agenda, require preparation, manage the interactions, watch the time, leave with clear decisions, and spell out the next steps. Yet how many managers actually run meetings this way? In GlaxoSmithKline's pharmaceutical research organization, for example, the creation of very large, cross-functional drug development teams had spawned numerous meetings of teams and subteams – so many that some researchers were spending more time in meeting rooms than on project work. When Amber Salzman became head of development operations, she sponsored a "fit for purpose" initiative that required all team leaders to redesign their team memberships and their meetings and tailor them only to the issues required for that stage of drug development. That initiative saved thousands of hours of professional time and refocused many of the teams on what was most important for bringing their products to market.

Ask *How do you run meetings? Are all of them necessary? Can you apply meeting discipline more rigorously?*

Unclear, redundant, or conflicting assignments. In a perfect world, managers would give assignments that carefully spelled out the expected results, the timelines, and which other people would be involved. In reality, many assignments are given with little context or specificity – "go study this," for instance, "get this started," or "work with so-and-so on this and get back to me." It's also not unusual for a manager to give similar or overlapping assignments to different people without telling them. When subordinates get unclear or contradicting directions, all too often they end up tripping over one another and wasting their time and energy. That was the case when Nortel launched an initiative to increase sales force productivity, with different functions and regions all commissioning various projects that ultimately targeted the same set of people. When the telecom company's senior leaders realized how many complex but uncoordinated tasks were being given to the sales force, they directed a companywide "global sales effectiveness council" to pull the efforts together and serve as a governance body that would guide a simpler and more consolidated rollout process.

Ask *Do you have people working on intersecting or overlapping assignments? Do you have mechanisms to identify, combine, or coordinate such work?*

E-mail etiquette. It might seem relatively insignificant or innocuous, but e-mail overload is a serious source of organizational complexity. When you send large numbers of people a message that discusses issues many of them don't need to know about, you're just burdening your colleagues with low-value information that distracts them from important matters. A frequent culprit is the "reply all" button, which can create hundreds of e-mails, often about insignificant topics such as meeting schedules. Another source of complexity is the recirculation of documents in multiple drafts and redrafts. This creates extra work for the recipients, who must read and organize them, particularly if they must comply with document retention (and destruction) standards. Worse, recipients can become confused about which version is most current and make edits or comments on the wrong one – a waste of time and a source of potential errors.

Ask *Have you established protocols for e-mail behavior, electronic circulation of documents, and retention of materials?*

PowerPoint perfection. Presentations with charts and graphs have become the currency of decision making in many organizations. Well-done slides can focus the issues, present data quickly and clearly, and foster constructive dialogue, but presentations can overwhelm decision makers with data, arguments, and entertainment. Creating long, overloaded decks has become an industry in itself, taught and reinforced in business schools, and outsourced by consulting firms and other companies to experts in India who crank out data-loaded templates on a 24/7 basis. The result in many cases is what managers refer to as "death by PowerPoint" – presentations that are so long and complex that they bore their audience senseless. To counter this trend at Nortel, executive vice president Dennis Carey instituted the "one-minute drill" for presentations – forcing people to reduce their message to its essence, in slides that could be presented in only a minute.

Ask *To what extent has the "presentation culture" in your company obfuscated issues and slowed decision making? Have you created ways to reduce the size and complexity of presentations?*

products. Fidelity Investments managers do regular tours of duty on the firm's 800-number lines, so that they can hear directly from customers about their experiences. Fidelity also has a "product laboratory" where it tests new products and gets feedback about how easy they are to use. While Fidelity was shaping a web-based retirement planning service, it brought in current and potential customers from different demographic segments to explore the new tool and provide suggestions.

Engaging employees in simplification at the grassroots level can be powerful. At Nortel, employees generated 3,000 simplification and improvement ideas, implemented 900, and saved $14 million.

Royal Philips Electronics has a "simplicity advisory board" made up of outside experts who help the company create simplified offerings, such as instruction manuals that nontechnological consumers can understand.

Build disciplined processes. Once ConAgra had reorganized its enterprise functions and brand groups, it uncovered a set of processes that resembled a postconstruction Tower of Babel. It had sales reports with massive amounts of data that ran hundreds of pages, but the newly united finance function couldn't analyze them because brands each had different units of sale – pounds, pallets, cartons, dollars, shipments, cans, and more. Similarly, ConAgra's supply chain managers had to negotiate the purchase of dozens of sizes of cans, requiring different procedures, vendors, and manufacturing processes. Even ingredients were overly complex; the company was using 12 types of carrots, for instance.

Those processes had to be examined and rewired (or eliminated) one at a time. But Rodkin and his team knew that if it were to stick, process simplification had to become an ongoing activity. So they introduced an initiative similar to the GE Work-Out, called RoadMap, which brought together people from across the company to redesign critical processes.

An early RoadMap simplified financial processes by establishing a uniform reporting protocol for units of measure (such as pounds or kilograms), product units (such as cans or cartons), and organization units (division, brand, or subbrand). For two days representatives of the consumer brand operating groups, the commercial businesses, and the enterprise functions – more than 60 people in all – debated these standards with one simple ground rule: By the end of the second day they would come to a single decision by which they would all abide. And if they couldn't come to a decision, then the CEO or CFO would decide. As it turned out, the group did reach consensus, which allowed finance and IT to spend the next several months building a truly companywide reporting system that was successfully launched in October 2006, exactly one year after Rodkin had joined ConAgra.

By the end of the year, after dozens of RoadMap sessions, ConAgra had in place a far simpler set of enterprisewide processes – for reporting, planning, capital expenditures, new product development and introduction, performance management, and more. In addition, many of the process rewiring efforts had produced substantial savings. For example, simplified processes allowed corporate HR to reduce the number of its staff members who processed forms and paperwork in the field, while doubling the number of employees doing these transactions through the centralized HR business center – without adding any head count in the center. In the Canadian division, an effort focused on simplifying ways of managing discontinued products, ordering raw and packaging materials, and tracking inventory reduced inventory write-offs by $1.5 million. By this point more than 1,000 ConAgra employees had participated in simplification initiatives – either in RoadMap sessions or on implementation teams – so that a cultural embrace of simplicity was starting to happen. Rodkin and his senior team reinforced that shift by continually beating the drum about simplicity in speeches, town hall meetings, employee lunches, and videos.

Engaging employees across the organization in process simplification, particularly at the grassroots level, can be powerful. People at all levels become more likely to step up and correct a problem before it gums up the works. At Nortel, CEO Mike Zafirovski and EVP Dennis Carey created a two-hour workshop called Own-It, in which teams of employees were taught simple Six Sigma tools like DMAIC, Process Maps, Fishbone, and Pareto. Employees were then asked to identify processes that they "owned" and could simplify. If the process cut across areas outside their control, they were encouraged to fix what they could and then engage others as needed. In a little over a year, Nortel trained 2,700 people to lead these workshops, and 25,000 employees participated in at least one. Employees generated 3,000 simplification and improvement ideas, implemented 900, and saved $14 million. More important, a culture of continuous process improvement and simplification developed at the company.

Improve managerial habits. If managers are serious about reducing complexity, they need to identify how their own (often unintentional) patterns of behavior complicate matters, and make a personal commitment to simplification.

As part of the change effort at ConAgra, Gary Rodkin invited his senior team to suggest how he himself could manage in a simpler, more effective manner. One thing he learned was that he occasionally failed to specify which person should take the lead on a cross-functional or cross-unit issue. That created what the team called "jump balls": multiple executives' assuming that they had the lead or that someone else did. Team members would then jockey to catch the ball, creating confusion; or in some cases, no one tried to get it. For instance, an innovative product idea that used commercial food technology but would be introduced in the frozen foods business was held up because it was unclear whether an executive from R&D or one from the consumer sector should lead the effort. After discussing this tendency with the rest of the leadership team, Rodkin was able to reduce the frequency of jump balls and simplify the resolution of critical issues. He also realized that this seemingly innocuous pattern had been replicated in some of the management teams the next level down and was creating complexity there. So working on it with his team as a collective issue had a powerful impact far beyond Rodkin's own behavior.

ConAgra's CEO declared simplicity, accountability, and collaboration to be key priorities – ones that would constitute 50% of the performance review criteria for managers.

...

It sounds paradoxical, but making your organization simple and keeping it that way takes a lot of hard work. It requires an explicit strategy and vigilant attention over time. However, simplicity must be more than a feel-good theme; the four elements of a simplification strategy will be effective only if positioned as business imperatives. ConAgra's Rodkin made it clear to his managers and associates, as soon as he arrived, that the company's complexity was driving up costs, hurting profit margins, and hindering the ability to invest in growth opportunities. He set specific cost-reduction targets that were clearly tied to eliminating duplication, and he publicly declared simplicity, accountability, and collaboration to be key priorities – ones that would constitute 50% of the performance review criteria for managers.

Similarly, when Peter Löscher became chief executive of Siemens, in 2007, he set out to simplify an overly complicated structure that may have allowed managers to hide improper payments, contributing to financial irregularities. He made a commitment to creating a more streamlined, transparent structure, as well as a less complex product portfolio. And then there's Mike Zafirovski at Nortel. He used "Business Made Simple" as his galvanizing theme shortly after he became CEO, in 2005, and translated it into a set of ambitious goals for reducing costs, speeding up product development and delivery, taking the complexity out of networks, and making it easy for customers to harness the latest technologies. Zafirovski made simplicity the foundation for the company's strategy across its business – from R&D, to marketing, to customer service, to choosing strategic partners, to mergers and acquisitions.

It's a given that senior executive support is vital to the success of any change initiative. But it's easy to give short shift to notions that seem "soft," like simplicity. These CEOs made simplicity a mandatory, "hard" objective, which is the only way it can get any traction.

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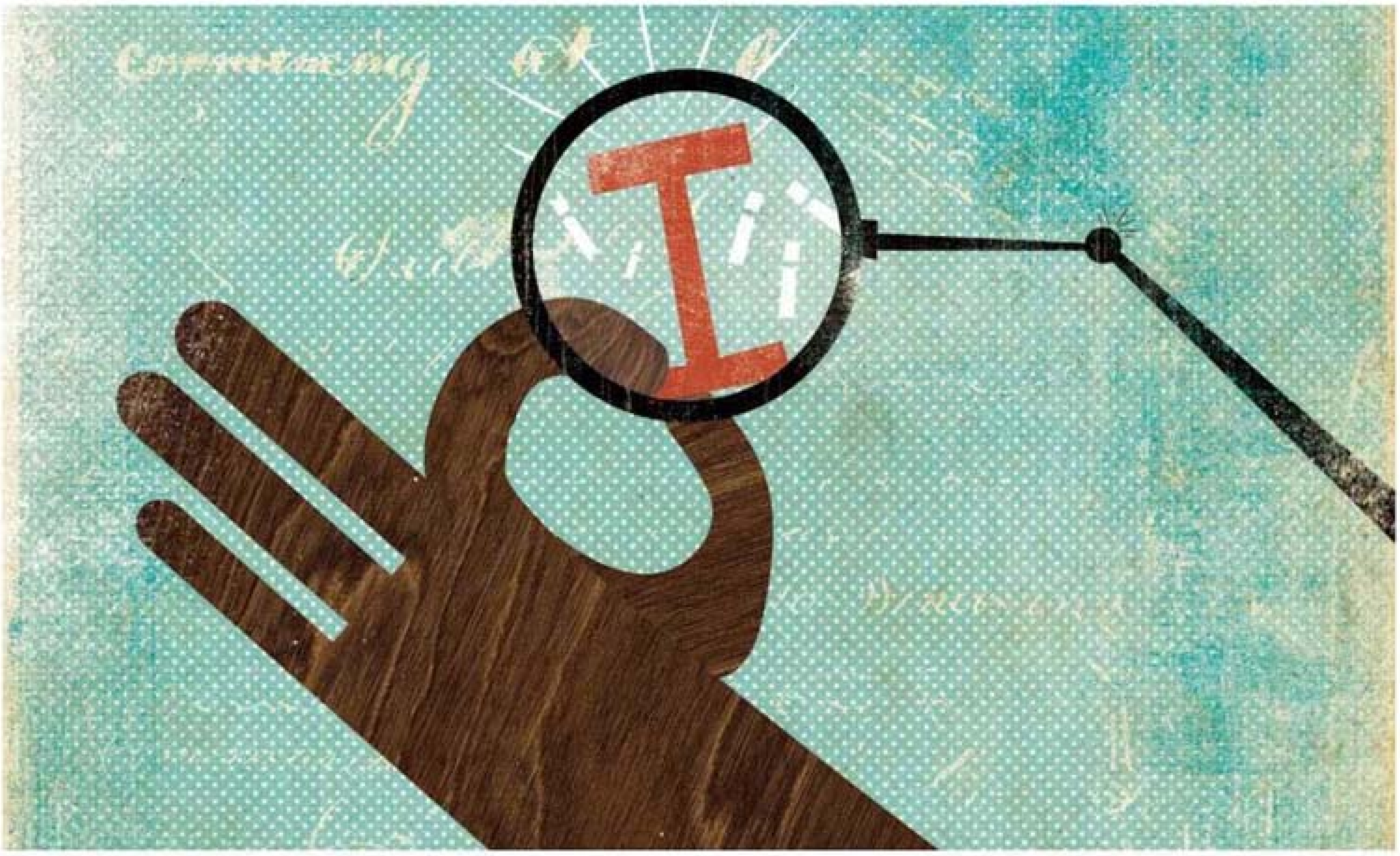
To order, see page 147.



Is It Real? Can We Win? Is It Worth Doing?

Managing Risk and Reward in an Innovation Portfolio

by George S. Day

MINOR INNOVATIONS MAKE UP 85% to 90% of companies' development portfolios, on average, but they rarely generate the growth companies seek. At a time when companies should be taking bigger – but smart – innovation risks, their bias is in the other direction. From 1990 to 2004 the percentage of major innovations in development portfolios dropped from 20.4 to 11.5 – even as the number of growth initiatives rose.[1] The result is internal traffic jams of safe, incremental innovations that delay all projects, stress organizations, and fail to achieve revenue goals.

These small projects, which I call "little i" innovations, are necessary for continuous improvement, but they don't give companies a competitive edge or contribute much to profitability. It's the risky "Big I" projects – new to the company or new to

Andrew Bannecker

the world – that push the firm into adjacent markets or novel technologies and can generate the profits needed to close the gap between revenue forecasts and growth goals. (According to one study, only 14% of new-product launches were substantial innovations, but they accounted for 61% of all profit from innovations among the companies examined.)[2]

The aversion to Big I projects stems from a belief that they are too risky and their rewards (if any) will accrue too far in the future. Certainly the probability of failure rises sharply when a company ventures beyond incremental initiatives within familiar markets. But avoiding risky projects altogether can strangle growth. The solution is to pursue a disciplined, systematic process that will distribute your innovations more evenly across the spectrum of risk.

Two tools, used in tandem, can help companies do this. The first, the risk matrix, will graphically reveal risk exposure across an entire innovation portfolio. The second, the R-W-W ("real, win, worth it") screen, sometimes known as the Schrello screen, can be used to evaluate individual projects. Versions of the screen have been circulating since the 1980s, and since then a growing roster of companies, including General Electric, Honeywell, Novartis, Millipore, and 3M, have used them to assess business potential and risk exposure in their innovation portfolios; 3M has used R-W-W for more than 1,500 projects. I have expanded the screen and used it to evaluate dozens of projects at four global companies, and I have taught executives and Wharton students how to use it as well.

Although both tools, and the steps within them, are presented sequentially here, their actual use is not always linear. The information derived from each one can often be reapplied in later stages of development, and the two tools may inform each other. Usually, development teams quickly discover when and how to improvise on the tools' structured approach in order to maximize learning and value.

The Risk Matrix

To balance its innovation portfolio, a company needs a clear picture of how its projects fall on the spectrum of risk. The risk matrix employs a unique scoring system and calibration of risk to help estimate the probability of success or failure for each project based on how big a stretch it is for the firm: The less familiar the intended market (x axis) and the product or technology (y axis), the higher the risk. (See the exhibit "Assessing Risk Across an Innovation Portfolio.")

A project's position on the matrix is determined by its score on a range of factors, such as how closely the behavior of targeted customers will match that of the company's current customers, how relevant the company's brand is to the intended market, and how applicable its technology capabilities are to the new product.

A portfolio review team – typically consisting of senior managers with strategic oversight and authority over development budgets and allocations – conducts the evaluation, with the support of each project's development team. Team members rate each project independently and then explain their rationale. They discuss reasons for any differences of opinion and seek consensus. The resulting scores serve as a project's coordinates on the risk matrix.

The determination of each score requires deep insights. When McDonald's attempted to offer pizza, for example, it assumed that the new offering was closely adjacent to its existing ones, and thus targeted its usual customers. Under that assumption, pizza would be a familiar product for the present market and would appear in the bottom left of the risk matrix. But the project failed, and a postmortem showed that the launch had been fraught with risk: Because no one could figure out how to make and serve a pizza in 30 seconds or less, orders caused long backups, violating the McDonald's service-delivery model. The postmortem also revealed that the company's brand didn't give "permission" to offer pizza. Even though its core fast-food customers were demographically similar to pizza lovers, their expectations about the McDonald's experience didn't include pizza.

Once the risk matrix has been completed, it typically reveals two things:

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Article at a Glance

Minor innovations typically make up most of a company's development portfolio, but they will never generate the growth companies seek. To address this shortfall, companies should undertake a systematic, disciplined review of their innovation portfolios and increase the proportion of major innovations while carefully managing the risk. Two tools can help them do so.

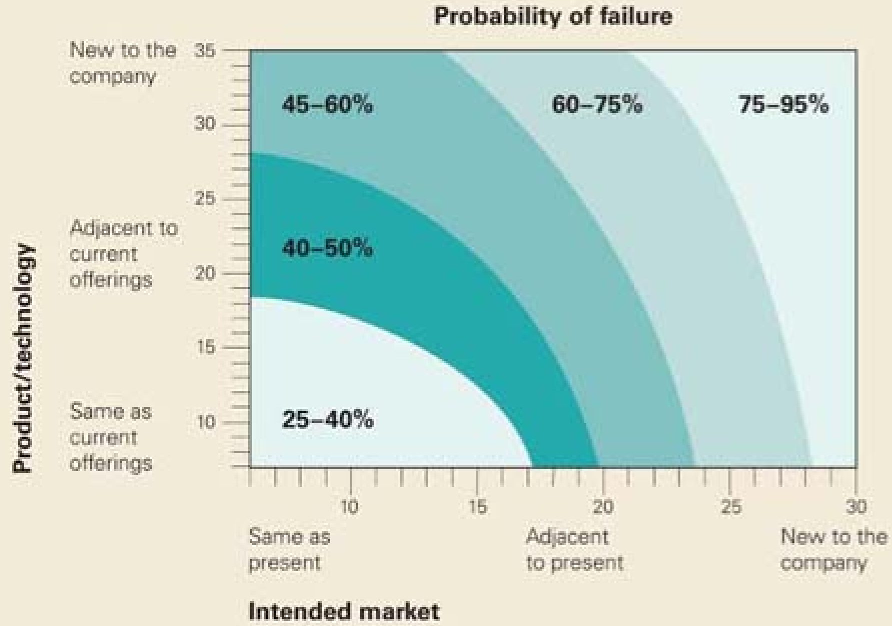
The risk matrix will graphically reveal the distribution of risk across a company's innovation portfolio, showing each project's probability of success or failure based on how big a stretch it is for the firm. The less familiar the intended market and the product or technology, the higher the risk.

The R-W-W ("real, win, worth it") screen allows companies to evaluate the risks and potential of individual projects by answering questions in three broad topic areas: "Is it real?" explores the nature of the potential market and looks at the feasibility of building the product. "Can we win?" considers whether the innovation and the company can be competitive. "Is it worth doing?" examines the profit potential and whether developing the innovation makes strategic sense.

Assessing Risk Across an Innovation Portfolio

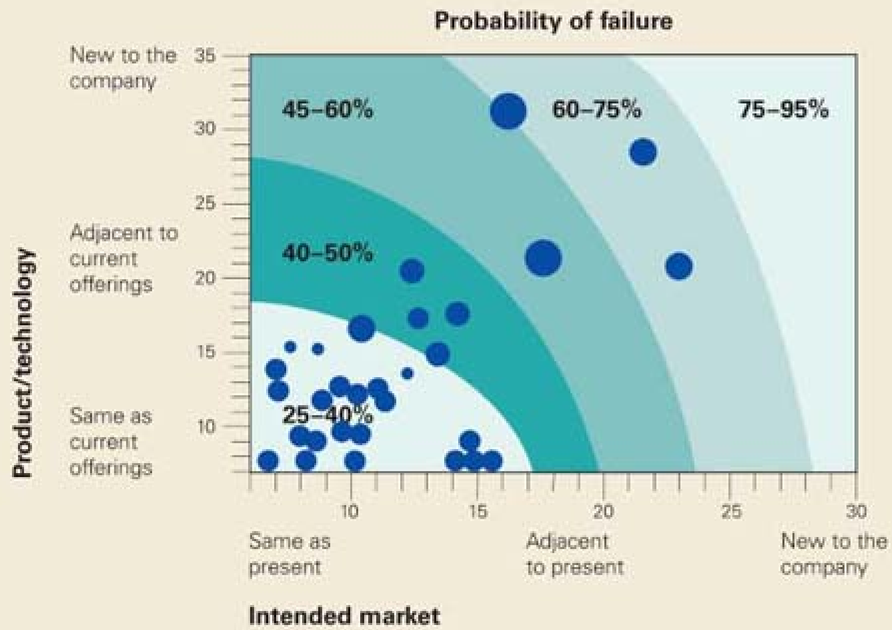
The Risk Matrix*

This tool will reveal the distribution of risk across a company's innovation portfolio. Each innovation can be positioned on the matrix by determining its score on two dimensions – how familiar to the company the intended market is (*x* axis) and how familiar the product or technology is (*y* axis) – using the grid opposite ("Positioning Projects on the Matrix"). Familiar products aimed at the company's current markets will fall in the bottom left of the matrix, indicating a low probability of failure. New products aimed at unfamiliar markets will fall in the upper right, revealing a high probability of failure.



Risk and Revenue

Each dot on this risk matrix stands for one innovation in an imaginary company's portfolio. The size of each dot is proportional to the project's estimated revenue. (Companies may choose to illustrate estimated development investment or some other financial measure instead.) This portfolio, dominated by relatively low-risk, low-reward projects, is typical in its distribution.



*This risk matrix was developed from many sources, including long-buried consulting reports by A.T. Kearney and other firms, the extensive literature on the economic performance of acquisitions and alliances, and numerous audits of product and service innovations. It broadly defines "failure" as significantly missing the objectives that were used to justify the investment in the growth initiative. Estimates of the probability of failure have been thoroughly validated in dozens of interviews with consultants and senior managers involved in innovation initiatives and are consistent with recent surveys that place the overall failure rate of new products close to 40%. The ranges in probabilities take into account some of the variability in organizations' definitions of failure and in what constitutes a new market or technology for a given company. The probabilities do not apply to fast-moving consumer goods (where incremental innovations have high long-run failure rates) or ethical pharmaceuticals, and don't distinguish whether "new to the company" is also "new to the world." (Although these are distinct categories, in my experience most major new-to-the-company innovations are also new to the world; for the purposes of this article, they're considered to be broadly overlapping.) "Market" refers to customers, not geographies.

Positioning Projects on the Matrix

Position each innovation product or concept by completing each statement in the left-hand column with one of the options offered across the top to arrive at a score from 1 to 5. Add the six scores in the "Intended Market" section to determine the project's *x*-axis coordinate on the risk matrix. Add the seven scores in the "Product/Technology" section to determine its *y*-axis coordinate.

	Intended Market					
	...be the same as in our present market		...partially overlap with our present market		...be entirely different from our present market or are unknown	
Customers' behavior and decision-making processes will...	1	2	3	4	5	
Our distribution and sales activities will...	1	2	3	4	5	
The competitive set (incumbents or potential entrants) will...	1	2	3	4	5	
	...highly relevant		...somewhat relevant		...not at all relevant	
Our brand promise is...	1	2	3	4	5	
Our current customer relationships are...	1	2	3	4	5	
Our knowledge of competitors' behavior and intentions is...	1	2	3	4	5	
					TOTAL (*x*-axis coordinate)	

	Product/Technology					
	...is fully applicable		...will require significant adaptation		...is not applicable	
Our current development capability...	1	2	3	4	5	
Our technology competency...	1	2	3	4	5	
Our intellectual property protection...	1	2	3	4	5	
Our manufacturing and service delivery system...	1	2	3	4	5	
	...are identical to those of our current offerings		...overlap somewhat with those of our current offerings		...completely differ from those of our current offerings	
The required knowledge and science bases...	1	2	3	4	5	
The necessary product and service functions...	1	2	3	4	5	
The expected quality standards...	1	2	3	4	5	
					TOTAL (*y*-axis coordinate)	

that a company has more projects than it can manage well, and that the distribution of Big I and little i innovations is lopsided. Most companies will find that the majority of their projects cluster in the bottom left quadrant of the matrix, and a minority skew toward the upper right.

This imbalance is unhealthy if unsurprising. Discounted cash flow analysis and other financial yardsticks for evaluating development projects are usually biased against the delayed payoffs and uncertainty inherent in Big I innovations. What's more, little i projects tend to drain R&D budgets as companies struggle to keep up with customers' and salespeople's demands for a continuous flow of incrementally improved products. The risk matrix creates a visual starting point for an ongoing dialogue about the company's mix of projects and their fit with strategy and risk tolerance. The next step is to look closely at each project's prospects in the marketplace.

Screening with R-W-W

The R-W-W screen is a simple but powerful tool built on a series of questions about the innovation concept or product, its potential market, and the company's capabilities and competition (see the exhibit "Screening for Success"). It is not an algorithm for making go/no-go decisions but, rather, a disciplined process that can be employed at multiple stages of product development to expose faulty assumptions, gaps in knowledge, and potential sources of risk, and to ensure that every avenue for improvement has been explored. The R-W-W screen can be used to identify and help fix problems that are miring a project, to contain risk, and to expose problems that can't be fixed and therefore should lead to termination.

Innovation is inherently messy, nonlinear, and iterative. For simplicity, this article focuses on using the R-W-W screen in the early stages to test the viability of product concepts. In reality, however, a given product would be screened repeatedly during development – at the concept stage, during prototyping, and early in the launch planning. Repeated assessment allows screeners to incorporate increasingly detailed product, market, and financial analyses into the evaluation, yielding ever more accurate answers to the screening questions.

R-W-W guides a development team to dig deeply for the answers to six fundamental questions: *Is the market real? Is the product real? Can the product be competitive? Can our company be competitive? Will the product be profitable at an acceptable risk? Does launching the product make strategic sense?*

The development team answers these queries by exploring an even deeper set of supporting questions. The team determines where the answer to each question falls on a continuum ranging from definitely yes to definitely no. A definite no to any of the first five fundamental questions typically leads to termination of the project, for obvious reasons. For example, if the consensus answer to *Can the product be competitive?* is a definite no, and the team can imagine no way to change it to a yes (or even a maybe), continuing with development is irrational. When a project has passed all other tests in the screen, however, and thus is a very good business bet, companies are sometimes more forgiving of a no to the sixth question, *Does launching the product make strategic sense?*

The ability to crystallize the market concept is far more important than how well a company fields a fundamentally new product or technology.

This article will delineate the screening process and demonstrate the depth of probing needed to arrive at valid answers. What follows is not, of course, a comprehensive guide to all the issues that might be raised by each question. Development teams can probe more or less deeply, as needed, at each decision point. (For more on team process, see the sidebar "The Screening Team.")

Is it Real?

Figuring out whether a market exists and whether a product can be made to satisfy that market are the first steps in screening a product concept. Those steps will indicate the degree of opportunity for any firm considering the potential market, so the inquiring company can assess how competitive the environment might be right from the start.

One might think that asking if the envisioned product is even a possibility should come before investigating the potential market. But establishing that the market is real takes precedence for two reasons: First, the robustness of a market is almost always less certain than the technological ability to make something. This is one of the messages of the risk matrix, which shows that the probability of a product failure becomes greater when the *market* is unfamiliar to the company than when the *product or technology* is unfamiliar. A company's ability to crystallize the market concept – the target segment and how the product can do a better job of meeting its needs – is far more important than how well the company fields a fundamentally new product or technology. In fact, research by Procter & Gamble suggests that 70% of product failures across most categories occur because companies misconstrue the

Screening for Success

Each product concept in your company's innovation portfolio should be assessed by its development team using the R-W-W screen below. A definite yes or no answer to the first-column questions *Is it real?*, *Can we win?*, and *Is it worth doing?* requires digging deeply for robust answers to the supporting questions in the second and third columns. Often a team will answer maybe; its goal should be to investigate all possible avenues to converting no or maybe into yes. A definite no to any second-column question typically leads to termination of the project, since failure is all but certain. A definite no to any third-column question argues strongly against proceeding with development. (The full set of questions in columns two and three of the screen come from evaluations of more than 50 product failures within two companies I worked with by teams of auditors who asked, "What questions, properly answered, might have prevented the failure?")

Is it real?	**Is the market real?**	Is there a need or desire for the product? Can the customer buy it? Is the size of the potential market adequate? Will the customer buy the product?
	Is the product real?	Is there a clear concept? Can the product be made? Will the final product satisfy the market?
Can we win?	**Can the product be competitive?**	Does it have a competitive advantage? Can the advantage be sustained? How will competitors respond?
	Can our company be competitive?	Do we have superior resources? Do we have appropriate management? Can we understand and respond to the market?
Is it worth doing?	**Will the product be profitable at an acceptable risk?**	Are forecasted returns greater than costs? Are the risks acceptable?
	Does launching the product make strategic sense?	Does the product fit our overall growth strategy? Will top management support it?

market. New Coke is a classic market-concept failure; Netflix got the market concept right. In each case the outcome was determined by the company's understanding of the market, not its facility with the enabling technologies.

Second, establishing the nature of the market can head off a costly "technology push." This syndrome often afflicts companies that emphasize how to solve a problem rather than what problem should be solved or what customer desires need to be satisfied. Segway, with its Personal Transporter, and Motorola, with its Iridium satellite phone, both succumbed to technology push. Segway's PT was an ingenious way to gyroscopically stabilize a two-wheeled platform, but it didn't solve the mobility problems of any target market. The reasons for Iridium's demise are much debated, but one possibility is that mobile satellite services proved less able than terrestrial wireless roaming services to cost-effectively meet the needs of most travelers.

Segway's Personal Transporter was an ingenious way to gyroscopically stabilize a two-wheeled platform, but it didn't solve the mobility problems of any target market.

Whether the market and the product are real should dominate the screening dialogue early in the development process, especially for Big I innovations. In the case of little i innovations, a close alternative will already be on the market, which has been proved to be real.

Is the market real? A market opportunity is real only when four conditions are satisfied: The proposed product will clearly meet a need or solve a problem better than available alternatives; customers are able to buy it; the potential market is big enough to be worth pursuing; and customers are willing to buy the product.

Is there a need or desire for the product? Unmet or poorly satisfied needs must be surfaced through market research using observational, ethnographic, and other tools to explore customers' behaviors, desires, motivations, and frustrations. Segway's poor showing is partly a market-research failure; the company didn't establish at the outset that consumers actually had a need for a self-balancing two-wheeled transporter.

Once a need has been identified, the next question is, *Can the customer buy it?* Even if the proposed product would satisfy a need and offer superior value, the market isn't real when there are objective barriers to purchasing it. Will budgetary constraints prevent customers from buying? (Teachers and school boards, for example, are always eager to invest in educational technologies but often can't find the funding.) Are there regulatory requirements that the new product may not meet? Are customers bound by contracts that would prevent them from switching to a new product? Could manufacturing or distribution problems prevent them from obtaining it?

The team next needs to ask, *Is the size of the potential market adequate?* It's dangerous to venture into a "trombone oil" market, where the product may provide distinctive value that satisfies a need, but the need is minuscule. A market opportunity isn't real unless there are enough potential buyers to warrant developing the product.

Finally, having established customers' need and ability to buy, the team must ask, *Will the customer buy the product?* Are there subjective barriers to purchasing it? If alternatives to the product exist, customers will evaluate them and consider, among other things, whether the new product delivers greater value in terms of features, capabilities, or cost.

The Screening Team

Project screening teams vary by company, type of initiative, and stage of development. Over the course of R-W-W screening, teams typically involve members from across functions, including R&D, marketing, and manufacturing. They should also work with senior managers who are familiar with the screen and have the expertise and the instincts to push dispassionately for accurate answers, particularly at each decision point during development. At the same time, however, these managers should be sympathetic and willing to provide the team with the resources to fill information gaps.

A critical job in managing the R-W-W process is preventing teams from regarding the screen as an obstacle to be overcome or circumvented. It's also important that the team not regard the screen as simply a go/no-go tool imposed by management – a potential threat to a favorite project. Such a misperception will subvert proper use of the screen as a learning tool for revealing dubious assumptions and identifying problems and solutions.

Because the members of the development team are both evaluators and advocates, the screen is vulnerable to misuse and manipulation. Team members' convictions about the merits of the project may lead them to make cursory evaluations if they fear that a deep assessment, including a frank voicing of doubts, might imperil the project. One way to avoid this pitfall is to enlist a credible outside facilitator, perhaps someone from another part of the company who has a solid new-product track record and no stake in the outcome. This person's job should be to unearth all the key uncertainties, information gaps, and differences of opinion and help resolve them.

Improved value doesn't necessarily mean more capabilities, of course. Many Big I innovations, such as the Nintendo Wii, home defibrillators, and Salesforce .com's CRM software as a service, have prevailed by outperforming the incumbents on a few measures while being merely adequate on others. By the same token, some Big I innovations have stumbled because although they had novel capabilities, customers didn't find them superior to the incumbents.

Even when customers have a clear need or desire, old habits, the perception that a switch is too much trouble, or a belief that the purchase is risky can inhibit them. One company encountered just such a problem during the launch of a promising new epoxy for repairing machine parts during routine maintenance. Although the product could prevent costly shutdowns and thus offered unique value, the plant engineers and production managers at whom it was targeted vetoed its use. The engineers wanted more proof of the product's efficacy, while the production managers feared that it would damage equipment. Both groups were risk avoiders. A postmortem of the troubled launch revealed that maintenance people, unlike plant engineers and production managers, like to try new solutions. What's more, they could buy the product independently out of their own budgets, circumventing potential vetoes from higher up. The product was relaunched targeting maintenance and went on to become successful, but the delay was expensive and could have been avoided with better screening.

Customers may also be inhibited by a belief that the product will fail to deliver on its promise or that a better alternative might soon become available. Addressing this reluctance requires foresight into the possibilities of improvement among competitors. The prospects of third-generation (3G) mobile phones were dampened by enhancements in 2.5G phones, such as high-sensitivity antennae that made the incumbent technology perform much better.

It's dangerous to venture into a "trombone oil" market, where the product may provide distinctive value that satisfies a need, but the need is minuscule.

Is the product real? Once a company has established the reality of the market, it should look closely at the product concept and expand its examination of the intended market.

Is there a clear concept? Before development begins, the technology and performance requirements of the concept are usually poorly defined, and team members often have diverging ideas about the product's precise characteristics. This is the time to expose those ideas and identify exactly what is to be developed. As the project progresses and the team becomes immersed in market realities, the requirements should be clarified. This entails not only nailing down technical specifications but also evaluating the concept's legal, social, and environmental acceptability.

Can the product be made? If the concept is solid, the team must next explore whether a viable product is feasible. Could it be created with available technology and materials, or would it require a breakthrough of some sort? If the product can be made, can it be produced and delivered cost-effectively, or would it be so expensive that potential customers would shun it? Feasibility also requires either that a value chain for the proposed product exists or that it can be easily and affordably developed, and that de facto technology standards (such as those ensuring compatibility among products) can be met.

Some years ago the R-W-W screen was used to evaluate a radical proposal to build nuclear power–generating stations on enormous floating platforms moored offshore. Power companies were drawn to the idea, because it solved both cooling and not-in-my-backyard problems. But the team addressing the *Is the product real?* stage of the process found that the inevitable flexing of the giant platforms would lead to metal fatigue and joint wear in pumps and turbines. Since this problem was deemed insurmountable, the team concluded that absent some technological breakthrough, the no answer to the feasibility question could never become even a maybe, and development was halted.

Will the final product satisfy the market? During development, trade-offs are made in performance attributes; unforeseen technical, manufacturing, or systems problems arise; and features are modified. At each such turn in the road, a product designed to meet customer expectations may lose some of its potential appeal. Failure to monitor these shifts can result in the launch of an offering that looked great on the drawing board but falls flat in the marketplace.

Consider the ongoing disappointment of e-books. Even though the newest entrant, the Sony Reader, boasts a huge memory and breakthrough display technology, using it doesn't begin to compare with the experience of reading conventional books. The promised black-on-white effect is closer to dark gray on light gray. Meanwhile, the Reader's unique features, such as the ability to store many volumes and to search text, are for many consumers insufficiently attractive to offset the near $300 price tag. Perhaps most important, consumers are well satisfied with ordinary books. By July of 2007 the entire e-book category had reached only $30 million in sales for the year.

Can We Win?

After determining that the market and the product are both real, the project team must assess the company's ability to gain and hold an adequate share of the market. Simply finding a real opportunity doesn't guarantee success: The more real the opportunity, the more likely it is that hungry competitors are eyeing it. And if the market is already established, incumbents will defend their positions by copying or leapfrogging any innovations.

Two of the top three reasons for new-product failures, as revealed by audits, would have been exposed by the *Can we win?* analysis: Either the new product didn't achieve its market-share goals, or prices dropped much faster than expected. (The third reason is that the market was smaller, or grew more slowly, than expected.)

The questions at this stage of the R-W-W screening carefully distinguish between the offering's ability to succeed in the marketplace and the company's capacity – through resources and management talent – to help it do so.

Can the product be competitive? Customers will choose one product over alternatives if it's perceived as delivering superior value with some combination of benefits such as better features, lower life-cycle cost, and reduced risk. The team must assess all sources of perceived value for a given product and consider the question *Does it have a competitive advantage?* (Here the customer research that informed the team's evaluation of whether the market and the product were real should be drawn on and extended as needed.) Can someone else's offering provide customers with the same results or benefits? One company's promising laminate technology, for instance, had intrigued technical experts, but the launch failed because the customers' manufacturing people had found other, cheaper ways to achieve the same improvement. The team should also consider whether the product offers additional tangible advantages – such as lifetime cost savings, greater safety, higher quality, and lower maintenance or support needs – or intangible benefits, such as greater social acceptability (think of hybrid cars and synthetic-fur coats) and the promise of reduced risk that is implicit in a trusted brand name.

Can the advantage be sustained? Competitive advantage is only as good as the company's ability to keep imitators at bay. The first line of defense is patents. The project team should evaluate the relevance of its existing patents to the product in development and decide what additional patents may be needed to protect related intellectual property. It should ask whether a competitor could reverse engineer the product or otherwise circumvent patents that are essential to the product's success. If maintaining advantage lies in tacit organizational knowledge, can that knowledge be protected? For example, how can the company ensure that the people who have it will stay? What other barriers to imitation are possible? Can the company lock up scarce resources or enter into exclusive supply contracts?

Consider the case of 3M's computer privacy screen. Although the company's microlouver technology promised unique privacy benefits, its high price threatened to limit sales to a small market niche, making the project's status uncertain. An R-W-W screening, however, revealed that the technology was aggressively patented, so no competitor could imitate its performance. It also clarified an opportunity in adjacent markets for antiglare filters for computers. Armed with these insights, 3M used the technology to launch a full line of privacy and antiglare screens while leveraging its brand equity and sales presence in the office-products market. Five years later the product line formed the basis of one of 3M's fastest-growing businesses.

How will competitors respond? Assuming that patent protection is (or will be) in place, the project team needs to investigate competitive threats that patents can't deflect. A good place to start is a "red team" exercise: If we were going to attack our own product, what vulnerabilities would we find? How can we reduce them? A common error companies make is to assume that competitors will stand still while the new entrant fine-tunes its product prior to launch. Thus the team must consider what competing products will look like when the offering is introduced, how competitors may react after the launch, and how the company could respond. Finally, the team should examine the possible effects of this competitive interplay on prices. Would the product survive a sustained price war?

If the company doesn't have superior resources, addressing the deficiency is often straightforward. When the U.S. market leader for high-efficiency lighting products wanted to expand into the local-government market, for example, it recognized two barriers: The company was unknown to the buyers, and it had no experience with the competitive bidding process they used. It overcame these problems by hiring people who were skilled at analyzing competitors, anticipating their likely bids, and writing proposals. Some of these people came from the competition, which put the company's rivals at a disadvantage.

Sometimes, though, deficiencies are more difficult to overcome, as is the case with brand equity. As part of its inquiry into resources, the project team must ask whether the company's brand

A common error companies make is to assume that competitors will stand still while the new entrant fine-tunes its product prior to launch.

Can our company be competitive? After establishing that the offering can win, the team must determine whether or not the company's resources, management, and market insight are better than those of the competition. If not, it may be impossible to sustain advantage, no matter how good the product.

Do we have superior resources? The odds of success increase markedly when a company has or can get resources that both enhance customers' perception of the new product's value and surpass those of competitors. Superior engineering, service delivery, logistics, or brand equity can give a new product an edge by better meeting customers' expectations. The European no-frills airline easyJet, for example, has successfully expanded into cruises and car rentals by leveraging its ability to blend convenience, low cost, and market-appropriate branding to appeal to small-business people and other price-sensitive travelers.

provides – or denies – permission to enter the market. The 3M name gave a big boost to the privacy screen because it is strongly associated with high-quality, innovative office supplies – whereas the McDonald's name couldn't stretch to include pizza. Had the company's management asked whether its brand equity was both relevant and superior to that of the competition – such as Papa Gino's – the answer would have been equivocal at best.

Do we have appropriate management? Here the team must examine whether the organization has direct or related experience with the market, whether its development-process skills are appropriate for the scale and complexity of the project, and whether the project both fits company culture and has a suitable champion. Success requires a passionate cheerleader who will energize the team, sell the vision to senior management, and overcome skepticism or adversity along the way. But because enthusiasm can blind champions to potentially crippling faults and lead to a biased search for evidence that confirms a project's viability, their advocacy must be constructively challenged throughout the screening process.

Can we understand and respond to the market? Successful product development requires a mastery of market-research tools, an openness to customer insights, and the ability to share them with development-team members. Repeatedly seeking the feedback of potential customers to refine concepts, prototypes, and pricing ensures that products won't have to be recycled through the development process to fix deficiencies.

Most companies wait until after development to figure out how to price the new product – and then sometimes discover that customers won't pay. Procter & Gamble avoids this problem by including pricing research early in the development process. It also asks customers to actually buy products in development. Their answers to *whether* they would buy are not always reliable predictors of future purchasing behavior.

Is It Worth Doing?

Just because a project can pass the tests up to this point doesn't mean it is worth pursuing. The final stage of the screening provides a more rigorous analysis of financial and strategic value.

Will the product be profitable at an acceptable risk? Few products launch unless top management is persuaded that the answer to *Are forecasted returns greater than costs?* is definitely yes. This requires projecting the timing and amount of capital outlays, marketing expenses, costs, and margins; applying time to breakeven, cash flow, net present value, and other standard financial-performance measures; and estimating the profitability and cash flow from both aggressive and cautious launch plans. Financial projections should also include the cost of product extensions and enhancements needed to keep ahead of the competition.

Forecasts of financial returns from new products are notoriously unreliable. Project managers know they are competing with other worthy projects for scarce resources and don't want theirs to be at a disadvantage. So it is not surprising that project teams' financial reports usually meet upper management's financial-performance requirements. Given the susceptibility of financial forecasts to manipulation, overconfidence, and bias, executives should depend on rigorous answers to the prior questions in the screen for their conclusions about profitability.

Are the risks acceptable? A forecast's riskiness can be initially assessed with a standard sensitivity test: How will small changes in price, market share, and launch timing affect cash flows and breakeven points? A big change in financial results stemming from a small one in input assumptions indicates a high degree of risk. The financial analysis should consider opportunity costs: Committing resources to one project may hamper the development of others.

To understand risk at a deeper level, consider all the potential causes of product failure that have been unearthed by the R-W-W screen and devise ways to mitigate them – such as partnering with a company that has market or technology expertise your firm lacks.

Does launching the product make strategic sense? Even when a market and a concept are real, the product and the company could win, and the project would be profitable, it may not make strategic sense to launch. To evaluate the strategic rationale for development, the project team should ask two more questions.

Does the product fit our overall growth strategy? In other words, will it enhance the company's capabilities by, for example, driving the expansion of manufacturing, logistics, or other functions? Will it have a positive or a negative impact on brand equity? Will it cannibalize or improve sales of the company's existing products? (If the former, is it better to cannibalize one's own products than to lose sales to competitors?) Will it enhance or harm relationships with stakeholders – dealers, distributors, regulators, and so forth? Does the project create opportunities for follow-on business or new markets that would not be possible otherwise? (Such an opportunity helped 3M decide to launch its privacy screen: The product had

The 3M name gave a big boost to the privacy screen, whereas the McDonald's name couldn't stretch to include pizza.

only a modest market on its own, but the launch opened up a much bigger market for antiglare filters.) These questions can serve as a starting point for what must be a thorough evaluation of the product's strategic fit. A discouraging answer to just one of them shouldn't kill a project outright, but if the overall results suggest that a project makes little strategic sense, the launch is probably ill-advised.

Will top management support it? It's certainly encouraging for a development team when management commits to the initial concept. But the ultimate success of a project is better assured if management signs on because the project's assumptions can withstand the rigorous challenges of the R-W-W screen.

1. Robert G. Cooper, "Your NPD Portfolio May Be Harmful to Your Business Health," *PDMA Visions*, April 2005.

2. W. Chan Kim and Renée Mauborgne, "Strategy, Value Innovation, and the Knowledge Economy," *Sloan Management Review*, Spring 1999.

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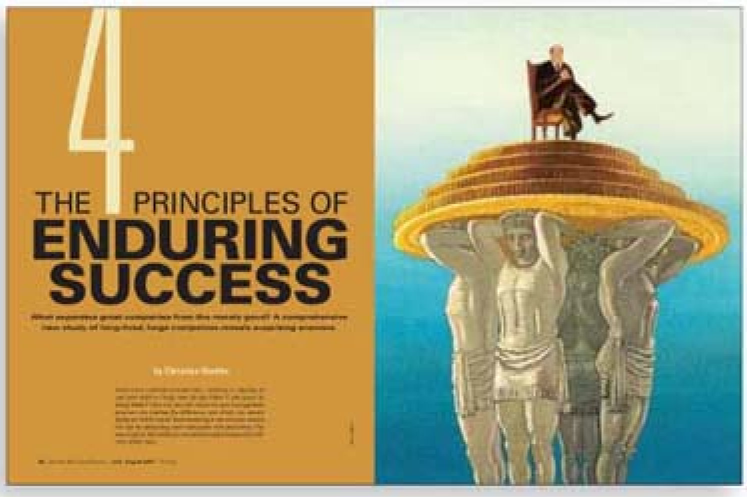
To order, see page 147.

Letters to the Editor

The Four Principles of Enduring Success

In "The Four Principles of Enduring Success" (July–August 2007), Christian Stadler seems to base his conclusions on factors that are objectively measurable but not necessarily important. As a result, the principles he proposes may be impossible – and sometimes even inadvisable – for most companies



to implement. For example, are the principles of exploiting assets and diversifying portfolios equally valid for both a biotech firm and a white goods producer? Should the principles of remembering mistakes and being conservative drive companies in knowledge-intensive businesses?

Through my work with numerous CEOs and other senior managers of several top American and European organizations, I've determined that companies must meet two criteria to become great: They must enable – not simply encourage – organizational learning, and they need to demand a passion for greatness. If companies don't learn from past mistakes, they cannot distinguish when to abide by those lessons and when to take a radical leap of faith. And if they don't instill passion in their workforce, employees may be too apathetic to cultivate institutional memory and could kill efforts to diversify. Though my standards are hard to measure objectively, any executive of any company in any environment can – and should – attain them.

Stadler cites the circumstances surrounding a fire at a Philips plant in support of supply-side diversification. Jean-François Baril, a senior vice president for sourcing and procurement at Nokia and a key player in that incident, once observed, "When you go to the Olympic Games, the issue is not only hard skills. Everyone has them. The issue is about intense passion. Passion creates energy." Baril would tell you that passion and organizational learning, not diversification, drove Nokia's success in that situation.

Amit Mukherjee
President
Ishan Advisors
Watertown, Massachusetts

Stadler responds: Amit Mukherjee's suggestion that greatness is achieved when CEOs enable organizational

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We welcome letters from all readers wishing to comment on articles in this issue. Early responses have the best chance of being published. Please be concise and include your title, company affiliation, location, and phone number. E-mail us at hbr_letters@hbsp.harvard.edu; send faxes to 617-783-7493; or write to The Editor, Harvard Business Review, *60 Harvard Way, Boston, MA 02163. HBR reserves the right to solicit and edit letters and to republish letters as reprints.*

learning and demand a passion for greatness is partially affirmed by the research that my colleagues and I have conducted. We have observed that gold medalist companies have cultures and leadership that enable learning to a larger extent than do those of silver medalists, and that they install specific mechanisms, use stories, and apply formal training much earlier and more often as well.

Our view regarding a passion for greatness, though, is more critical. There is no separation between cause and effect: When a company is doing well, people are encouraged and passionate about it. When things are going badly, passion is harder to find. In addition, history shows that passionate actions do not guarantee that an organization will make the right decisions – as many technology start-ups discovered recently. Although Mukherjee is right that passion matters, he overlooks the fact that this criterion does not separate good companies from great ones. Our silver medalists were not short of passion; they simply failed to steer it in the right direction!

Nevertheless, we do not claim to have discovered an ultimate truth. Though the overall pattern we observed was remarkably consistent across time and throughout the industries we studied, we do not intend to imply that our propositions work in all industries.

Women and the Labyrinth of Leadership *and* The Tests of a Prince

In their article "Women and the Labyrinth of Leadership" (September 2007), Alice H. Eagly and Linda L. Carli document the maze of barriers that confront women on the road to professional and business achievement. They write that vestiges of gender prejudice continue to stack the deck against women who aspire to leadership.

So I was amazed and discouraged when I turned to page 92 and found Ivan Lansberg's article, "The Tests of a Prince," which was accompanied by a large illustration of an alpha male figure. The article is about corporate heirs as future leaders of their businesses and contains a buried reference to Machiavelli's *The Prince,* from which I presume the title is drawn. One can only assume that we all agree, whether subconsciously or not, that those future leaders are – or should be – men.

Is this not graphic evidence of the barriers to attaining fair rewards, recognition, and leadership opportunities that professional women deal with every day? It makes one wonder just how problematic HBR considers this not-so-vestigial prejudice to be. I hope that HBR, as a leader in the field of business management, will pay closer attention to the messages it sends.

Leslie Hilton
President
SuccessPartner
Denver

The Wisdom of (Expert) Crowds

In his article "The Wisdom of (Expert) Crowds" (Forethought, September 2007), Robert S. Duboff accurately describes the standard Delphi technique of prediction but grossly misstates its normal application. The Delphi system is neither commonly used nor even helpful in confirming forecasts of opportunities or validating assessments of how trends affect a given company's present business. Those activities fall in the province of strategic planning and various prognostication procedures. And good luck! As Niels Bohr once observed, "Prediction is very difficult, especially about the future."

Nevertheless, the article appears under exactly the right heading: Decision Making. The Delphi technique is most useful as a tool for reaching considered decisions – particularly for helping a company's cross-functional team come to a consensus on which opportunities to pursue. Contrary to

Duboff's contention, however, outside experts have no place in this scenario. They are not qualified – and they do not have the right – to make decisions for a company. That is properly the exclusive domain of the organization's own executives.

Here's how the Delphi technique should work as a corporate decision-making tool – say, in the case of new-product development:

The new-product development leader forms a cross-functional team comprising designated representatives from each department that can contribute expertise and decisions regarding the subject – technology, R&D, production, marketing, finance, and general management.

Prospective new-product concepts, supported by available data, are then presented to the team. After the presentation, a list of those concepts is distributed to each team member, who is asked to cast a vote, based on his or her own perspective and experience, indicating whether each concept is ideal, questionable, or no good. The team leader collects and tallies the votes and displays the results for all to see.

Now, armed with the knowledge of how their peers in different departments view each concept, team members reassess their own votes. Those in the minority may decide either to go along with the majority or to open a discussion and attempt to persuade the group of their own perspective's superiority. Either way, the team members reach consensus for each concept, which allows the general manager to make final decisions at the end of the day. (Incidentally, in my experience, compressing the duration of the entire process from several weeks to half a day renders the technique no less reliable.)

Many companies have benefited from using the Delphi decision-making process. A manufacturer of army tanks, for example, saw an opportunity presented by crumbling highway infrastructure and developed a transportable, temporary, readily assembled bridge structure. An exotic metals manufacturer, targeting the ongoing demographic changes of the U.S. population, designed and developed a sophisticated new component for specific medical systems for the aged.

How did these new products fare in the marketplace? In the words of one CEO: "More successful from day one than we anticipated."

Frederick D. Buggie
President
Strategic Innovations International
Lake Wylie, South Carolina

Duboff responds: I am glad to hear that Frederick Buggie and others have found additional applications of the core Delphi technique, which entails convening a panel of experts to reflect on an issue and then vote iteratively on the likelihood of the ideas generated.

The process Buggie outlines is certainly reasonable for decision making and clearly far better than letting independent interests push forward their own concepts. Nevertheless, the Delphi technique *is* an attempt to discern the most probable future: It is named for the ancient oracle at Delphi and was initiated after World War II, when disparate experts were asked to assess the likelihood of alternative outcomes in Europe.

As I noted in my article, recruiting a wide array of experts and combining their various predictions and perspectives for use in scenario planning have made the core technique more useful. Delphi panels (and, more broadly, outside consultants) provide objective points of view and insights that corporate leaders – who obviously have jurisdiction over their company's decisions – can consider when making their determinations.

There is certainly room for, and value in, adaptations such as Buggie's. I think compressing the process into half a day, however, would diminish the participants' ability to really consider and react to others' perspectives.

The Next 20 Years: How Customer and Workforce Attitudes Will Evolve

For the past three decades, business has fought to gain academic credibility through professional rigor and the use of sound research methodology. When I subscribed to *Harvard Business Review,* I expected to read about the latest relevant trends in business management thought. Unfortunately, Neil Howe and William Strauss's article on generational change, "The Next 20 Years: How Customer and Workforce Attitudes Will Evolve" (July–August 2007), fails to meet that standard in several ways.

First, the authors do not seem to present new ideas. Rather, they appear to rehash their 1991 book, *Generations.* Second, the article focuses entirely on the United States – and so is of little relevance to the 95% of the


The Next 20 Years: How Customer and Workforce Attitudes Will Evolve

people in the world, and a significant portion of HBR's readers, who aren't American. Most important, the authors have shaped the evidence to fit their framework. The exhibit entitled "America as a Sequence of Generations," for example, is an opportunistic and random selection of famous Americans. George W. Bush is cited as a famous Boomer – why not Bill Clinton or Bill Gates or Steven Spielberg?

Howe and Strauss's simplistic framework and pick-and-choose approach to history do not offer much for readers seeking to manage complexity and diversity. That is not to say that generational differences are not important, just that the article provides only a superficial and historically shaky analysis. But then, I am a cynical Gen Xer, so I would say that, wouldn't I?

George Horsington
General Manager
Swire Production Solutions
Singapore

Howe and Strauss respond: The adequacy of generational theory, or any other construct of social change, should be judged by its ability to predict. Interest in our perspective is rising because most of the forecasts we made in 1991 have been borne out. Back then, for example, no one – except us – predicted that the little kids of that time would mature into the very protected, highly programmed, well-behaved, family-oriented college-age youths we see around us today.

Common sense suggests that to forecast the characteristics of a given age bracket in the future, one should begin by looking at the same group of people in their current – younger – age bracket. Apply this method across all generations, and one can anticipate changes in the national mood.

We kept our focus on the United States for the sake of brevity. But we do see broadly similar generational trends since at least the 1930s throughout the English-speaking world, Europe, and East and South Asia. The Chinese, in particular, are fascinated by the rhythms of history and by generations, which may explain why the first translation of our 1997 book, *The Fourth Turning,* was in Chinese. The birth years and collective traits of that country's generations parallel those of America's. Like U.S. Boomers, for example, China's Red Guard Generation came of age in an era of cultural revolution.

Obviously, famous individuals can serve only as examples of a generation. But if one reflects on all of the individuals we and Horsington suggest (George Bush, Bill Clinton, Bill Gates, and Steven Spielberg), one surely can identify several common attributes – such as a preoccupation with vision, values, and cultural stewardship – that would never describe, say, leading midlife Americans in the 1950s or even (in all likelihood) in the 2020s, when Horsington's Generation X takes over.

Are You the Weakest Link in Your Company's Supply Chain?

In "Are You the Weakest Link in Your Company's Supply Chain?" (September 2007), Reuben E. Slone, John T. Mentzer, and J. Paul Dittmann note that "OfficeMax used to report in-stocks at an SKU, or company-wide, level – not at the store level." This brings to mind the most dumbfounding retail experience I've ever encountered: an OfficeMax visit that I still remember vividly after more than a decade.

Short one cable to complete my company's computer installation, I visited a nearby OfficeMax and located the shelf where that cable belonged. Though the shelf was overflowing with cables, the one I needed wasn't there.

Disappointed, I mentioned to the store manager that his shelf had been stocked incorrectly. His reply: "The district manager gets upset whenever he sees empty shelf space, so when we don't have the product that belongs there, we just fill it up with whatever we do have." Office Depot, 200 yards away, had the cable I needed, and in the right place, too.

A grocery store now stands on the site of the original OfficeMax; the Office Depot hasn't moved; and OfficeMax is trying for a fresh start. It has opened a new store five miles away – with shelves that are nicely, and correctly, stocked.

Charles M. Cohon
President
Prime Devices
Glenview, Illinois

2007 READER'S GUIDE

Reader's Guide Online

A full version of the 2007 Reader's Guide, in an easy-to-navigate format with index listings hyperlinked to both the executive summaries and the complete articles, can be found on the magazine's website at hbr.org. Subscribers may access any article listed in the index after logging in at hbr.org. Nonsubscribers may read any article's executive summary free of charge.

The 2007 Online Reader's Guide will be available on our website for all of 2008.

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Stuart Rose
When retailer Marks & Spencer hired Stuart Rose to turn the company around, he told the board that three things needed to be done right away: Improve the product, improve the stores, and improve the service. It was – and still is – that simple.
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British Library CEO Lynne Brindley on Helping to Spur Business Innovation
Sarah Cliffe
Lynne Brindley, the CEO of the British Library, explains how the United Kingdom's exclusive repository for rare books, manuscripts, and scientific papers has loosened the design of its Business & IP Centre to encourage entrepreneurship and innovation.
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Leading Change: Why Transformation Efforts Fail
John P. Kotter
Companies often cope with new, more-challenging environments by making fundamental changes in the way they do business. To succeed, follow these eight critical steps in the right order – and with plenty of patience.
JANUARY
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Beating the Market with Customer Satisfaction
Christopher W. Hart
A growing body of research conclusively shows that higher customer satisfaction leads to higher share prices.
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The Customers' Revenge
Dan Ariely
With commentary by Nate Bennett, Tom Farmer, Nancy Fein, Barak Libai, and Chris Martin
A disgruntled Atida customer is threatening to air his case on YouTube. Is it new-age extortion, or does the automaker need a fresh approach to customer service?
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How Valuable Is Word of Mouth?
V. Kumar, J. Andrew Petersen, and Robert P. Leone
Your most profitable customers are probably not the ones who buy the most – they're the ones who do the best job of referring your firm to others. Use this tool to distinguish the two groups – and raise the lifetime value of both.
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Northwestern Mutual's Ed Zore on Staying Relevant to Customers
Thomas A. Stewart
Ed Zore is the CEO of Northwestern Mutual, a highly admired 150-year-old insurer. Relevance, not innovation, matters most to customers, he says, and *should* matter most to companies as well.
FORETHOUGHT, DECEMBER
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Service with a Very Big Smile
New research confirms that the bigger the employees' smiles, the happier the customers.
FORETHOUGHT, MAY
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Silo Busting: How to Execute on the Promise of Customer Focus
Ranjay Gulati
More and more companies claim that they offer solutions – packages of products and services that are hard to copy and can command premium prices. To truly solve customers' problems, however, companies often have to make significant changes to their structures, processes, and mind-sets.
MAY
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Understanding Customer Experience
Christopher Meyer and Andre Schwager
Customer satisfaction is just a slogan unless companies face up to the unvarnished reality of their customers' subjective experiences. Here's a process to ensure that every corporate function plays a role in monitoring, probing, and enhancing customer experience.
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Work with Me
Simon J. Bell and Andreas B. Eisingerich
Should service firms show clients their inner workings or keep their cards close? Recent research touts the benefits of letting customers know how firms operate.
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Decision Making

Hotter Heads Prevail
Andrew O'Connell
A detached and impassive executive may seem like the corporate decision-making ideal, but people make better choices when they're experiencing intense emotions, according to new research.
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The Wisdom of (Expert) Crowds
Robert S. Duboff
The Delphi technique involves recruiting panels of experts from a variety of fields and asking them to iteratively evaluate predictions about the future of, say, an emerging innovation until they reach consensus. Shaping the strongest predictions into several possible scenarios prepares managers to act quickly when one outcome begins to unfold.
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Good Money After Bad?
John W. Mullins
With commentary by Ivan Farneti, Fred Hassan, Robert M. Johnson, and Christoph Zott
Jack Brandon is a committed entrepreneur with a sound proprietary technology but not much marketing expertise. Should his VC backers put more money into a second product when he hasn't succeeded in selling the first?
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Forethought: Special Report

Climate Business, Business Climate
Climate change will transform the business landscape. Companies will see the price of carbon emissions rise steeply, in both monetary and social terms. Businesses will face new costs and risks and discover new ways to seize competitive advantage. Here's what executives need to do to prepare for the coming carbon-constrained world.
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Ethics and Society

Beware of Bad Microcredit
Steve Beck and Tim Ogden
Failing to reduce poverty by supporting the wrong microcredit program can tarnish a company's good name. Executives in charge of corporate social responsibility should insist on clearly defined measures of success, invest in improving microcredit's effectiveness, and support the growth of small companies in regions of poverty.
FORETHOUGHT, SEPTEMBER
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The CEO's Private Investigation
Joseph Finder
With commentary by Harry "Skip" Brandon, James B. Comey, Eric A. Klein, Christopher E. Kubasik, and William J. Teuber, Jr.
If a CEO suspects her colleagues of wrongdoing, is it appropriate for her to commission a private investigation?
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Finance and Accounting

The Flaw in Customer Lifetime Value
Detlef Schoder
Marketers commonly estimate customer lifetime value in order to decide which customers are worth continued investment. But the way companies typically calculate that value is flawed because it overlooks the real option of abandoning unprofitable customers.
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So You Think You Understand Revenues
Robert Shaw and Vincent-Wayne Mitchell
The sophisticated technologies used to understand costs don't illuminate revenue sources well. For that you need a whole new breed of accountant.
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The Truth About Private Equity Performance
Oliver Gottschalg and Ludovic Phalippou
Private equity fund performance is most often reported in a way that exaggerates the truth. A modified calculation gives a more accurate read of performance and often changes a fund's relative rank.
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General Management

The Art of Designing Markets
Alvin E. Roth
Sometimes markets break down. A new branch of economics can resurrect them, make them more efficient – and even create new ones where none existed.
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Breakthrough Ideas for 2007
Ordinary people, not "influentials," are the best word-of-mouth marketers…leaders should embrace the word "hope"…patriarchy is making a comeback…health care costs are falling (it's spending that's on the rise)…and other thought-provoking ideas.
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The Next 20 Years: How Customer and Workforce Attitudes Will Evolve
Neil Howe and William Strauss
The generation gap is actually just part of a historical pattern, according to two eminent scholars – a pattern we can use to forecast market, workplace, and social trends for decades.
JULY–AUGUST
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Who Owns the Long Term? Perspectives from Global Business Leaders
Maurice Lévy, Mike Eskew, Wulf H. Bernotat, and Marianne Barner
Top executives of global companies discuss how they manage for the long term: Stay close to your front line and time your moves well; maintain your vision and values during tough periods; balance your customers' energy needs with environmental concerns; and be socially responsible.
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Globalization

Cocreating Business's New Social Compact
Jeb Brugmann and C.K. Prahalad
Companies and NGOs are finding mutual benefit in going into business together, not as wary rivals but as trusted partners. The innovative business models they're developing are leading to real breakthroughs in the creation of new markets and the eradication of poverty.
FEBRUARY
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Forward-Thinking Cultures
Mansour Javidan
Singapore is the most future-oriented country in the world, new research from Thunderbird business school reveals, whereas Russia is the least. Yet people the world over aspire to plan for the future, a fact global managers can use to inspire workers in present-oriented cultures to look ahead.
FORETHOUGHT, JULY–AUGUST
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China + India: The Power of Two
Tarun Khanna
After decades of hostility, the dragon and the tiger have begun to cooperate. Companies that make use of both nations' capabilities stand to gain competitive advantage.
DECEMBER
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Mao's Pervasive Influence on Chinese CEOs
Shaomin Li and Kuang S. Yeh
Executives of multinationals partnering with Chinese firms should be alert to Mao Zedong's lingering influence on some of the country's most successful executives. In particular, watch for a leadership tactic that can undermine a joint venture.
FORETHOUGHT, DECEMBER
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Nurturing Respect for IP in China
Georg von Krogh and Stefan Haefliger
The best way to foster an appreciation for intellectual-property rights in China is to let partner firms experience the benefits of locally generated knowledge.
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If Private Equity Sized Up Your Business
Robert C. Pozen
How can your company capture the kind of value increase for its shareholders that a private equity firm would seek? Try making the same types of changes.
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Reducing Directors' Legal Risk
Michael Klausner
Outside directors are at lower risk of liability than they might think, but they can protect themselves even further.
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Health Care

What Health Consumers Want
Caroline Calkins and John Sviokla
Consumers of health care constitute a highly diverse market, but the idea that companies might segment customers and profit by addressing their varied needs seems almost foreign to the health industry. You can tap hidden value by making use of patterns in the demand for health products and services, especially if you segment consumers according to health and wealth at the same time.
FORETHOUGHT, DECEMBER
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Realizing the Promise of Personalized Medicine
Mara G. Aspinall and Richard G. Hamermesh
The future of medicine – and the medical business – lies in using genetic and other diagnostic tests to tailor more treatments to individuals. First, the health care system must clear four barriers.
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HBR CASE STUDY
We Googled You
Diane Coutu
With commentary by danah m. boyd, Michael Fertik, Jeffrey A. Joerres, and John G. Palfrey, Jr.
Keeping skeletons in the closet has become almost impossible in the Internet age. But should they cost an otherwise promising candidate a job?
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How Risky Is Overtime, Really?
Harris Allen and William Bunn, MD
Not all that much, empirical data from two medical researchers suggest.
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How to Teach Pride in "Dirty Work"
Employees in stigmatized occupations can be helped to cope with or even feel proud of their jobs with an array of techniques, including developing an occupational ideology to confer a more positive image on the work, creating social buffers such as professional associations, and avoiding specifics in conversation with outsiders.
FORETHOUGHT, SEPTEMBER
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Making Relationships Work
A Conversation with Psychologist John M. Gottman
Diane Coutu
Good personal relationships clearly are essential for success and fulfillment in the workplace – what's elusive is how to maintain them. The best science on the art of marriage might just point the way.
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Munchausen at Work
Nathan Bennett
Someone suffering from Munchausen syndrome by proxy, a psychological disorder, fabricates or induces illness in another to win attention and praise as a caregiver. A similar pathology in the workplace leads employees to create or exaggerate problems in order to get credit for solving them. Here are some questions to help managers recognize such behavior.
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Women and the Labyrinth of Leadership
Alice H. Eagly and Linda L. Carli
The "glass ceiling" metaphor doesn't accurately depict the complex, varied barriers women encounter today in their pursuit of senior leadership roles – and it causes managers to invest in the wrong solutions. It's time to rename the challenge.
SEPTEMBER
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Younger Women at the Top

More women than men at *Fortune* 1,000 firms have reached executive officer positions in their thirties, forties, and fifties – and they've done it faster. Still, nearly half of those companies lack female executive officers.

FORETHOUGHT, APRIL

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Innovation and Creativity

Breakthrough Thinking from Inside the Box

Kevin P. Coyne, Patricia Gorman Clifford, and Renée Dye

Ask people to think outside the box, and many of them simply freeze up. You'll generate far more – and far more useful – ideas if you construct new boxes for people to think within.

DECEMBER

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A Buyer's Guide to the Innovation Bazaar

Satish Nambisan and Mohanbir Sawhney

Too many choices in the marketplace of ideas can be overwhelming. With this conceptual guide, companies can determine what kinds of outside innovations they should acquire – and who can help them do so.

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Eight Ways to Build Collaborative Teams

Lynda Gratton and Tamara J. Erickson

Businesses need large, diverse teams to pull off major initiatives – yet the size and complexity of such groups make it hard to get anything done. These practices will help firms ensure strong, effective collaboration, even when teams span the globe.

NOVEMBER

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Innovate Faster by Melding Design and Strategy

Ravi Chhatpar

If designers are brought into the innovation process at the very beginning, they can test prototypes and share users' responses even as the business case is being developed, enabling companies to nimbly adjust to changes in market opportunities.

FORETHOUGHT, SEPTEMBER

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The Innovation Value Chain

Morten T. Hansen and Julian Birkinshaw

Subscribing to the latest innovation advice won't help your business if you don't understand your firm's unique strengths and flaws. Here's a framework for assessing your company's innovation processes and determining which best practices will help you address weak spots.

JUNE

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Is It Real? Can We Win? Is It Worth Doing?

George S. Day

Overly cautious companies can strangle their own growth by avoiding risky projects. Better to screen them systematically for maximum balance and profit.

DECEMBER

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Meet the Innovation Capitalist

Satish Nambisan and Mohanbir Sawhney

Large firms puzzling over whether to pay for developed technology or take a risk on bleeding-edge concepts now have a third choice – a new kind of "innomediary" that identifies and refines innovations, reducing market risk in return for a share in the potential rewards.

FORETHOUGHT, MARCH

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$152,000 for Your Thoughts

Gary Carini and Bill Townsend

Making employees prove the worth of their ideas results in better concepts and more-motivated workers. Executives must give people the tools to stand behind their ideas and must follow up with strong rewards.

FORETHOUGHT, APRIL

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Preparing for the Perfect Product Launch

James P. Hackett

How come some projects fail while others succeed? This is the story of a CEO who refused to accept failures as inevitable and set up a system to prevent them.

APRIL

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Saving the Internet

Jonathan Zittrain

The very openness and user adaptability that make the Internet a creative wellspring also allow for the propagation of assorted evils – spam, porn, predation, fraud, privacy violations – that threaten the integrity of the Internet itself.

JUNE

Reprint R0706B

The Value Captor's Process: Getting the Most out of Your New Business Ventures

Rita Gunther McGrath and Thomas Keil

It's a mistake to assume that a venture is successful only if it proceeds directly to go and produces payback within two years. Value captors have learned how to systematically mine all the possible benefits of their initiatives – including the failures.

MAY

Reprint R0705J

Knowledge Management

The Knowledge-Creating Company

Ikujiro Nonaka

Japanese companies, masters of manufacturing, have also been leaders in the creation, management, and use of knowledge – especially the tacit and often subjective insights, intuitions, and ideas of employees.

JULY–AUGUST

Originally published in 1991

Reprint R0707N

Leadership

Becoming the Boss

Linda A. Hill

The experience of becoming a boss for the first time leaves an indelible mark – some might call it a scar – on the psyche. But the transition to new manager doesn't have to be quite so painful.

JANUARY

Reprint R0701D; OnPoint 1723

The Best Advice I Ever Got

Hans-Paul Bürkner

Interviewed by Daisy Wademan

By watching a colleague assemble diverse, high-performing teams, the CEO of the Boston Consulting Group learned the art of nurturing team members' strengths and steering them away from tasks that would expose their weaknesses.

FORETHOUGHT, DECEMBER

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The Best Advice I Ever Got

Fred Carl, Jr.

Interviewed by Daisy Wademan

The founder and CEO of Viking Range recalls the eventful words of an early adviser: "You should run this from day one like it's a public company. Treat it like it's going to be big." He did, and it was.

FORETHOUGHT, NOVEMBER

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Building a Leadership Brand

Dave Ulrich and Norm Smallwood

A reputation for producing good leaders time and again is part of a strong company brand. To build that kind of enduring capability, firms must do more than focus on the traits of individual leaders. They need to follow five key strategies.

JULY–AUGUST

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The CEO's Second Act

David A. Nadler

A new CEO's brilliance can fade quickly once he or she has solved the company's immediate problems and the next set of challenges comes along. A chief executive's Act II requires a lot less swashbuckling and a lot more humility.

JANUARY

Reprint R0701F

The Chief Strategy Officer

R. Timothy S. Breene, Paul F. Nunes, and Walter E. Shill

Overwhelmed CEOs are increasingly hiring CSOs. Their job: to keep strategy front and center, drive real execution, and direct and sustain change in complex organizations.

OCTOBER

Reprint R0710D

Courage as a Skill

Kathleen K. Reardon

Courage in business is rarely impulsive; rather, it results from careful deliberation and preparation. The "courage calculation," consisting of six decision-making processes that can be refined over time, helps managers make bold moves that will lead to success while averting career suicide.

JANUARY

Reprint R0701E; OnPoint 1726

Discovering Your Authentic Leadership
Bill George, Peter Sims, Andrew N. McLean, and Diana Mayer
How do you become an authentic leader? A new study shows that you do not have to be born one. You can learn to be authentic by understanding your life story and by developing self-awareness.
FEBRUARY
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The Ethical Mind
A Conversation with Psychologist Howard Gardner
Bronwyn Fryer
Leaders have earned their reputation as ethical miscreants – a huge cost to public trust and organizational health. It's time to take a look in the mirror and step up to the ethical plate.
MARCH
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Firing Back: How Great Leaders Rebound After Career Disasters
Jeffrey A. Sonnenfeld and Andrew J. Ward
Stunning recovery is possible from even the most catastrophic of setbacks. Michael Milken, Martha Stewart, Home Depot's Bernie Marcus, Bank One's Jamie Dimon, and others came back from the depths by following the path of the universal hero.
JANUARY
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A Formula for the Future
A Conversation with Craigie Zildjian
Gardiner Morse
The oldest family-run business in the U.S., the Zildjian Company has been making cymbals, first in Turkey and then in America, since 1623. As a 14th-generation leader of the company, Craigie Zildjian sees innovation in collaboration with customers as her best path to continued success.
FORETHOUGHT, JULY–AUGUST
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The Four Truths of the Storyteller
Peter Guber
Leaders can use well-crafted stories to captivate and inspire people whose help they need. A top movie producer and entertainment industry executive shares the secrets he's learned.
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THE HBR INTERVIEW
The Institutional Yes
Jeff Bezos
Interviewed by Julia Kirby and Thomas A. Stewart
Amazon.com is known for its bold and sometimes counterintuitive strategic moves. Its founder and CEO reveals that the company's strategy derives from a distinctive and deeply held cultural point of view.
OCTOBER
Reprint R0710C

THE HBR INTERVIEW
Lessons from Toyota's Long Drive
Katsuaki Watanabe
Interviewed by Thomas A. Stewart and Anand P. Raman
Toyota's president explains why the automaker must combine radical change and continuous improvement if it wants to remain one of the world's leading companies.
JULY–AUGUST
Reprint R0707E

The Hidden Good News About CEO Dismissals
Chuck Lucier and Jan Dyer
Four times more CEOs are being fired today than in 1995, a Booz Allen Hamilton study finds. That's good news. It's not that CEOs are being pressured to think more in the short term; it's that boards are finally clearing away the deadwood.
FORETHOUGHT, JULY–AUGUST
Reprint F0707C

How Successful Leaders Think
Roger Martin
Great leaders refuse to choose between A and B. Through holistic thinking, they forge an innovative third way.
JUNE
Reprint R0706C

In Praise of the Incomplete Leader
Deborah Ancona, Thomas W. Malone, Wanda J. Orlikowski, and Peter M. Senge
It's time to end the myth of the complete leader: the flawless person at the top who's got it all figured out. The sooner leaders stop trying to be all things to all people, the better off their organizations will be. Only when leaders accept themselves as incomplete – as having both strengths and weaknesses – will they be able to make up for their missing skills by relying on others.
FEBRUARY
Reprint R0702E

A Leader's Framework for Decision Making
David J. Snowden and Mary E. Boone
Leadership approaches that work well in one set of circumstances can fall far short in others. With the proper decision-making framework, you can sort issues into their appropriate contexts and tailor your management style to fit each one.
NOVEMBER
Reprint R0711C

The Leadership Team: Complementary Strengths or Conflicting Agendas?
Stephen A. Miles and Michael D. Watkins
When members of a leadership team play complementary roles, the whole is often greater than the sum of its parts – but such relationships may also result in confusion, especially when members move on. Organizations can learn to enjoy the advantages and minimize the risks of complementarity without sowing the seeds of disaster during succession.
APRIL
Reprint R0704F

Leading Clever People
Rob Goffee and Gareth Jones
It's not quite as bad as herding cats, but attracting and retaining the smart, creative people on whom your organization depends can be a challenge – especially because they don't like to be led. Approaching them as a benevolent guardian rather than as a traditional leader will improve your odds of success.
MARCH
Reprint R0703D; HBR Article Collection "Leading Creative People" 1867

Making Judgment Calls
Noel M. Tichy and Warren G. Bennis
A leader's judgment call may seem like a momentous event. The best calls, however, are part of a larger process that begins with preparation and ends with execution. Instead of trying to slam-dunk their decisions, good leaders attend to the entire judgment process and take advantage of "redo loops" at every stage.
OCTOBER
Reprint R0710E

Moments of Truth: Global Executives Talk About the Challenges That Shaped Them as Leaders
When did you realize you had the right stuff to lead? HBR's editors ask a wide range of business leaders that question and get some surprising answers.
JANUARY
Reprint R0701A

Picking Winners
A Conversation with MacArthur Fellows Program Director Daniel J. Socolow
Diane Coutu
What can business leaders learn from the organization that confers the storied "genius grants"? For one thing, that exceptional creativity is very hard to find. If you're looking for a way to pack your staff with outstanding talent, you're probably on the wrong track.
MAY
Reprint R0705H

Raising Haier
Zhang Ruimin
The CEO of Haier explains how he has grown with the challenges he has tackled in transforming a struggling appliance company into a world-class global enterprise.
FEBRUARY
Reprint R0702J

Stay on the Q&A Offensive
A Conversation with Michael Sheehan
Julia Kirby
The Q&A should be more than just an afterthought, says communications consultant Michael Sheehan. It may be the only part of your speech people actually listen to.
FORETHOUGHT, APRIL
Reprint F0704G

The Tests of a Prince
Ivan Lansberg
Corporate heirs have a particular challenge when it comes to turning stakeholders into followers. To prove they have what it takes, they must manage a four-part iterative testing process.
SEPTEMBER
Reprint R0709F

What Every Leader Needs to Know About Followers
Barbara Kellerman
Your subordinates are not an amorphous bunch. A new typology that classifies them according to their level of engagement can help you better understand their relationships with superiors and manage them more effectively.
DECEMBER
Reprint R0712F

What Your Leader Expects of You
Larry Bossidy
A longtime CEO reveals the behaviors that leaders should look for in their subordinates – behaviors that drive individual as well as corporate performance and growth – and what those subordinates should expect in return.
APRIL
Reprint R0704C

Rules to Acquire By
Bruce Nolop
Study after study finds that acquisitions tend to destroy value – yet most high-performing companies rely on them to grow. That makes sense only if, like Pitney Bowes, you can learn how to do them well.
SEPTEMBER
Reprint R0709J

Negotiation

Investigative Negotiation
Deepak Malhotra and Max H. Bazerman
Too many people try to win negotiations like a sales person – through persuasion. The best way to get what you want, however, is to think like a detective: Dig for information that will help you understand the other side.
SEPTEMBER
Reprint R0709D; HBR Article Collection "Nuts and Bolts Negotiation" 2486

Operations

Are Your Engineers Talking to One Another When They Should?
Manuel E. Sosa, Steven D. Eppinger, and Craig M. Rowles
Avoiding expensive mistakes in the design of complex, highly engineered products boils down to making sure the right product-component teams communicate. A new application of an old project management tool can help managers see where such communication should be taking place – but isn't.
NOVEMBER
Reprint R0711J

Are You the Weakest Link in Your Company's Supply Chain?
Reuben E. Slone, John T. Mentzer, and J. Paul Dittmann
A CEO who pays special attention to supply chain management enhances the company's competitive advantage – and avoids classic, potentially costly pitfalls for the firm and its suppliers, partners, and customers.
SEPTEMBER
Reprint R0709H

Break the Paper Jam in B2B Payments
Steve Berez and Arpan Sheth
Many companies still overlook the virtues of electronic invoice and payment systems: Some 70% of business-to-business transactions involve paper invoices and checks, and managing them costs about $116 billion a year. Electronic systems can help cut accounts payable overhead by more than 50% – but suppliers need to be converted quickly.
FORETHOUGHT, NOVEMBER
Reprint F0711D

High-Tech Ways to Keep Cupboards Full
Peter J. McGoldrick and Peter M. Barton
Makers of nondurable goods should focus on keeping customers' – not just retailers' – shelves fully stocked.
FORETHOUGHT, MARCH
Reprint F0703B

Improve Your Return on Returns
Andrew O'Connell
A "reverse logistics" value chain strategy – what you do with goods your customers send back – can strengthen your company's competitiveness, according to the authors of a recent article in the *Academy of Management Perspectives*. Estée Lauder built a $250 million product line from returned cosmetics.
FORETHOUGHT, NOVEMBER
Reprint F0711F

Lessons from the Leaders of Retail Loss Prevention
Adrian Beck and Colin Peacock
Arresting thieves and investing in technology, the main approaches to retail loss prevention, haven't managed to diminish the problem over the past 15 years. A study of companies that have successfully reduced shrinkage uncovers nine practices behind their success, beginning with organizational and senior management commitment to making loss prevention a priority.
FORETHOUGHT, NOVEMBER
Reprint F0711H

Make Your Back Office an Accelerator
Paul Rogers and Hernan Saenz
A new study identifies exactly how much bang for the buck a firm can get when it makes targeted cuts in back-office costs and takes steps to boost efficiency.
FORETHOUGHT, MARCH
Reprint F0703G

Pandemic Preparedness: Who's Your Weak Link?
George Abercrombie
A company's ability to function during a flu pandemic is only as good as the weakest link in its supply chain. Hoffmann-La Roche, the maker of a frontline antiflu drug, works closely with its suppliers to ensure that their preparedness plans are as robust as its own.
FORETHOUGHT, DECEMBER
Reprint F0712B

Performing a Project *Pre*mortem
Gary Klein
In a premortem, team members assume that the project they are planning has just failed – as so many do – and then generate plausible reasons for its demise. Those with reservations may speak freely at the outset, so that the project can be improved rather than autopsied.
FORETHOUGHT, SEPTEMBER
Reprint F0709A

The Process Audit
Michael Hammer
Redesigning business processes can generate dramatic improvements in performance, but the effort is notoriously difficult. Many executives have floundered, uncertain about what exactly needs to be changed, by how much, and when. A new framework can take the mystery out of reengineering business processes and help you plan and assess your company's process-based transformations.
APRIL
Reprint R0704H

Selecting Management Tools Wisely
Darrell Rigby and Barbara Bilodeau
With so many management tools out there, from benchmarking to outsourcing, it's hard to decide which ones to try. To help executives make informed choices, the authors compare levels of use and satisfaction for the most popular tools, and chart the evolution of a select few.
FORETHOUGHT, DECEMBER
Reprint F0712E

Simplicity-Minded Management
Ron Ashkenas
As corporations add layer upon layer of complexity, they grow increasingly unwieldy and ungovernable. Simplification is no longer a "nice to have" virtue; it's an imperative for bottom-line success.
DECEMBER
Reprint R0712H

Organization and Culture

Avoiding Integrity Land Mines
Ben W. Heineman, Jr.
How do you keep thousands of employees, operating in hundreds of countries, as honest as they are competitive? General Electric's longtime general counsel describes the systems the company has put in place to do just that.
APRIL
Reprint R0704G

HBR CASE STUDY
Why Didn't We Know?
Ralph Hasson
With commentary by Stephen R. Hardis, Jackson W. Robinson, Mary Rowe, and Hal Shear
A whistle-blower sues Galvatrens for wrongful termination. The lawsuit triggers a much larger discussion about the company's system for uncovering misconduct. How should the company strengthen that system – and what roles should the board and management play?
APRIL
Reprint R0704A, Reprint Case only R0704X, Reprint Commentary only R0704Z

Inner Work Life: Understanding the Subtext of Business Performance
Teresa M. Amabile and Steven J. Kramer
New research shows how business performance is driven by workers' state of mind – and how managers, if they're not careful, can drive both down.
MAY
Reprint R0705D; HBR Article Collection "Build a Motivated Workforce, 2nd Edition" 2102

A Larger Language for Business
A Conversation with David Whyte
Lisa Burrell
Poet David Whyte talks about how poetry begets courageous conversation and, in turn, better leadership.
FORETHOUGHT, MAY
Reprint F0705F

Promise-Based Management: The Essence of Execution
Donald N. Sull and Charles Spinosa
The most vexing leadership challenges stem from broken or poorly crafted commitments between employees and colleagues, customers, or other stakeholders. To overcome such problems and foster a productive, reliable workforce, managers must cultivate and coordinate promises in a systematic way.
APRIL
Reprint R0704E

Reconcilable Differences
Jonathan Knowles and Richard Ettenson
If Marketing and Finance can learn to get along, both can advance their agendas.
FORETHOUGHT, JUNE
Reprint F0706D

Simple Rules for Making Alliances Work
Jonathan Hughes and Jeff Weiss
At least 60% of all corporate alliances fail. If you don't want yours to join the scrap heap, consider adopting five principles.
NOVEMBER
Reprint R0711H

To Thine Own Staff Be Agreeable
Gary Davies and Rosa Chun
Studies show that the more staffers' opinions of a company outshine customers', the greater that company's sales growth will be.
FORETHOUGHT, JUNE
Reprint F0706H

What It Means to Work Here
Tamara J. Erickson and Lynda Gratton
You won't find – and keep – deeply engaged employees by aping your rivals' talent-management practices. Potential hires need to know what's unique about your company. By creating "signature experiences" that convey your firm's values and heritage, you can attract the people who are most likely to be productive for the long term.
MARCH
Reprint R0703G

Why Employees Are Afraid to Speak
James R. Detert and Amy C. Edmondson
In a word – self-preservation. And they're just as afraid to share innovative ideas as to blow the whistle.
FORETHOUGHT, MAY
Reprint F0705B

Performance Measurement

The Cost of Myopic Management
Natalie Mizik and Robert Jacobson
A study of 2,859 firms shows that companies unwisely cutting costs to artificially improve performance are fooling no one for long. Their stock rises sharply right afterward but falls precipitously in the next few years, as poor management comes home to roost.
FORETHOUGHT, JULY–AUGUST
Reprint F0707E

Higher Net Price – Or Bust
Paul Calthrop
When it comes to judging the success of innovations, the important measure to track isn't sales; it's net prices.
FORETHOUGHT, MAY
Reprint F0705G

Maximizing Your Return on People
Laurie Bassi and Daniel McMurrer
An innovative tool can measure how effectively your company manages human capital and, unlike current HR metrics, can predict organizational performance. Use this new survey to find out where your company stands.
MARCH
Reprint R0703H

Productivity Is Killing American Enterprise
Henry Mintzberg
When they cut R&D, underinvest in their brands, and – worse – cut worker and middle management ranks, leaders are merely punishing their employees (and stockholders) for their own inability to create real value, says this McGill University professor. Productivity improvements come from better management or applying new technologies, not from making fewer people do more work.
FORETHOUGHT, JULY–AUGUST
Reprint F0707G

The Strategic Secret of Private Equity
Felix Barber and Michael Goold
The real reason private equity firms earn such high returns is so simple that most people overlook it: Those firms buy to sell rather than to keep.
SEPTEMBER
Reprint R0709B

Using the Balanced Scorecard as a Strategic Management System
Robert S. Kaplan and David P. Norton
How do you ensure today's actions will help your company reach tomorrow's goals? By using the balanced scorecard to link long-term strategic objectives with short-term budgetary needs.
JULY–AUGUST
Originally published in 1996
Reprint R0707M

Research and Development

Getting Unusual Suspects to Solve R&D Puzzles
Karim R. Lakhani and Lars Bo Jeppesen
Your problem solvers could be not only out in the wider world but also in the wide reaches of your own organization.
FORETHOUGHT, MAY
Reprint F0705H

Novartis's Great Leap of Trust
A Conversation with Daniel Vasella
Andrew O'Connell
CEO Daniel Vasella explains why his company is placing a big bet on China's future as a world scientific power.
FORETHOUGHT, MARCH
Reprint F0703F

Where More R&D Dollars Should Go
Jim Scinta
Companies are expecting to spend more on R&D this year, but they're putting it in the wrong place – too much on new project development and not enough on the basic research that will produce tomorrow's revenues.
FORETHOUGHT, JULY–AUGUST
Reprint F0707H

Risk Management

A Growing Focus on Preparedness
Darrell Rigby and Barbara Bilodeau
Scenario-planning tools are getting better, and companies are using them more effectively to prepare for an uncertain future, according to the latest results from Bain & Company's ongoing 14-year survey of corporate tool use.
FORETHOUGHT, JULY–AUGUST
Reprint F0707D

HBR CASE STUDY
Boss, I Think Someone Stole Our Customer Data
Eric McNulty
With commentary by Bill Boni, John Philip Coghlan, Jay Foley, and James E. Lee
Flayton Electronics, a regional chain, faces threats to its reputation after a possible data breach. How should the firm address the interests of stakeholders – especially customers – in this information-age crisis?
SEPTEMBER
Reprint R0709A, Reprint Case only R0709X, Reprint Commentary only R0709Z

HBR CASE STUDY
The Dark Side of Customer Analytics
Thomas H. Davenport and Jeanne G. Harris
With commentary by George L. Jones, Katherine N. Lemon, Michael B. McCallister, and David Norton
A customer data–sharing deal between two companies could reap easy money for both. But things could get complicated if customers find out how their personal information is being used. How can the companies leverage the data responsibly?
MAY
Reprint R0705A, Reprint Case only R0705X, Reprint Commentary only R0705Z

Reputation and Its Risks
Robert G. Eccles, Scott C. Newquist, and Roland Schatz
Reputations make or break companies, yet most leaders inadequately manage reputational risk. Understanding the three factors that affect this type of risk is the first step in building a process for identifying, measuring, and controlling threats.
FEBRUARY
Reprint R0702F

Scorched Earth: Will Environmental Risks in China Overwhelm Its Opportunities?
Elizabeth Economy and Kenneth Lieberthal
China's environmental problems are so bad they're beginning to constrain the country's GDP growth. Why, then, are multinationals paying so little attention to them? Failure to factor environmental issues into corporate strategy may turn China's seemingly enormous promise into a nightmare for many firms.
JUNE
Reprint R0706F; HBR Article Collection "China Tomorrow, Prospects and Perils, 3rd Edition" 2129

Sales

Managing Global Accounts
George S. Yip and Audrey J.M. Bink
Global account management may not be right for everyone – but when it fits, it increases both profits and customer satisfaction. Here's a guide for choosing when to offer GAM and to whom.
SEPTEMBER
Reprint R0709G

Self-Management

Cognitive Fitness
Roderick Gilkey and Clint Kilts
To be as sharp at 60 as you were at 25, you'll need to do some mental push-ups. Here's how you can strengthen your brain's neural networks and cognitive abilities.
NOVEMBER
Reprint R0711B; HBR Article Collection "Get in Shape to Lead" 2613

Crisis at the Summit
George D. Parsons and Richard T. Pascale
Some superstars thrive on the adrenaline rush of mastering a challenge. Once they're at the top of their game, however, the rush disappears, and a dangerous affliction can set in. If they don't recognize the early warning signs, these talented performers may derail what should be a brilliant career.
MARCH
Reprint R0703E

Find the Gold in Toxic Feedback
Fernando Bartolomé and John Weeks
Even rude or irrelevant feedback can be useful, but only a rare few can put ego aside and extract the hidden value.
FORETHOUGHT, APRIL
Reprint F0704F

How Leaders Create and Use Networks
Herminia Ibarra and Mark Hunter
One test of leadership capability is whether you can leverage social contacts into business results. You may do a lot of networking, but is it the right kind?
JANUARY
Reprint R0701C; OnPoint 1727

The Making of an Expert
K. Anders Ericsson, Michael J. Prietula, and Edward T. Cokely
To become an expert, you must discard the myth that genius is born, not made. Scientific research overwhelmingly shows that elite performance comes primarily from years of practice, dedicated coaching, and relentless effort to understand and correct mistakes.
JULY–AUGUST
Reprint R0707J

Manage Your Energy, Not Your Time
Tony Schwartz and Catherine McCarthy
Want to accomplish dramatically more and do it better? The answer is not working longer hours but increasing your capacity for work through systematic rituals that recharge your four key sources of energy.
OCTOBER
Reprint R0710B

My Extreme MBA
A Conversation with Rory Stewart
Lew McCreary
Negotiating leadership challenges in hostile territory takes a balance of principled commitment and canny pragmatism.
OCTOBER
Reprint R0710H

Realizing What You're Made Of
Glenn E. Mangurian
If you hit rock bottom, would you recover? Here's the story of an executive who did – and learned volumes about resilience and leadership in the process.
MARCH
Reprint R0703J

Surviving Your New CEO
Kevin P. Coyne and Edward J. Coyne, Sr.
Your company just hired a new CEO, and you figure that a reorganization – maybe even a few terminations – could be on the way. You're not worried, though: Your solid record and excellent reputation as a senior executive mean you're safe. Right? Wrong.
MAY
Reprint R0705C; HBR Article Collection "Managing Up, 2nd Edition" 2099

What to Ask the Person in the Mirror
Robert S. Kaplan
No matter how talented and successful you are, you will make mistakes. But the higher up the ladder you go, the fewer people there are to tell you when you've faltered. To assess your performance, you should periodically ask yourself a series of pointed questions.
JANUARY
Reprint R0701H; OnPoint 1730; HBR Article Collection "Habits of Highly Effective Managers, 2nd Edition" 1728

Strategy and Competition

The Battle for China's Good-Enough Market
Orit Gadiesh, Philip Leung, and Till Vestring
From China's fast-growing middle market for reliable-enough products at low-enough prices will emerge the world's leading companies. Ignore it at your peril.
SEPTEMBER
Reprint R0709E; HBR Article Collection "Doing Business in China" 2487

Competitive Advantage on a Warming Planet
Jonathan Lash and Fred Wellington
Whatever business you're in, your company will increasingly feel the effects of climate change. Firms that manage and mitigate their exposure to the associated risks while seeking new opportunities for profit will gain a competitive advantage over rivals in a carbon-constrained future.
MARCH
Reprint R0703F

Finding Your Next Core Business
Chris Zook
It may be hidden right under your nose. Here's how to evaluate your current core and where to look for a new one.
APRIL
Reprint R0704D; HBR Article Collection "Growth Strategies That Work – Again and Again, 2nd Edition" 1904

The Four Principles of Enduring Success
Christian Stadler
When a company is doing well, how would anyone know if it could improve? A landmark benchmarking study – comparing prosperous companies with firms that have done even better – points the way.
JULY–AUGUST
Reprint R0707D

How Managers' Everyday Decisions Create – or Destroy – Your Company's Strategy
Joseph L. Bower and Clark G. Gilbert
Every time a manager allocates resources, that decision moves the company either into or out of alignment with its announced strategy. This powerful insight will change how you think about driving strategy in your business.
FEBRUARY
Reprint R0702C; OnPoint 1831

If You Love Your Information, Set It Free
David Weinberger
Organizations that fear sharing their data with aggregators might be surprised to learn they can benefit from letting other firms disseminate their information online.
FORETHOUGHT, JUNE
Reprint F0706A

Managing Differences: The Central Challenge of Global Strategy
Pankaj Ghemawat
To build competitive advantage, executives need to manage the differences that arise at the borders of markets. Three types of strategy are at their disposal: adaptation, aggregation, and arbitrage. The trick is figuring out when to use which ones.
MARCH
Reprint R0703C; HBR Article Collection "Choosing the Right Global Strategy" 1866

Managing Our Way to Economic Decline
Robert H. Hayes and William J. Abernathy
Unlike European and Japanese managers, American managers have sometimes avoided the hard, make-or-break decisions concerning technological competitiveness. Examining how this shortsighted neglect contributed to U.S. economic decline several decades ago offers useful lessons for today's companies.
JULY–AUGUST
Originally published in 1980
Reprint R0707L

Mapping Your Competitive Position
Richard A. D'Aveni
A price-benefit positioning map can quickly show how your product or brand stacks up against your competitors' – not as you hope it does, but as your customers actually see it.
NOVEMBER
Reprint R0711G

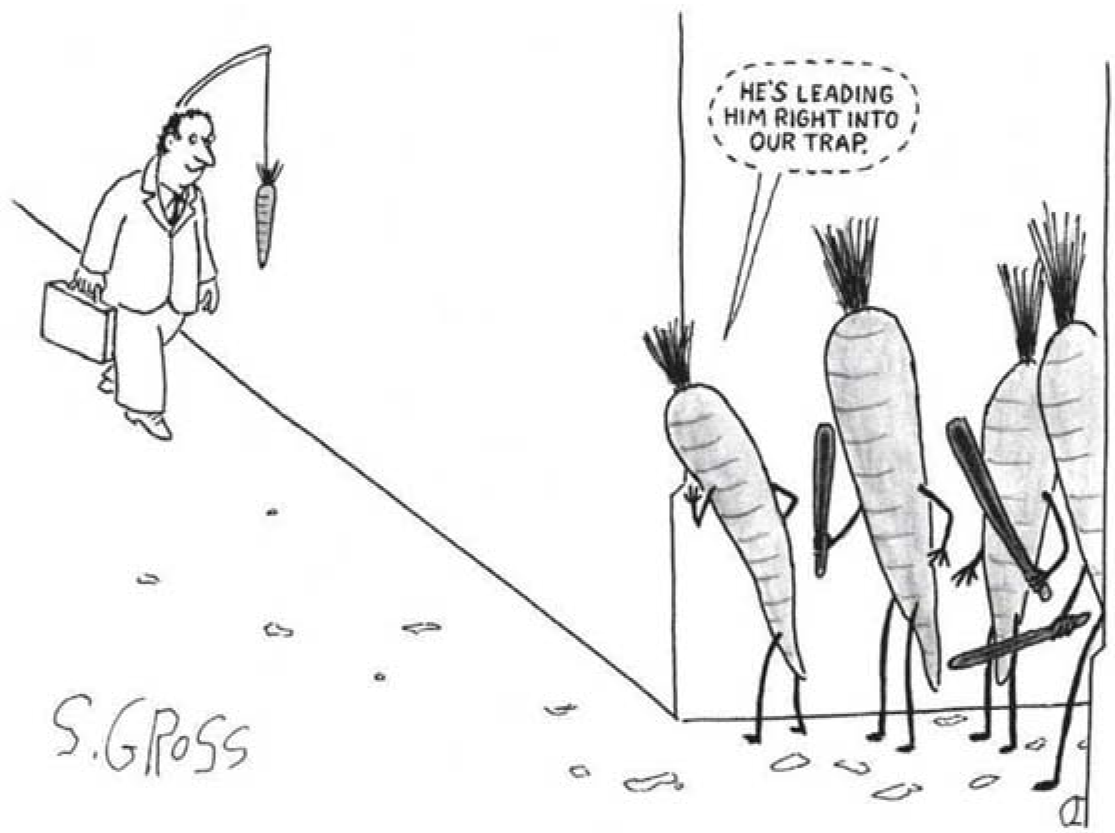
Outdoor-Apparel Start-Up CEO Chris Van Dyke on New Ways to Feed Customers' Passions
Andrew O'Connell
Chris Van Dyke, the CEO of the outdoor apparel start-up Nau, offers some intriguing ideas about how to engage a generation of customers who are comfortable shopping online and eager to enter into a dialogue with the companies they buy from.
FORETHOUGHT, SEPTEMBER
Reprint F0709F

Private Equity's Long View
Walter Kiechel III
When getting a company ready to sell in the short term, it turns out, PE firms employ many of the best strategy practices – use debt aggressively, focus on cash flow, reduce costs, concentrate on the dominant part of the business and sell the rest – that make for success in the long term. They just do it in months, not years.
FORETHOUGHT, JULY–AUGUST
Reprint F0707A

A Road Map for Natural Capitalism
Amory B. Lovins, L. Hunter Lovins, and Paul Hawken
Some farsighted companies have shown that it's possible to offer better products and more-innovative services at a significantly lower cost by being up to 100 times more efficient in the use of natural resources. Can you compete if you don't follow suit?
JULY–AUGUST
Originally published in 1999
Reprint R0707P; HBR Article Collection "Going Green, Profitably" 2280

Set Up to Fail
A Conversation with Paul Ormerod
Gardiner Morse
Most organizations bend over backward to avoid failure. They shouldn't, says economist Paul Ormerod. History shows that failure and success are inherently random, so firms should innovate and adapt.
FORETHOUGHT, JUNE
Reprint F0706G

Teams



Sam Gross

Executive Summaries

DECEMBER 2007

> The great storyteller takes time to understand what his listeners know about, care about, and want to hear.
> –page 52

LEADERSHIP

COVER STORY

52 | The Four Truths of the Storyteller

Peter Guber

A well-told story's power to captivate and inspire people has been recognized for thousands of years. Peter Guber is in the business of creating compelling stories: He has headed several entertainment companies – including Sony Pictures, PolyGram, and Columbia Pictures – and produced *Rain Man*, *Batman*, and *The Color Purple*, among many other movies. In this article, he offers a method for effectively exercising that power.

For a story to enrapture its listeners, says Guber, it must be *true to the teller*, embodying his or her deepest values and conveying them with candor; *true to the audience*, delivering on the promise that it will be worth people's time by acknowledging listeners' needs and involving them in the narrative; *true to the moment*, appropriately matching the context – whether it's an address to 2,000 customers or a chat with a colleague over drinks – yet flexible enough to allow for improvisation; and *true to the mission*, conveying the teller's passion for the worthy endeavor that the story illustrates and enlisting support for it.

In this article, Guber's advice – distilled not only from his years in the entertainment industry but also from an intense discussion over dinner one evening with storytelling experts from various walks of life – is illustrated with numerous examples of effective storytelling from business and elsewhere. Perhaps the most startling is a colorful anecdote about how Guber's own impromptu use of storytelling, while standing on the deck of a ship in Havana harbor, won Fidel Castro's grudging support for a film project.

Reprint R0712C

FORETHOUGHT

14 | What Health Consumers Want

Caroline Calkins and John Sviokla

Consumers of health care constitute a highly diverse market, but the idea that companies might segment customers and profit by addressing their varied needs seems almost foreign to the health industry. You can tap hidden value by making use of patterns in the demand for health products and services, especially if you segment consumers according to health and wealth at the same time. **Reprint F0712A**

Pandemic Preparedness: Who's Your Weak Link?

George Abercrombie

A company's ability to function during a flu pandemic is only as good as the weakest link in its supply chain. Hoffman-La Roche, the maker of a frontline antiviral drug, works closely with its suppliers to ensure that their preparedness plans are as robust as its own. **Reprint F0712B**

Mao's Pervasive Influence on Chinese CEOs

Shaomin Li and Kuang S. Yeh

Executives of multinationals partnering with Chinese firms should be alert to Mao Zedong's lingering influence on some of the country's most successful executives – and, in particular, watch for a leadership tactic that can undermine a joint venture. **Reprint F0712C**

The Truth About Private Equity Performance

Oliver Gottschalg and Ludovic Phalippou

Private equity fund performance is most often reported in a way that exaggerates the truth. A modified calculation gives a more accurate read of performance and can change a fund's relative rank. **Reprint F0712D**

Selecting Management Tools Wisely

Darrell Rigby and Barbara Bilodeau

With so many management tools out there, from benchmarking to outsourcing, it's hard to decide which ones to try. To help executives make informed choices, the authors compare levels of use and satisfaction for the most popular tools, and chart the evolution of a select few. **Reprint F0712E**

The Best Advice I Ever Got

Hans-Paul Bürkner

By watching a colleague assemble diverse, high-performing teams, the CEO of the Boston Consulting Group learned the art of nurturing individual strengths and steering team members away from tasks that would expose their weaknesses. **Reprint F0712F**

Hotter Heads Prevail

A detached and impassive executive may seem like the corporate decision-making ideal, but people make better choices when they're experiencing intense emotions, according to new research. **Reprint F0712G**

Conversation with Ed Zore

Ed Zore is the CEO of Northwestern Mutual, a highly admired 150-year-old insurer. Relevance, not innovation, matters most to customers, he says, and *should* matter most to companies as well. **Reprint F0712H**

The Flaw in Customer Lifetime Value

Detlef Schoder

Marketers commonly estimate customer lifetime value in order to decide which customers are worth continued investment. But the way companies typically calculate that value is flawed because it overlooks the real option of abandoning unprofitable customers. **Reprint F0712J**

Reviews

Featuring *A Farewell to Alms: A Brief Economic History of the World*, by Gregory Clark.

HBR CASE STUDY

31 | The Customers' Revenge

Dan Ariely

Venerable Detroit automaker Atida Motors has a new call center in Bangalore that the company hopes will raise its reputation for customer service. But it doesn't appear to be doing so yet. Complaints about the Andromeda XL – the hip new model Atida hopes will capture the imagination of Wall Street – are flooding the call center. Call backlogs are building, and letters of complaint are piling up. One loyal Atida customer is so upset about getting the brush-off that he's not only talking to a lawyer but threatening to go on YouTube and take his case to the court of public opinion. In the internet age, does Atida need a new way to deal with unhappy customers?

Tom Farmer, the creator of the unintentionally viral PowerPoint presentation "Yours Is a Very Bad Hotel," says that Atida needs to stop defining customer service solely as a response to bad news and nip problems in the bud by making online dialogue intrinsic to the brand experience.

Nate Bennett, of Georgia Tech, and Chris Martin, of Centenary College, observe that Atida has violated its customers' sense of fairness within three dimensions – distributive, procedural, and interactional – thus increasing their desire for revenge.

Lexus Vice President for Customer Service Nancy Fein thinks Atida isn't even in the ballpark when it comes to world-class customer service. She offers as an example a Lexus rep who drove 80 miles to deliver $1,000 to a stranded Lexus owner whose purse had been stolen.

Barak Libai, of Tel Aviv University and MIT's Sloan School, suggests that Atida invest in a CRM system so that it can determine which customers have enough purchasing and referral value to be given the red carpet treatment and which should be gently let go.

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| HUMAN RESOURCES |

45 | Making Relationships Work
A Conversation with Psychologist John M. Gottman

Unless you're a hermit, you can't avoid relationships. And your professional career certainly won't go anywhere if you don't know how to build strong, positive connections. Leaders need to connect deeply with followers if they hope to engage and inspire them.

Despite the importance of interpersonal dynamics in the workplace, solid research on the topic is only now beginning to emerge – and psychologist John M. Gottman, executive director of the Relationship Research Institute, is leading the way. His research shows that how we behave at work is closely related to how we behave at home.

Few people understand personal relationships better than Gottman, who has studied thousands of married couples for the past 35 years. He and his colleagues use video cameras, heart monitors, and other biofeedback equipment to measure what goes on when couples experience moments of either conflict or closeness. By mathematically analyzing the data, Gottman has provided hard scientific evidence for what makes good relationships.

In this interview with HBR senior editor Diane Coutu, Gottman emphasizes that successful couples look for ways to accentuate the positive: They try to say yes as often as possible. Even thriving relationships, however, still have room for conflict. Individuals embrace it as a way to work through essential personality differences. Gottman also points out that good relationships aren't about clear communication – they're about small moments of attachment and intimacy. Still, he warns, too much of a good thing can be a menace in the workplace, where simple friendships can spill over into emotional affairs.

Reprint R0712B

GLOBALIZATION

60 | China + India: The Power of Two

Tarun Khanna

China and India are burying the hatchet after four-plus decades of hostility. A few companies from both nations have been quick to gain competitive advantages by viewing the two as symbiotic. If Western corporations fail to do the same, they will lose their competitive edge – and not just in China and India but globally.

The trouble is, most companies and consultants refuse to believe that the planet's most populous nations can mend fences. Not only do the neighbors annoy each other with their foreign policies, but they're also vying to dominate Asia. Moreover, the world's fastest-growing economies are archrivals for raw materials, technologies, capital, and overseas markets.

Still, China and India are learning to cooperate, for three reasons. First, these ancient civilizations may have been at odds since 1962, but for 2,000 years before that, they enjoyed close economic, cultural, and religious ties. Second, neighbors trade more than non-neighbors do, research suggests. Third, China and India have evolved in very different ways since their economies opened up, reducing the competitiveness between them and enhancing the complementarities.

Some companies have already developed strategies that make use of both countries' capabilities. India's Mahindra & Mahindra developed a tractor domestically but manufactures it in China. China's Huawei has recruited 1,500 engineers in India to develop software for its telecommunications products. Even the countries' state-owned oil companies, including Sinopec and ONGC, have teamed up to hunt for oil together.

Multinational companies usually find that tapping synergies across countries is difficult. At least two American corporations, GE and Microsoft, have effectively combined their China and India strategies, allowing them to stay ahead of global rivals.

Reprint R0712D

INNOVATION & CREATIVITY

70 | Breakthrough Thinking from Inside the Box

Kevin P. Coyne, Patricia Gorman Clifford, and Renée Dye

Companies often begin their search for great ideas either by encouraging wild, outside-the-box thinking or by conducting quantitative analysis of existing market and financial data and customer opinions. Those approaches can produce middling ideas at best, say Coyne, founder of an executive-counseling firm in Atlanta, and Clifford and Dye, strategy experts at McKinsey. The problem with the first method is that few people are very good at unstructured, abstract brainstorming. The problems with the second are that databases are usually compiled to describe current – not future – offerings, and customers rarely can tell you whether they need or want a product if they've never seen it.

The secret to getting your organization to regularly generate lots of good ideas, and occasionally some great ones, is deceptively simple: First, create new boxes for people to think within so that they don't get lost in the cosmos and they have a basis for offering ideas and knowing whether they're making progress in the brainstorming session. Second, redesign ideation processes to remove obstacles that interfere with the flow of ideas – such as most people's aversion to speaking in groups larger than ten. This article offers a tested approach that poses concrete questions. For example, what do Rollerblades, Häagen-Dazs ice cream, and Spider-Man movies have in common? The answer: Each is something that adults loved as children and that was reproduced in an expensive form for grown-ups. Asking brainstorming participants to ponder how their childhood passions could be recast as adult offerings might generate some fabulous ideas for new products or services.

Reprint R0712E; HBR Article Collection "Cooking Up the Next Big Thing" 2655

LEADERSHIP

84 | What Every Leader Needs to Know About Followers

Barbara Kellerman

Countless studies, workshops, and books have focused on leaders – the charismatic ones, the retiring ones, even the crooked ones. Virtually no literature exists about followers, however, and the little that can be found tends to depict subordinates as an amorphous group or explain their behavior in the context of leaders' development. Some works even fail to sufficiently distinguish among varying types of followers – barely registering the fact that those who tag along mindlessly are a breed apart from those who are deeply devoted and consciously, actively involved. These distinctions have critical implications for the way leaders should lead and managers should manage, according to Kellerman, a professor at Harvard's Kennedy School of Government. Additionally, today's followers are influenced by a range of cultural and technological changes that have affected what they want and how they view and communicate with their ostensible leaders.

In this article, Kellerman explores the evolving dynamic between leaders and subordinates and offers a typology that managers can use to determine and appreciate how their followers are different from one another. Using the level of engagement with a leader or group as a defining factor, the author segments followers into five types: *Isolates* are completely detached; they passively support the status quo with their inaction. *Bystanders* are free riders who are somewhat detached, depending on their self-interests. *Participants* are engaged enough to invest some of their own time and money to make an impact. *Activists* are very much engaged, heavily invested in people and process, and eager to demonstrate their support or opposition. And *diehards* are so engaged they're willing to go down with the ship – or throw the captain overboard.

Reprint R0712F

MERGERS & ACQUISITIONS

92 Deals Without Delusions

Dan Lovallo, Patrick Viguerie, Robert Uhlaner, and John Horn

Pursuing a merger or acquisition is inherently difficult. Things get even harder when executives are blind to their own faulty assumptions, say Lovallo – a professor at the University of Western Australia Business School and a senior adviser to McKinsey – and three of his McKinsey colleagues. The authors identify biases that can surface at each step of the M&A process and provide practical tips for rising above them – an approach they call *targeted debiasing.*

During the preliminary due-diligence stage, biases abound. To overcome the *confirmation bias,* aggressively seek evidence that challenges your initial hypothesis about a deal. The best medicine for *overconfidence* in identifying revenue and cost synergies is to learn from precedents at your firm and others. Avoiding *underestimation of cultural differences* between your company and the target requires understanding the differences in the ways people interact at each organization. Misjudging the time and resources you need is at the core of the *planning fallacy,* which you can elude by formally identifying best practices and continually revisiting them. Finally, dilute *conflict of interest* by soliciting dispassionate external expertise.

The bidding phase is vulnerable to the *winner's curse,* a phenomenon common in auctions. To avoid paying too much for a target, actively generate alternatives to the deal under consideration and develop a set of bidding cutoff rules.

After offering an initial bid, deal makers are susceptible to *anchoring,* whereby they remain attached to their original price estimate, and to the *sunk cost fallacy* that they've invested too much to stop now. The secret to overcoming both: Use your newly available access to the target's books to better assess the investment case – and change your tune accordingly.

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OPERATIONS

101 Simplicity-Minded Management

Ron Ashkenas

Large organizations are by nature complex, but over the years new business challenges – globalization, innovative technologies, and regulations, to name a few – have conspired to add layer upon layer of complexity to corporate structure and management. Organizations have become increasingly ungovernable and unwieldy: Performance is declining, accountability is unclear, decision rights are muddy, and data are crunched repeatedly, often with no clear purpose in mind. To avoid frustration and inefficiency, executives need to systematically attack the causes of complexity in their companies.

Ashkenas and his partners at Robert H. Schaffer & Associates have worked with dozens of firms to help them develop strategies for simplifying. In this article, the author details the elements of a simplicity-minded strategy: Streamline the structure; prune products, services, and features; build disciplined processes; and improve managerial habits.

ConAgra Foods' experience illustrates how one company turned itself around through careful execution of a simplicity strategy. The packaged-food supplier had become enormously successful by acquiring well-known brands and then allowing them to operate autonomously, evolving into a $14 billion organization with more than 100 brands, a food services business, and a commodity trading operation. ConAgra, however, had no common method for reporting, tracking, or analyzing results. Over time, therefore, it became a highly unwieldy enterprise, riddled with inefficiencies and unable to communicate adequately with investors and other stakeholders. When CEO Gary Rodkin came on board, in 2005, he invested in a series of initiatives to combat complexity. The tactic not only made life easier for customers and employees but also saved millions of dollars in costs.

This article has an online interactive questionnaire that can help you assess your own company's level of complexity.

Reprint R0712H

INNOVATION & CREATIVITY

110 Is It Real? Can We Win? Is It Worth Doing?
Managing Risk and Reward in an Innovation Portfolio

George S. Day

Minor innovations make up most of a company's development portfolio, on average, but they never generate the growth companies seek. The solution, says Day – the Geoffrey T. Boisi Professor of Marketing and a codirector of the Mack Center for Technological Innovation at Wharton – is for companies to undertake a systematic, disciplined review of their innovation portfolios and increase the number of major innovations at an acceptable level of risk.

Two tools can help them do this. The first, called the risk matrix, graphically reveals the distribution of risk across a company's entire innovation portfolio. The matrix allows companies to estimate each project's probability of success or failure, based on how big a stretch it is for the firm to undertake. The less familiar the product or technology and the intended market, the higher the risk.

The second tool, dubbed the R-W-W (real-win-worth it) screen, allows companies to evaluate the risks and potential of individual projects by answering six fundamental questions about each one: *Is the market real?* explores customers' needs, their willingness to buy, and the size of the potential market. *Is the product real?* looks at the feasibility of producing the innovation. *Can the product be competitive?* and *Can our company be competitive?* investigate how well suited the company's resources and management are to compete in the marketplace with the product. *Will the product be profitable at an acceptable risk?* explores the financial analysis needed to assess an innovation's commercial viability. Last, *Does launching the product make strategic sense?* examines the project's fit with company strategy and whether management supports it.

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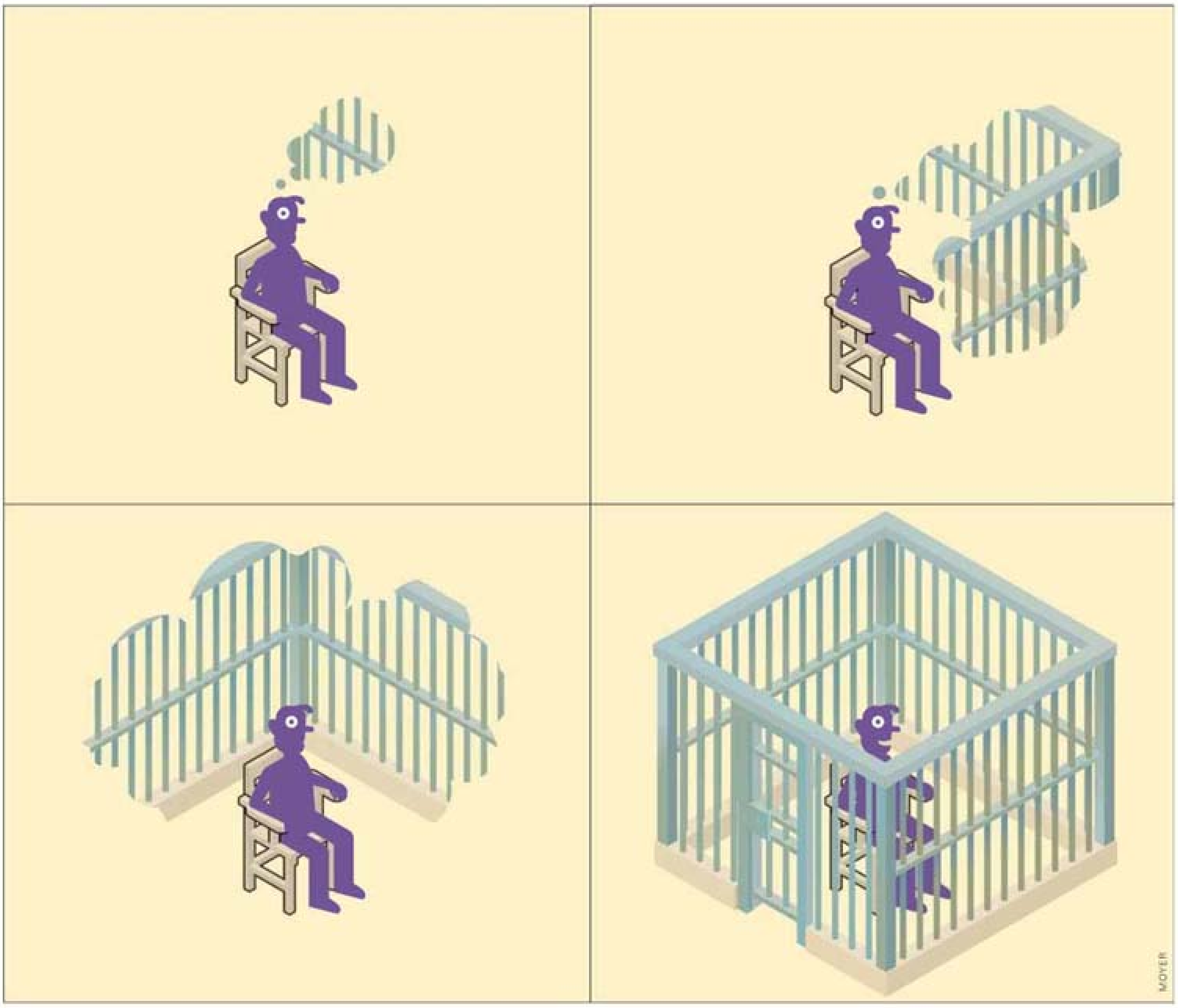

Trap Happy

THE THOUGHTS in our head offer limitless possibility. But because uncertainty is uncomfortable, we often rush to crystallize our inchoate musings into a decision. "We crave the certainty of choosing between well-defined alternatives and the closure that comes when a decision has been made," notes Roger Martin in "How Successful Leaders Think" (HBR June 2007).

Unfortunately, our desire for quick and comforting closure rules out innovative approaches that might become evident if we were to keep our options open longer. We trap ourselves in situations where we "settle for the best available bad choice," says Martin.

For example, people's strong bias in favor of alternatives that perpetuate the status quo leads to backward-looking solutions – meeting the competitive challenge of automobiles with a more sophisticated buggy whip. "Breaking from the status quo means taking action," write John S. Hammond, Ralph L. Keeney, and Howard Raiffa in "The Hidden Traps in Decision Making" (HBR September–October 1998). "And when we take action, we take responsibility, thus opening ourselves to criticism and to regret." Want to feel safe? Lock your cage.

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