

Harvard Business Review

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December 2006

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&
KRAMER**

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THE PURSUIT OF PERFECTION



**There are 193 countries in the world.
None of them are energy independent.**

So who's holding whom over a barrel?



Global Oil Flows



The fact is, the vast majority of countries rely on the few energy-producing nations that won the geological lottery, blessing them with abundant hydrocarbons. And yet, even regions with plenty of raw resources import some form of energy. Saudi Arabia, for example, the world's largest oil exporter, imports refined petroleum products like gasoline.

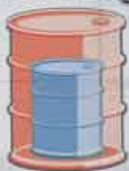
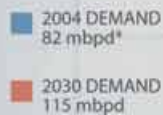
So if energy independence is an unrealistic goal, how does everyone get the fuel they need, especially in a world of rising demand, supply disruptions, natural disasters, and unstable regimes?

True global energy security will be a result of cooperation and engagement, not isolationism. When investment and expertise are allowed to flow freely across borders, the engine of innovation is ignited, prosperity is fueled and the energy available to everyone increases. At the same time, balancing the needs of producers and consumers is as crucial as increasing supply and curbing demand. Only then will the world enjoy energy peace-of-mind.

Succeeding in securing energy for everyone doesn't have to come at the expense of anyone. Once we all start to think differently about energy, then we can truly make this promise a reality.

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Projected Global Oil Demand



Source: International Energy Agency
*million barrels per day

OBJECTIVES EFFICIENCIES

ENERGY IMPORTS BY OIL EXPORTING COUNTRIES

	GASOLINE	ELECTRICITY	NATURAL GAS	COAL
Saudi Arabia				
Russia				
Norway				
UAE				
Nigeria				

Source: Energy Information Administration

WHAT NEEDS TO BE DONE

- DIVERSIFY ENERGY SUPPLIES
- FIND MORE TRADITIONAL FUELS
- DEVELOP ALTERNATIVES AND RENEWABLES
- FOSTER OPEN MARKETS & TRANSPARENCY
- ENCOURAGE CONSERVATION/ENERGY EFFICIENCY

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as well as fill up a stage.



December 2006



62 Managing the Right Tension

Dominic Dodd and Ken Favaro

Profitability or growth? The short term or the long? The organization or the units? Only one of these tensions matters to your company at any given time. Here's how to pick the right one—and avoid the traps companies fall into when they focus on only one side of a tension at a time.



HBR
Spotlight

Making a Real Difference

76 Introduction

78 Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility

Michael E. Porter and Mark R. Kramer

As Whole Foods, Volvo, and Toyota have found, when CSR initiatives are conceived within the context of a company's strategy, they can become a powerful source of opportunity, innovation, and competitive advantage, benefiting both the company and society.

94 Disruptive Innovation for Social Change

Clayton M. Christensen, Heiner Baumann, Rudy Ruggles, and Thomas M. Sadtler

Many social problems persist because organizations meant to address them focus on status quo solutions that meet the needs of narrow groups. What's required are simpler alternatives—broad-reaching, disruptive innovations in health care, education, economic development, and other sectors—that existing providers aren't set up to offer.

104 Strategies to Fight Low-Cost Rivals

Nirmalya Kumar

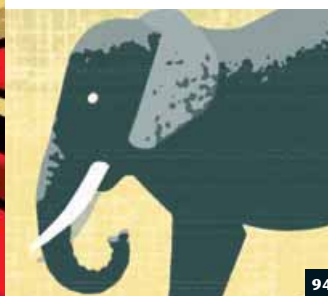
Ignoring low-cost rivals is a mistake. So is setting off a price war. Traditional companies have only a few options for responding to the latest wave of cut-price competition, but they can learn how to choose the right approach.

114 Innovating Through Design

Roberto Verganti

Products that emerge from “design-driven innovation” often point toward some new way of living—and result in long commercial lives for new designs and bold consumer expectations for the brand.

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Drone? Hardly.

*Carl Davies
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West Wales UAV Centre*

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Corporate Social Responsibility: Getting the Logic Right

If you start from the premise that business and society are interdependent, corporate social responsibility becomes an opportunity, not a duty.

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The CEO Who Couldn't Keep His Foot out of His Mouth

Lisa Burrell

Growing Places owes much of its recent profitable growth to Rob Miranda, the child care company's innovative CEO. But Rob's verbal gaffes are hurting morale and the stock price. Should his colleagues and the board keep cleaning up after him? With commentary by Ronald A. Heifetz, John H. Biggs, Torie Clarke, and Roger Brown.

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Extreme Jobs: The Dangerous Allure of the 70-Hour Workweek

Sylvia Ann Hewlett and Carolyn Buck Luce

Today's overachieving professionals labor longer, take on more responsibility, and earn more than the workaholics of yore—and their numbers are growing.



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Leadership Under Fire

Dov Frohman

How far would you go to ensure the survival of your company? How far would you have to go? The head of Intel Israel faced these questions during the First Gulf War. This is the story of the choices he made when the stakes could not have been higher.

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Lift Outs: How to Acquire a High-Functioning Team

Boris Groysberg and Robin Abrahams

Excising an experienced team from another company and implanting it into your own can quickly—and dramatically—increase your pool of talent. Learn how to maneuver your way through the four stages of a successful lift out.

142 2006 READER'S GUIDE

A listing of articles published in HBR this past year.

157 LETTERS TO THE EDITOR

Low-cost airline Southwest leaves its competitors in the dust when it comes to operating efficiency. What's really holding legacy carriers back, though, is not their misinterpretation of Southwest's success but their often vilified, yet utterly necessary, hub-and-spoke system.

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Blindsided

Don Moyer

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Corporate Social Responsibility: Getting the Logic Right

AT A DINNER IN NEW YORK last spring, a friend offered a spirited exposition of the Chicago-school argument that a corporation's only responsibility to society is to make as much money as it legally can. That's a fine theoretical position, but the others around the table, executives all, found themselves uncomfortable. Theory (and preference) aside, you can't walk that talk. A company that shunned society would soon be ostracized in return, to its very real cost. A few weeks later, at a gathering in Tokyo, an executive puzzled aloud over the opposite problem: companies that, in the name of corporate social responsibility, fund programs against their own interests. To him, an odor of hypocrisy surrounds a brewer that tells people not to drink or an oil company that calls for energy conservation.

These two positions share a logical flaw: They assume that companies and society have opposing interests. Given that premise, it is almost inevitable that a company's social-responsibility efforts will be an incoherent admixture of sincere philanthropic initiatives and reactive attempts to palliate pressure groups. They may make employees feel good and the mayor shut up, but they rarely amount to more than a hill of beans.

In fact, however, companies and society are not in different camps; they are in the same boat. Companies cannot thrive in corrupt, enervated, impoverished societies; and the train of social progress will move much faster with locomotives of private enterprise at its head. If you start from the premise that business and society are interdependent, CSR becomes an opportunity, not a duty. And if you allow Harvard's Michael Porter to guide your thinking, you can move corporate social responsibility from the PR periphery to the strategic center of general management. In "Strategy and Society," Porter and Mark Kramer explain how a company can use competitive strategy to plumb the opportunity of corporate social responsibility—and in the process strengthen its own long-term competitiveness while producing much more social good than traditional CSR does.

To me, Michael Porter's work always delivers two seemingly contradictory rewards. It's surprising ("That's the



answer!"), and it's inevitable ("Why didn't I see it before?"). Maybe that's why his analysis feels as practical as it does smart. I had that same double reaction to "Managing the Right Tension," by Dominic Dodd and Ken Favaro of the Marakon Associates consulting firm. In every company I've known, there are wrestling matches between short- and long-term performance, profitability and growth, and the interests of the corporation as a whole and those of its units. The bouts are almost always unproductive. Worse, if one side wins – "We're going for growth!" – the next turn of

the wheel of fortune reverses the decision. Dodd and Favaro show two things: First, at any given time, only one of these tensions matters most. Second, the best way to manage the right tension, once you've identified it, is not to pick one side over the other (after all, you want both) but to find how best to strengthen what the two sides have in common (in the case of growth and profitability, it's customer benefit). This is a brilliant article: Don't miss it.

Over the past few months, we have invested a lot of thought in our Web site, www.hbr.org. Our goal is to create the world's premier management site – a magazine and companion that helps you become better leaders, see the future first, and discover ideas that really work. The effort, led by senior editor Eric Hellweg, is starting to pay off in a better-looking site, clearer navigation, and new features. We will unveil a complete redesign in a few months. Meanwhile, don't let the great be the enemy of the good. Subscribers can register on the site for free access not only to the current issue but also to a full year's worth of articles. A premium subscription gives you exclusive access to the entire HBR archive online – an extraordinary trove of the best business thinking ever.

Thomas A. Stewart

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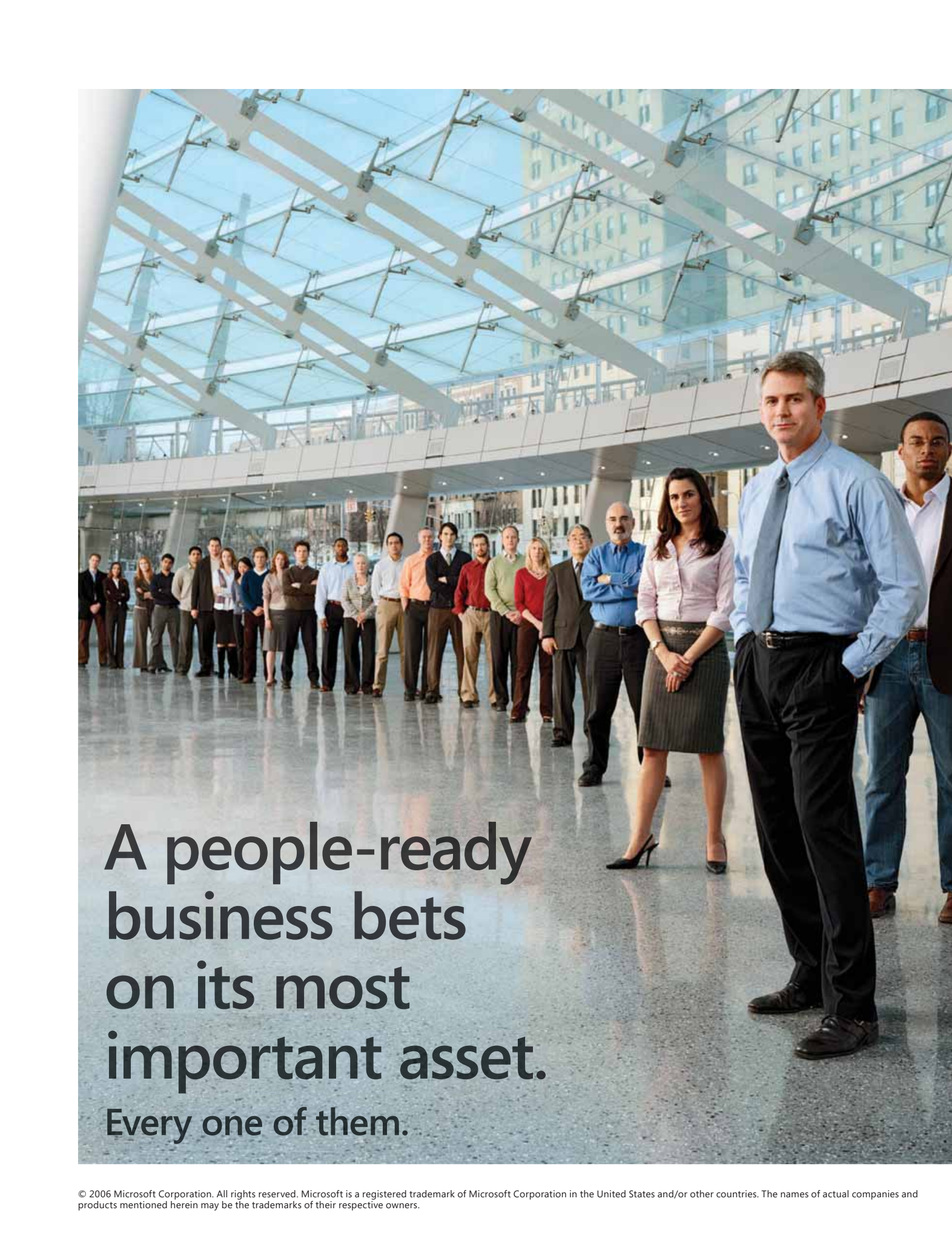
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A survey of ideas, trends, people, and practices on the business horizon



GRIST

The Curse of Knowledge by CHIP HEATH AND DAN HEATH

Many sensible strategies fail to drive action because executives formulate them in sweeping, general language. “Achieving customer delight!” “Becoming the most efficient manufacturer!” “Unlocking shareholder value!” One explanation for executives’ love affair with vague strategy statements relates to a phenomenon called the curse of knowledge. Top executives have had years of immersion in the logic and conventions of business, so when they speak abstractly, they are simply summarizing the wealth of concrete

data in their heads. But frontline employees, who aren’t privy to the underlying meaning, hear only opaque phrases. As a result, the strategies being touted don’t stick.

In 1990, a Stanford University graduate student in psychology named Elizabeth Newton illustrated the curse of knowledge by studying a simple game in which she assigned people to one of two roles: “tapper” or “listener.” Each tapper was asked to pick a well-known song, such as “Happy Birthday,” and tap out the

rhythm on a table. The listener’s job was to guess the song.

Over the course of Newton’s experiment, 120 songs were tapped out. Listeners guessed only three of the songs correctly: a success ratio of 2.5%. But before they guessed, Newton asked the tappers to predict the probability that listeners would guess correctly. They predicted 50%. The tappers got their message across one time in 40, but they thought they would get it across one time in two. Why?

WENDY WAHMAN

When a tapper taps, it is impossible for her to avoid hearing the tune playing along to her taps. Meanwhile, all the listener can hear is a kind of bizarre Morse code. Yet the tappers were flabbergasted by how hard the listeners had to work to pick up the tune.

The problem is that once we know something—say, the melody of a song—we find it hard to imagine not knowing it. Our knowledge has “cursed” us. We have difficulty sharing it with others, because we can’t readily re-create their state of mind.

In the business world, managers and employees, marketers and customers, corporate headquarters and the front line, all rely on ongoing communication but suffer from enormous information imbalances, just like the tappers and listeners.

Leaders can thwart the curse of knowledge by “translating” their strategies into concrete language. Consider Trader Joe’s, a specialty food chain whose mission is “to bring our customers the best food and beverage values and the information to make informed buying decisions.” That’s the company’s abstract umbrella statement, and it hardly serves to distinguish Trader Joe’s from other retailers. But shopping at Trader Joe’s is nothing like shopping at Wal-Mart, and its aisles are full of inexpensive but exotic foodstuffs like Moroccan simmer sauce and red-pepper soup.

Trader Joe’s beats the curse of knowledge and pours meaning into its strategy by using concrete language elsewhere. It touts its reputation as the “home of cheap thrills,” describing its target customer as an “unemployed college professor who drives a very, very used Volvo.” The image is a simplification, obviously; at any given moment, there are probably zero of these “target customers” in Trader Joe’s. But because it simplifies a complex reality, the description ensures that all the employees of the organization have a common picture of its customers.

Would the professor like the red-pepper soup? Yes.

Stories, too, work particularly well in dodging the curse of knowledge, because they force us to use concrete language. FedEx, for example, uses a story related to its Purple Promise award, which honors employees who uphold FedEx’s guarantee that packages will “absolutely, positively” arrive overnight: In New York, a FedEx delivery truck broke down and the replacement van was running late. The driver initially delivered a few packages on foot; but then, despairing of fin-

ishing her route on time, she managed to persuade a competitor’s driver to take her to her last few stops.

Stories like this are tangible demonstrations of the company’s strategic aim to be the most reliable shipping company in the world. A top sales executive can use the New York story to say “This is how seriously we take reliability.” A new delivery driver can use the story as a guide to behavior: “My job is not to drive a route and go home at 5 PM; my job is to get packages delivered any way I can.”

STUDIES SHOW

Interest Doesn’t Always Compound

by MARC ABRAHAMS

When executives jet off to manage important offices in faraway places, it’s usually with a sense of eager anticipation. But they—and those who send them—need to manage expectations. Jeffrey Auerbach, an associate professor of history at California State University, Northridge, examined the workaday reality for executives in one of history’s great multinational enterprises: the British Empire.

Auerbach writes, “Throughout the nineteenth century and into the twentieth, British imperial administrators at all levels were bored by their experience traveling and working in the service of king or queen and country. Yet in the public mind, the British empire was thrilling—full of novelty, danger, and adventure, as explorers, missionaries, and settlers sailed the globe in search of new lands, potential converts, and untold riches.” But, Auerbach continues, “The reality simply could not live up to the expectations created by newspapers, novels, travel books, and propaganda. As a consequence, notwithstanding some famous exceptions, nineteenth-century colonial officials were deflated by the dreariness of their imperial lives, desperate to ignore or escape the empire they had built.”

As companies dispatch executives around the globe, the managers who send them should be mindful of the physical and emotional toll foreign assignments can take. Maybe those far-flung executives really are living their dream jobs and making the enterprise efficient and profitable. But that’s a big assumption.

MARC ABRAHAMS (marca@chem2.harvard.edu) is the editor and cofounder of the scientific humor magazine *Annals of Improbable Research*. In this regular *Forethought* column, he unearths studies that shed the oblique light of multidisciplinary research on the science of management.

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Concrete language and stories defeat the curse of knowledge and make executives' strategy statements stickier. As a result, all the members of an organization can share an understanding of the strategies and a language for discussing them.

CHIP HEATH (chip.heath@stanford.edu) is a professor of organizational behavior at Stanford Business School in California.

DAN HEATH (jdaneheath@gmail.com) is a consultant at Duke Corporate Education in Durham, North Carolina, and a co-founder of Thinkwell, a new-media publishing company in Austin, Texas. They are the authors of *Made to Stick: Why Some Ideas Survive and Others Die*, forthcoming from Random House in January.

Reprint F0612A

GENDER

How Many Women Do Boards Need?

by ALISON M. KONRAD AND VICKI W. KRAMER

Only about 15% of *Fortune* 500 board members are women—a conspicuously low figure. But, apart from issues of equity, is there any reason that companies should increase the number of women on their boards? Absolutely. To study the effect on boardroom dynamics of increasing a female presence, we interviewed 50 women directors, 12 CEOs (nine of them male), and seven corporate secretaries (one of them male) at *Fortune* 1000 companies. This work, done in collaboration with Sumru Erkut of the Wellesley Centers for Women, exposed dramatic differences among boards with one, two, or at least three women directors.

Interviewees said that women directors make three contributions that men are less likely to make: They broaden boards' discussions to better represent the concerns of a wide set of stakeholders, including employees, customers, and the community at large. They can be more dogged than men in pursuing answers to difficult questions (possibly because, as one male CEO put it, "the men feel a gender obligation to behave



as though they understand everything"). And they tend to bring a more collaborative approach to leadership, which improves communication among directors and between the board and management.

Reaping the value of these contributions, though, depends on having the right number of women. Solo women on boards often feel isolated and marginalized. When they are effective, it's not *because of* but *in spite of* being the only woman. Adding a second woman to a board helps reduce the sense of isolation, but it doesn't always cause change and may create its own difficulties. Two women may be perceived as a separate group and may find they have to be careful not to appear to be conspiring. What's more, they may not be distinguished from each other. One woman we spoke to explained, "I raised a question at a board meeting that caused the board to take some important action. Later on, the chairman thanked the other woman on the board for raising the question. No one said anything to correct him."

A clear shift occurs when boards have three or more women. At that critical mass, our research shows, women tend to be regarded by other board members not as "female directors" but simply as directors, and they don't report being isolated or ignored. Three women or more can also change the dynamic on an average-size board. As one woman director said, "The competition to get your voice heard is over. It's a supportive dynamic—less combative, more collaborative. You can see the guys decompress from their normal very aggressive style."

This culture change improves the board's overall performance. One male

CEO observed that as more women were added to the board, the original female directors became more active: "They were more vocal, more willing to push their issues, more relaxed."

A woman CEO in our study noted a "total and positive change" with the addition of more women; she said that men on the board acknowledged "how terrific the discussions and richness of outcomes have been" and that with women's voices, "there is a higher level of understanding of the business." Echoing that perception, one corporate secretary noted that having three or more women on a board makes the dynamic "much more conversational and less hierarchical and, as a result, all the directors get better information."

In 2005, only 76 of the *Fortune* 500 had three or more women on their boards. If companies want to fully realize the contribution that women can make to corporate governance, the goal should be not just to increase the number of boards that include a woman but to increase the number of women on boards.

ALISON M. KONRAD (akonrad@ivey.uwo.ca) is a professor of organizational behavior and holds the Corus Entertainment Chair in Women in Management at the Richard Ivey School of Business in London, Ontario. **VICKI W. KRAMER** (vickiwkramer@comcast.net) is the principal of V. Kramer & Associates in Philadelphia, a consultancy specializing in organizational effectiveness. The full report on this research, *Critical Mass on Corporate Boards*, is available from the Wellesley Centers for Women in Wellesley, Massachusetts.

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RETAILING

The High Cost of Low Wages

by WAYNE F. CASCIO

Wal-Mart's legendary obsession with cost containment shows up in countless ways, including aggressive control of employee benefits and wages. Managing labor costs isn't a crazy idea, of course. But stingy pay and benefits don't necessarily translate into lower costs in the long run.

Consider Costco and Wal-Mart's Sam's Club, which compete fiercely on low-price merchandise. Among warehouse retailers, Costco—with 338 stores and 67,600 full-time employees in the United States—is number one, accounting for about 50% of the market. Sam's Club—with 551 stores and 110,200 employees in the United States—is number two, with about 40% of the market.

Though the businesses are direct competitors and quite similar overall, a remarkable disparity shows up in their wage and benefits structures. The average wage at Costco is \$17 an hour. Wal-Mart does not break out the pay of its Sam's Club workers, but a full-time worker at Wal-Mart makes \$10.11 an hour on average, and a variety of sources suggest that Sam's Club's pay scale is similar to Wal-Mart's. A 2005 *New York Times* article by Steven Greenhouse reported that at \$17 an hour, Costco's average pay is 42% higher than Sam's Club's (\$9.86 an hour). Interviews that a colleague and I conducted with a dozen Sam's Club employees in San Francisco and Denver put the average hourly wage at about \$10. And a 2004 *BusinessWeek* article by Stanley Holmes and Wendy Zellner estimated Sam's Club's average hourly wage at \$11.52.

On the benefits side, 82% of Costco employees have health-insurance coverage, compared with less than half at Wal-Mart. And Costco workers pay just 8% of their health premiums, whereas Wal-Mart workers pay 33% of theirs. Ninety-one percent of Costco's employees are covered by retirement plans, with the company contributing an annual av-

erage of \$1,330 per employee, while 64 percent of employees at Sam's Club are covered, with the company contributing an annual average of \$747 per employee.

Costco's practices are clearly more expensive, but they have an offsetting cost-containment effect: Turnover is unusually low, at 17% overall and just 6% after one year's employment. In contrast, turnover at Wal-Mart is 44% a year—close to the industry average. In skilled and semi-skilled jobs, the fully loaded cost of replacing a worker who leaves (excluding lost productivity) is typically 1.5 to 2.5 times the worker's annual salary. To be conservative, let's assume that the total cost of replacing an hourly employee at Costco or Sam's Club is only 60% of his or her annual salary. If a Costco employee quits, the cost of replacing him or her is therefore \$21,216. If a Sam's Club employee leaves, the cost is \$12,617. At first glance, it may seem that the low-wage approach at Sam's Club would result in lower turnover costs. But if its turnover rate is the same as Wal-Mart's, Sam's Club loses more than twice as many people as Costco does: 44% versus 17%. By this calculation, the total annual cost to Costco of employee churn is \$244 million, whereas the total annual cost to Sam's Club is \$612 million. That's \$5,274 per Sam's Club employee, versus \$3,628 per Costco employee.

In return for its generous wages and benefits, Costco gets one of the most loyal and productive workforces in all of retailing—and, probably not coincidentally, the lowest shrinkage (employee theft) figures in the industry. While Sam's Club and Costco generated \$37 billion and \$43 billion, respectively, in U.S. sales last year, Costco did it with 38% fewer employees—admittedly, in part by selling to higher-income shoppers and offering more high-end goods. As a result, Costco generated \$21,805 in U.S. operating profit per hourly employee, compared with \$11,615 at Sam's Club. Costco's stable, productive workforce more than offsets its higher costs.

These figures challenge the common assumption that labor rates equal labor costs. Costco's approach shows that when it comes to wages and benefits, a cost-leadership strategy need not be a race to the bottom.

WAYNE F. CASCIO (*Wayne.Cascio@cudenver.edu*) is the U.S. Bank Term Professor of Management at the University of Colorado at Denver and Health Sciences Center. This article is adapted from his paper "Decency Means More than 'Always Low Prices': A Comparison of Costco to Wal-Mart's Sam's Club" (Academy of Management Perspectives, August 2006).

Reprint F0612D



MARKETING

Reverse Product Placement in Virtual Worlds

by DAVID EDERY

It's no secret that video games represent a potentially powerful marketing channel. The twin consumer trends of skipping TV ads with TiVo and spending more time in 3D virtual worlds have many marketers considering product placement in video games. Studies suggest that well-designed placements in games are more effective than placements on television or in films because, in a game's immersive environment, players can interact with the products they see.

But while embedding products in video games is increasingly common, an equally interesting commercial opportunity has gone relatively unnoticed: reverse placement, or the commercial translation of *fictional* brands or products from games into the real world. We've seen this occur occasionally with other media. Bertie Bott's Every Flavor Beans, a candy found in the Harry Potter books and movies, was converted into a popular real-world product by Cap Candy, a division of Hasbro. New flavors—including, in 2006, pickle and sausage—encourage repeat purchases of a product that allows children to gleefully share Harry Potter's nauseating ex-

periences if not his magic powers. The candy has all the right characteristics for reverse placement: It is memorable; it is prominently featured in the Harry Potter franchise; and it fits naturally in the context of the fiction, unlike many product placements that seem to have been shoe-horned into games and other media.

Although Every Flavor Beans emerged from the mind of J. K. Rowling, consumer product companies could take the initiative in creating virtual products for games. Why spend tens or hundreds of millions of dollars fighting mature competitors for mindshare and shelf space in the physical world when you can launch a new offering in an uncluttered fictional one? Indeed, with ever more consumers playing video games (including the on-line "massively multiplayer" variety, in which thousands of people can interact simultaneously), the physical world may ultimately cease to be the most important battleground for new products.

Ilya Vedrashko, a former media analyst for MIT's Convergence Culture Consortium, recently studied the possibility of introducing a cola not in commercials but in *Grand Theft Auto*—where it can be virtually consumed by millions of people over the course of hundreds of hours of play. Sound farfetched? Think again: *Grand Theft Auto* already features a soda called Sprunk (a parody of Sprite) that is one of the more recognizable fictional brands in popular media today.

Square Enix, publisher of the *Final Fantasy* video game franchise, surely recognized the possibilities when it recently decided to partner with Suntory, a beverage manufacturer, to market a new energy drink in Japan. The drink, called Potion, is intended to evoke the "health potion" that players of *Final Fantasy* can consume to restore their characters' "hit points" during a game. Potion was launched in March 2006 in two versions, one a standard bottle and the other a special bottle including a *Final Fantasy XII* "art card." Both proved popular and sold fast, with the three million units of the latter selling out especially quickly, according to Square Enix.

Theoretically, reverse placement should work for a wide range of consumer products. Clothing, toys, cell phones, and watches could all be introduced to consumers in video games and virtual worlds before they entered the real world. For example, to gauge consumer interest, the American Apparel clothing chain recently launched its first line of jeans in a store that appears in the virtual world *Second Life* several months before launching them in its real-world stores. Virtual products and brands could be created by consumer products companies, as American Apparel has done with its jeans; by video game developers, as *Grand Theft Auto*'s creator Rockstar Games has done with Sprunk; or even by game players themselves, as people are able to do in a user-created world like *Second Life*.

The first companies to seriously and thoughtfully exploit the potential of advertising and product creation in games will find themselves rewarded with lower costs for market entry and, ideally, enhanced customer relationships. And if nothing else, reverse placement promises to be more fun than, say, your umpteenth focus group.

DAVID EDERY (djedery@MIT.edu) is the worldwide games portfolio planner for Microsoft's Xbox Live Arcade in Redmond, Washington, and a research affiliate at the Massachusetts Institute of Technology's Comparative Media Studies Program in Cambridge, Massachusetts.

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Conversation

LARRY WINGET ON “IRRITATIONAL” LEADERSHIP

Shut Up and Stop Whining



Larry Winget bills himself as “The Pitbull of Personal Development” and travels around the world telling corporate audiences to stop complaining and take responsibility for their lot.

Hundreds of companies, including *Fortune* 500 firms such as IBM, Merck, and McDonald’s, have invited Winget to rant at managers and employees alike, hoping that his aggressive method and blunt message will inspire better performance. We spoke with Winget about his upcoming book, *It’s Called Work for a Reason!*, and why managers’ usual attempts at motivation are a waste of time. Following are edited excerpts of the conversation.

Your approach to audiences can be pretty abusive. What’s that about?

To get any idea across, first you have to wake people up. You know the old story about the mule—you can’t get a mule’s attention until you hit it in the head with a two-by-four? I’m sort of the two-by-four. I’m not like your typical business speaker who shows up and gives people a lot of jargon and statistics. I communicate very directly. Some consultant might say to the management team, “Poor employee performance reflects poor managerial skills.” What I say to them is “If your employees suck, it’s because you as managers suck!” And all of a sudden it becomes real personal. That’s not abusive. It’s just clear.

Why do they listen to you?

I think because I’m authentic. I’ve run businesses, I’ve gone bankrupt in business, and I’ve made millions in business. I’ve been a leader—I was a sales manager at AT&T—and I’ve shoveled manure. You name it. About ten years ago, I was your typical motivational speaker. I spoke on leadership and customer service and sales. At about that time, I was onstage and somebody heckled me. I’d never been heckled. I stopped and I said, “You know, bud, you ought to shut up and stop whining.” And the audience went crazy. I said, “I’m tired of trying to make you happy and convince you to be better. You’ll be better if you want to get better. And if you don’t want to get better, get out of everybody else’s way.” The audience loved it. And I thought, “Gee, that worked pretty good.” So I decided to quit giv-

ing the speech the audience wanted me to give and start giving the one I wanted to give. The one I wanted to give says “Your poor business results are your own fault. You created them. You can blame the customer, Wal-Mart, the economy, the Republicans, the Democrats, whoever you want. But the bottom line is, somebody’s successful in your industry, and if they can do it, you can do it.”

What’s wrong with the usual type of motivational talk? Motivational speeches are about making people feel good about themselves and enthusiastic about where they can go. But in my experience, it doesn’t work to paint a rosy picture and say “Doesn’t it look great over there?” and expect everyone to drop what they’re doing and go in that direction. What I do is, instead of trying to make people feel good about where they could go, I make them uncomfortable with where they are. I irritate them. That’s why I call myself an irritational speaker instead of a motivational speaker. You’ve got to be sick and tired of things being how they are before you can change. So I tell people, “You are better than the results you are getting. You shouldn’t be satisfied with where you are. You deserve better, and your customers deserve better.” I can make people so uncomfortable with where they are that they’ll do anything to be someplace else. And that’s what I think managers should do: create irritation through high expectations. As a leader, you should say to employees, “This is how I expect things to be. And if you’re not comfortable with that, go somewhere else where less is expected of you.”

You head up a multimillion-dollar company built on your brand. How are you as a manager?

I’m tough but fair. I always communicate clearly what I expect to be done, and then I always inspect what I expect. I’m very easy to get along with as long as people do their best and take responsibility for any mistake they make. If someone comes to me and says “Larry, I screwed up, and I’m sorry, and here’s what I plan to do to fix it, and I need your help in this way,” that goes a long way with me. But if someone lies to me, or shirks their responsibility, they’re done.

—GARDINER MORSE

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KNOWLEDGE MANAGEMENT

What's Your Return on Knowledge?

by DON COHEN

Businesses have been trying—and mainly failing—to calculate the return on knowledge-management investments for more than a decade. Early efforts to compute the total value of organizational knowledge were not only unconvincing but beside the point: They ignored the questions of how much of that knowledge was actually used to benefit the organization and whether efforts to capture and share knowledge put more of it to profitable use. Measures of KM activity—say, the number of documents downloaded from a repository—have a similar limitation: They don't tell you if access to those documents contributed enough to organizational performance to offset the costs of providing them.

The measurement problem hasn't been solved, but interviews I conducted with KM practitioners at more than a dozen organizations—ranging from high-tech, pharmaceutical, and oil companies to consultancies, government agencies, and NGOs—suggest that we have gotten savvier about it. We are beginning to understand when to look for a traditional return on investment in knowledge management, when trying to specify a dollar amount is inappropriate, and how to know whether KM investments are worthwhile when you can't come up with a convincing ROI.

Some firms do successfully measure return on their KM investments, but only for certain kinds of work. For instance, oil companies have shown that sharing technical knowledge among drilling teams reduces problems and speeds the process, saving tens of millions of dollars a year in the cost of establishing new wells. Xerox's Eureka database for communicating copier-repair tips among technicians cuts costs by about 10%. Xerox arrived at that figure by conducting a controlled experiment to compare the efficiency of groups that did or did not use the database. In instances like these, the key to measurability is focusing on activities

that are too complex to be captured in a standard set of instructions but are repeated, with variations, again and again.

When it comes to things like strategy consulting or basic research, though, it's often impossible to connect knowledge supplied with dollars earned or saved so directly. Consulting firms, among the most ardent users of knowledge management, understand that many interrelated factors—from subject-area expertise to tacit organizational knowledge to the robustness of their business networks—play a role in winning a particular contract or carrying out a lucrative engagement. There is no formula for determining how much knowledge management contributes to those successes. Nor is there a precise way to measure the return on KM investments in research that may (or may not) produce a hugely profitable innovation five years down the road. Attempts to quantify return on KM investments in such cases are likely to measure things that don't matter and miss things that do. In a consulting company, for instance, time saved—a common KM statistic—is a less important measure of the return on knowledge management than the quality of the output and its impact on the firm's reputation. Though time saved may be measurable, there's no guarantee it will be used productively. Quality and impact on organizational reputation, though they would be good measures of KM value, largely defy quantification.

So how do knowledge-based organizations approach the measurement problem? In the past, many KM initiatives were designed to make lots of knowledge available to lots of people, the assumption being that all that knowledge floating around was bound to generate some value. Because the effectiveness of such broad efforts is uncertain and unmeasurable, smart leaders today increasingly require clarity about the specific goals of KM efforts before approving them: Projects more often target particular roles, groups, or processes, and the expected outcomes are articulated up front.

Leaders of the knowledge-based organizations that have the most vibrant KM programs approach the measurement

problem by accepting soft indicators that knowledge management is earning its keep rather than demanding hard numbers that may be misleading. They do insist that the programs be evaluated, but they accept anecdotes about successful (or failed) knowledge reuse, stories of productive (or unproductive) collaborative projects, and surveys of employee and customer satisfaction as the best indicators of value. They realize that a telling anecdote is a better “measure” than a precise but irrelevant number. Knowing what you're striving for with your knowledge management makes it much easier to determine whether you're getting value for the money spent—even if the ROI never shows up on a balance sheet.

DON COHEN (doncohen@rcn.com) is a consultant on organizational knowledge and a research fellow with the Working Knowledge program at Babson College in Wellesley, Massachusetts.

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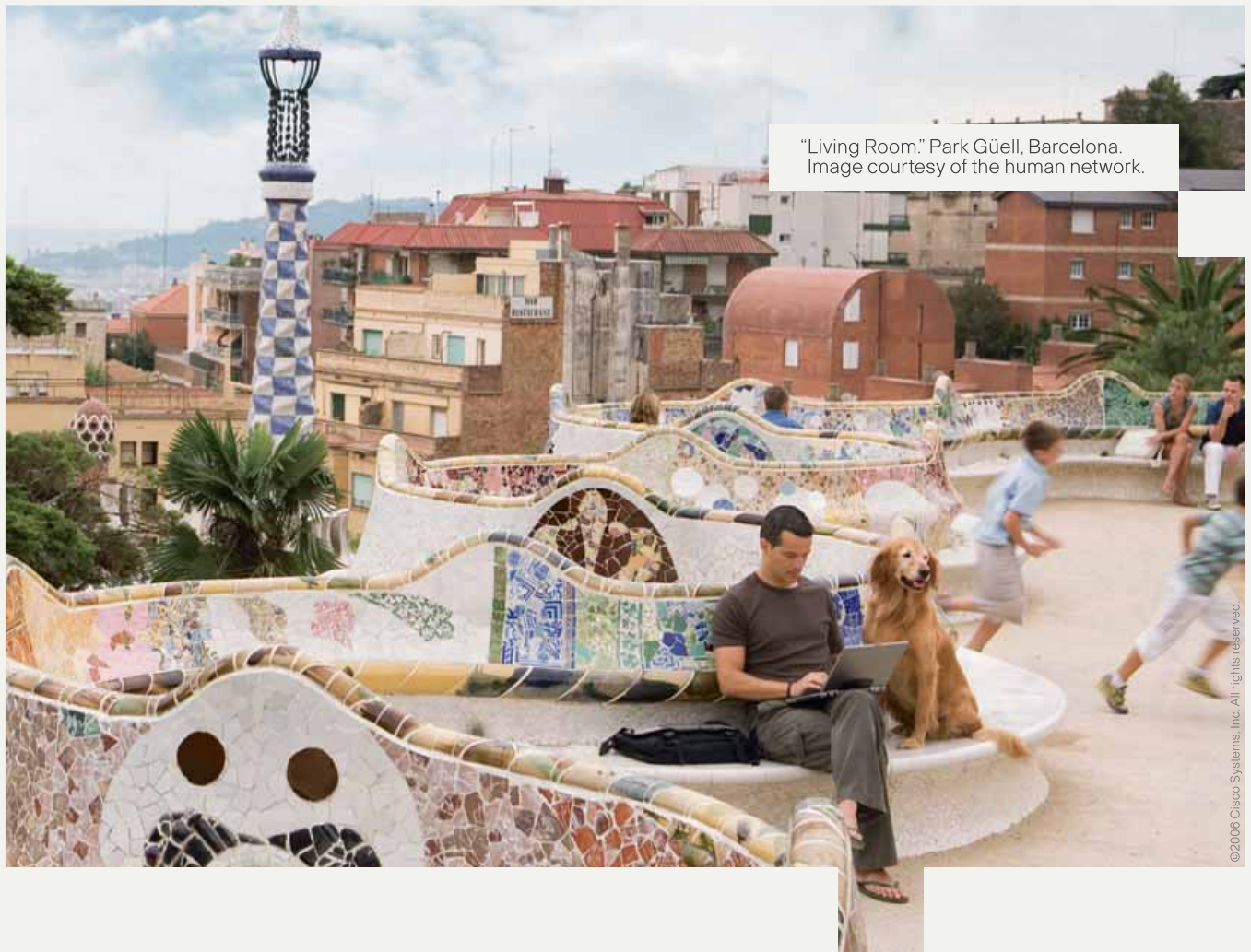
HUMAN RESOURCES

Tapping a Risky Labor Pool

by BRIAN BALLOU AND DAN L. HEITGER

The largest pool of unskilled entry-level labor in the United States consists of the 35 million people who are chronically unemployed or considered working poor because they earn less than 200% of the federal poverty-level income. In light of the significant financial and operational costs of high employee turnover, that's a risky pool for businesses to tap and manage, but they often have to do so to meet their labor needs, especially in industries such as retail, health care, manufacturing, and leisure. Legal and political pressure to replace the 7.5 million illegal immigrant workers in the United States with domestic employees makes it all the more important that companies get a handle on this part of the workforce.

Cincinnati Works, a nonprofit employment agency in Ohio, provides an innovative business model for doing so. Since



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its inception in 1996, the organization has greatly reduced turnover for many companies—in some cases, by more than half—by placing 4,000 working poor and chronically unemployed people in jobs and then providing services that help keep them there. Citigroup, Greyhound, Hilton, HMSHost, and Kroger, among others, have hired workers through its program.

After conducting numerous surveys and small-sample empirical studies, Cincinnati Works designed a risk-management tool kit that focuses on barriers to making an unstable workforce reliable and promotable. The agency monitors the performance of the workers it places and deals with the risks of placing them by identifying, measuring, and managing several key factors.

For example, through observation and externally conducted research, Cincinnati Works identified depression as a major barrier to job retention. (See the exhibit

“Managing Barriers to Employee Retention.”) So the agency hired mental- and spiritual-health experts to teach courses and provide one-on-one counseling, thus equipping employees to handle their fear of change, develop positive work attitudes, and build on their personal strengths in order to sustain employment. All people identified as chronically unemployed participate in a one-week workshop, after which they have access to services as needed. More than 67% of those placed through Cincinnati Works stay with the same employer for longer than a year. This beats the one-year retention rate of 25% achieved by agencies that place workers in similar jobs but do not focus on managing barriers to workforce sustainability.

At Fifth Third Bank, a prominent Cincinnati Works client, 90% of workers hired through the program stay at least one year. Compare that with the company’s one-year retention rate of 50% for

employees in comparable jobs who have not had access to the program’s services, such as meetings with a conflict-management counselor. This differential is typical among employers with highly structured environments; however, the Cincinnati Works model has been less successful at companies that don’t carefully define the tasks employees are expected to perform.

Fifth Third estimates that employee turnover costs 1.5 times the worker’s annual salary. Because the company has retained 36 of the 40 Cincinnati Works employees it has hired (as opposed to the 20 it would have kept under its usual retention rate), it has saved—based on an average salary of \$20,000—about \$480,000 through the program over the past three years.

The Cincinnati Works model is being replicated in Houston, where the urban-renewal expert Barbara Elliott is customizing it to address that location’s risks. For example, 90 languages are spoken in Houston public schools, and that fact shapes Elliott’s strategy for communicating with job seekers, matching employers with employees, and managing immigration issues.

Although the business model Cincinnati Works uses is probably too expensive for a company to implement on its own, such a model can serve many hiring organizations at once by providing a large pool of reliable, stable entry-level workers. Cincinnati Works spreads its barrier-removal costs across all job seekers placed each year (projected to be 700 in 2006), resulting in an average placement cost of about \$1,200. As we’ve seen, the savings in turnover well exceed this expense. The agency’s approach should bring similar savings anywhere entry-level jobs are continually filled, as long as the barriers are properly identified and managed.

BRIAN BALLOU (balloubj@muohio.edu) and **DAN L. HEITGER** (heitgedl@muohio.edu) are on the accounting faculty of Miami University’s Richard T. Farmer School of Business in Oxford, Ohio. They are also codirectors of the school’s Center for Governance, Risk Management, and Reporting.

Reprint F0612H

Managing Barriers to Employee Retention

Through observation and research, the nonprofit employment agency Cincinnati Works identified the factors most likely to keep unskilled entry-level workers from remaining in jobs. Here are the top three, along with the ways the agency measures and manages them. Cincinnati Works has found that most of these workers face multiple barriers (including some not listed here) and can achieve financial self-sufficiency only when all of them are under control.

Barrier	Unstable work history	Behavioral issues, such as depression and anger-management problems	Poor communication skills
Measured by	Number of jobs during the past year Average length of stay in previous jobs Absenteeism rates in previous jobs	Behavioral counselors’ assessment scores (gauging, for instance, probability of workplace violence) Number of self-reported workmen’s compensation claims in previous jobs Number of self-reported conflicts with previous coworkers	Supervisors’ evaluations of reading and writing skills and of ability to follow instructions
Managed by	Ensuring complete and accurate work history on applications to forestall rejection for omissions Repeatedly stressing “one year at one job” and denying access to core CW employers for failure to adhere to that goal Enhancing advancement prospects by offering computer classes, driver’s training, college courses, and career planning assistance	Providing on-site behavioral counseling and meaningful support from all professional staff	Teaching appropriate business communication skills Inviting employers to conduct CW-designed sessions on expectations and communication Providing communication coaching for both workers and supervisors

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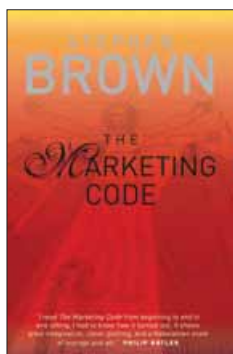
The Marketing Code

by Stephen Brown

(Cyan/Marshall Cavendish, 2006)

I've always enjoyed the reaction I get when I try to turn someone on to one of my favorite 1990s pop bands—Dread Zeppelin. It's a Led Zeppelin cover band, I explain, except the songs are all recast as reggae. As my listener's polite smile falters, I add the kicker: And the lead singer is an Elvis impersonator.

I'm having the same fun lately recommending *The Marketing Code*, by Stephen Brown, a professor of marketing research at the University of Ulster.



It's a marketing text, except that it's cast as a fictional narrative. It's so full of inside jokes about marketing that it could be classified as business humor. And did I mention it's a parody of *The Da Vinci Code*?

Somehow it succeeds in spite of itself. As pure parody, it's pitch-perfect. We're treated to the same kinds of curious codes, conspiracies, and cliff-hangers that made Dan Brown's book the world's all-time best seller. Grisly murders lead a reluctant hero to a trail of word games as clues and a series of "Who's a friend, who's a foe?" encounters. There's

even a character whose freakish physical presence rivals *Da Vinci's* towering albino. Here, it's our leading man, Simon Magill.

Just as much fun is the skewering of marketing concepts. The revered guru called Kate Phillips can only be Phil Kotler. A pair of jargon-hustlers named Jack Chang and Jill Eng are drawn from at least two real-world models. First, they summon up the Siamese twins Chang and Eng, who were a sensation in the 1830s thanks to the kind of hucksterism that Stephen Brown sees as the true heart and soul of marketing. More wickedly, their physical descriptions peg them as stand-ins for Insead's Chan Kim and Renée Mauborgne. The consultancy they work for is in the business of coining buzzwords like "nanomarketing" for clients. "You name it," Brown writes, "they stuck it in front of 'marketing,' 'accounting,' 'organization,' 'management,' or 'branding.' They were prefix providers." (Midway through the book the consultants stumble upon a powerful new offering for which the acronym is—what else?—GRAIL.)

Even as a marketing text, *The Marketing Code* succeeds—if one can be reconciled to Brown's contrarian view. On every page, evidence leaps out to support his theory that a seller hits the mark not when it kowtows to customers but when it teases, tantalizes, and entertains them. Good marketing, to Brown, is more sizzle than solicitude, more blockbuster than blocking and tackling. That, indeed, is the nature of the truth Magill seeks and ultimately finds. Like the secret of *The Da Vinci Code*, it is eternal but—in light of what has come to be canon—seriously subversive.

If *The Marketing Code* doesn't wind up in every marketer's Christmas stocking, it won't be for lack of wit or craftsmanship. Its weakness is that Dread Zeppelin-like mishmash of attributes. Murky positioning is a curious crime for a marketer as good as Brown to commit. Perhaps it's even worthy of a sequel.

—JULIA KIRBY

Andy Grove: The Life and Times of an American

Richard S. Tedlow

(Portfolio, 2006)

As the longtime CEO of Intel, Andy Grove embodied both the brilliant technologist and the savvy executive. Yet as described by Tedlow, a business historian, his management success had little to do with a rational, technocratic approach. Strategically, he followed his instincts and made "thick-headed" blunders as well as farsighted, daring moves. And as a manager, he drove off talented employees with his "charismatic intimidation" while inspiring survivors to fierce loyalty and creativity that pushed the company to astounding heights. Tedlow devotes a good deal of the book to Grove's harrowing Hungarian childhood under Nazis and Communists, which trained him to act resolutely despite his fears.

Econospinning: How to Read Between the Lines When the Media Manipulate the Numbers

Gene Epstein

(Wiley, 2006)

Here's a welcome correction that shows how not only journalists but even prominent economists, from Paul Krugman to Alan Greenspan, can suffer from gaps in their analysis. Epstein focuses on some hot-button issues in the U.S. economy and convincingly demonstrates that commentators have exaggerated recent developments. Unemployment figures, for example, have been better than realized, and corporate profits are not at historically high levels, as often claimed. He also explains why most monthly macroeconomic data—the numbers breathlessly reported by the media—are largely worthless in isolation owing to sampling errors and volatility. Epstein, the economics editor at *Barron's*, is well placed to make these criticisms, though this disconnected, repetitive book itself could have used more editing.

—JOHN T. LANDRY

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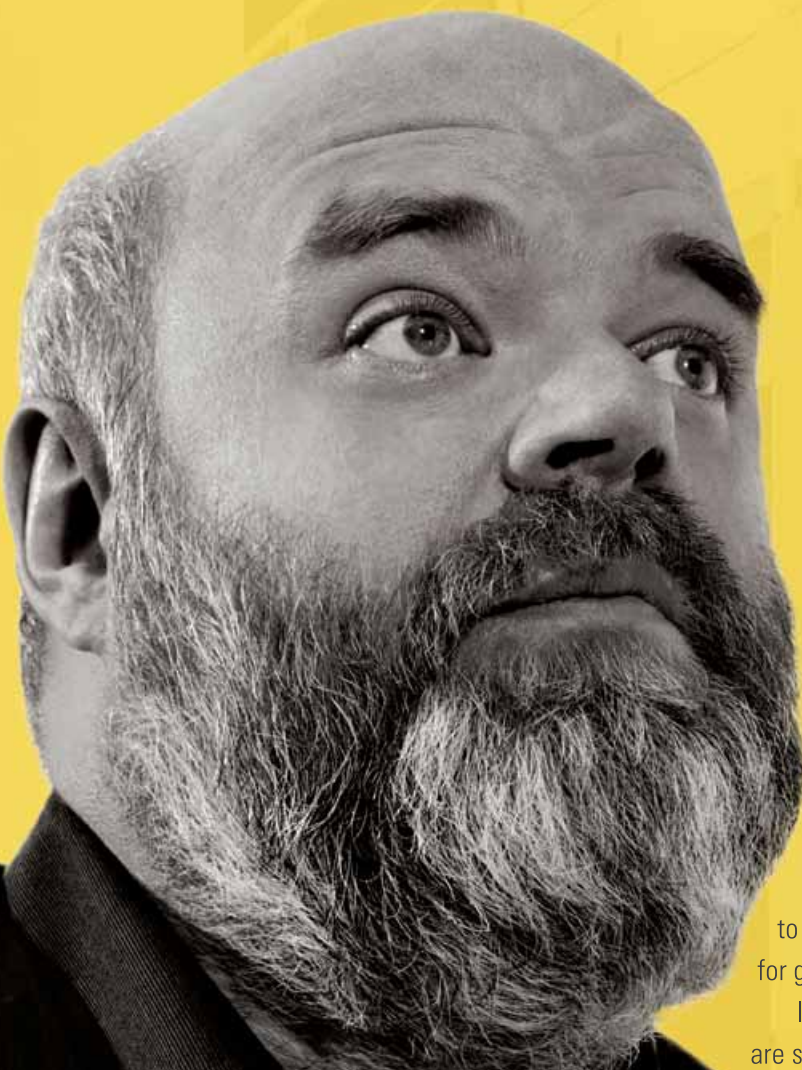
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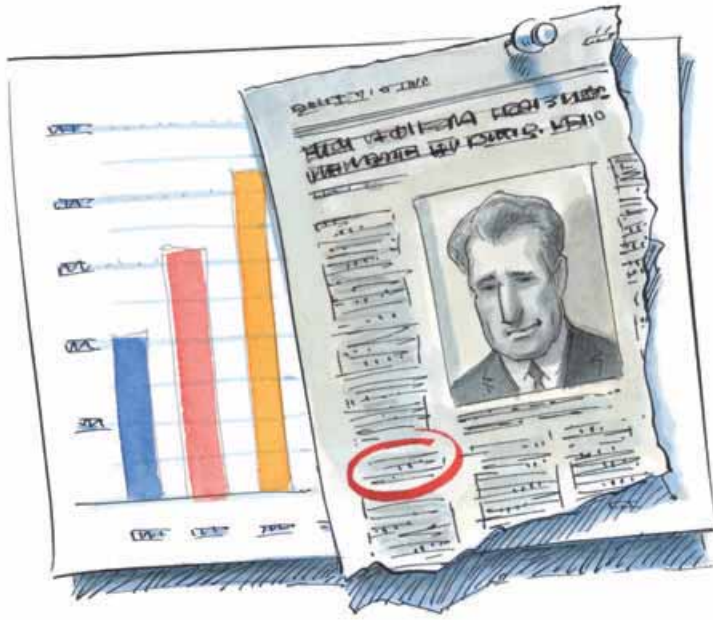
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The CEO Who Couldn't Keep His Foot out of His Mouth

by Lisa Burrell

Four years into the job, a top executive has revitalized his company's financial performance. But his verbal gaffes threaten to ruin staff morale, alienate customers, and drag down the firm's share price. Is it time for him to go?

"HERE'S WHERE the one-year-olds hang out," said Evan Breyer, the chairman and founder of Growing Places, ushering the small tour group into the Infant 2 room. He couldn't remember the last time he'd helped with a tour at the child care company's flagship facility. Probably not since he'd opened it seven years ago. This was a special case, though—he needed to be on hand to meet some important guests. Besides, he always got a kick out of seeing the children.

Judy Snow, the vice president of corporate affairs, led everyone inside. Four kids decked out in big, sloppy art shirts, elbow deep in shaving cream, were seated along the outer curve of a cashew-shaped table. They smeared and slapped at the mess in front of them.

"That's one of our sensory stations," Judy said. "As you can see, it's a hit."

The other three children in the room were digging through a large toy chest and stockpiling choice pieces of loot.

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

Elmo dolls of all sizes figured heavily in the mix. Judy gestured toward a shelf holding tubs of Cheerios, raisins, and Goldfish crackers, joking to the tour group, “Anyone want a snack?”

In response to this apparently general invitation, a little girl dropped the maracas she'd been clutching and toddled over to the food. The teacher closest to the bins dipped into the raisins with a Dixie cup and said, “Okay, Ada, but just a few.”

Judy chuckled and continued with her spiel about activities that develop

been calling her because he was working on a piece about child care in the community. “Sure,” Evan had said. “Let's make it a twofer.” He'd heard that Delores was incredibly warm. She could probably be counted on to coo over the little ones and ask nice questions. She'd set a pleasant tone for the coverage.

Delores did her job nicely. She fell in love with every child she met, even the rowdy preschoolers. When the group stepped into the Infant 1 room for a minute to say hello to the babies, Delores put a hand to her chest.

If Rob sat in the backseat, Evan thought, maybe he'd keep his mouth shut. Rob, giving his knuckles a quick, loud crack, looked oblivious.

fine motor skills. After they finished up in Infant 2, Evan thought, they should peek in on the babies – a sweet note to end the tour on – before meeting up with Rob Miranda, the CEO, for lunch.

Evan had asked Judy to arrange this walkabout to woo a potential sponsor for a new program. The board of Growing Places wanted the company to provide scholarships for kids whose families demonstrated financial need, and a corporate sponsor seemed like the perfect way to pay for the scholarships. Of the companies considered, the most promising turned out to be Thrivand, a maker of infant formulas, cereals, and beginners' foods. The board hoped to offer scholarships at a number of the company's day care facilities to start with and then, if the sponsor was pleased with the good press, extend the program to the other centers.

Delores Dayton, head of PR at Thrivand, had seemed enthusiastic about the idea; she'd agreed to fly with a few of her colleagues to Dublin, Ohio, to see Growing Places' flagship facility and talk over the possibilities. Judy had asked Evan if she could invite a local reporter to tag along for the tour. The reporter had

Evan laughed. “Sorry,” he said. “We can't let you take any of them home.”

“You don't know how much of a pleasure this is for me,” she said. “I spend all my time talking about what's good for children, but I don't get to *spend time* with them. My own are all grown up!”

As the group headed upstairs to the corporate offices, where they had left their things, Evan heard Rob's voice in the hallway. Good, he thought. After the reporter left, they could all head to lunch together.

Evan led the way into his office, which he had kept after Rob had succeeded him as CEO four years ago and Evan had scaled back his role. He scooped up the coats that were slung on the back of his desk chair.

“What'd you think?” Rob blurted as he burst into Evan's office not 30 seconds later. As everyone turned toward the door, Evan took the opportunity to swipe some dust off his desk with his sleeve. He didn't spend a lot of time there, but it was starting to look as though he'd have to come in more often, given the additional supervision Rob had seemed to require lately.

“It was lovely,” Delores said.

“What was lovely about it?” Rob wanted to know. He smiled a little, but his tone wasn't light. He wanted spe-

cifics, so he asked for them. That was his style.

Delores graciously complied. “The teachers – where did you find them? They're so seasoned. I expected to meet a bunch of kids right out of high school. There were a few, but most of your staff seem quite experienced.”

“We pay them,” Rob said simply. “What else?”

Evan wished Rob would tone it down a little, but he knew that probably wouldn't happen. Although Rob generated great ideas and had a gift for putting them in motion – the company had him to thank for its recent rapid growth – he didn't give two hoots about diplomacy. In fact, he took a certain amount of pride in his no-nonsense approach to business and the success it had brought him in a touchy-feely industry.

“The lactation rooms Judy told us about are a stroke of brilliance,” Delores added, willing enough, at this point, to heap on the praise. She was right, too – they were one of Rob's many ideas that had paid off. Growing Places provided mostly on-site child care and preschool classes for 60 companies in the midwestern United States. At each center, the children's parents worked right next door, and Rob had spent time drumming up ways to capitalize on their proximity. Since women who breast-feed often have a hard time keeping up with it after they return from maternity leave, Rob had figured they would appreciate a convenient place to nurse their babies during breaks in the workday. The lactation rooms had been a huge draw – instrumental in winning over many parents who'd considered hiring a nanny or choosing a day care center closer to home – and the host companies were thrilled to have such an attractive perk to add to their recruitment tools.

“The moms do like them,” Rob said. “What gets me, though, is how long some of these kids nurse. If they're old enough to ask for a Coke, it's time to move on.”

You've got to be kidding, Evan thought. Delores had tossed Rob a soft-

Lisa Burrell (lburrell@hbsp.harvard.edu) is a manuscript editor at HBR.



ball—why'd he have to go and say something like that?

Delores didn't appear to take offense, however. She patted her coat pocket for her car keys and said, "You guys want a ride to the restaurant? I can bring you back here on my way to the hotel."

"That'd be great," Evan said, relieved. "I thought we'd go to LaScala. Want me to sit in front and help you navigate? The access roads can be tricky." If Rob sat in the backseat, Evan thought, maybe he'd keep his mouth shut. Rob, giving his knuckles a quick, loud crack, looked oblivious. He probably had no idea how lucky he was that Delores hadn't reacted to his remark.

The reporter stood by the door, quietly scribbling.

It's Cleanup Time!

The next morning, Evan decided to brave the rush-hour trip into headquarters for the second day in a row. Although Rob seemed to have fared well with Delores—the lunch and the good-byes went fine—Evan thought there could still be some fallout. He was right. When he arrived at his office, Judy was waiting outside his door.

"Hey, Evan. Sorry to pester you first thing," she said. "I couldn't reach Rob."

"What's up? Did Delores back out?"

"Nope. But the *Sentinel* ran a raging editorial on Rob's nursing comment."

"Oh," Evan said. "The reporter?"

"The quote's accurate, as Delores would attest, so there's certainly no denying it. But we should still be okay.

I mean, bad coverage in the *Sentinel* isn't exactly the end of the world, as long as it doesn't spread. I've made an appointment to meet with the editor in chief to try to contain the damage."

"In case there is some sort of uproar, PR should prepare a public statement of apology."

"We're already on it."

"I think you're right," Evan said. "It could be worse. The board will be annoyed, but we can deal with this."

After Judy left, Evan headed outside for a quick walk around the block to clear his head. He thought back to when the board, at his urging, had brought in Rob to infuse the business with some fresh thinking and to shake things up a bit. During the company's first few

years, when Evan himself was CEO, Growing Places had struggled just to break even. Of course, it wasn't his fault entirely: Child care was a tough field, and only the most innovative companies turned even a modest profit. In the end, the board agreed with Evan that Growing Places needed a leader who

cities on the East and West coasts were contracting with on-site child care providers. It would take some effort to persuade large companies in the Midwest to do the same, but this was a rare opportunity to stand out among competitors. With that critical change in strategy, Growing Places had expanded over

Evan and the rest of the board had been well aware that Rob's entrepreneurial vision came with an abrasive personality and some disregard for social convention.

wasn't born and bred in the industry – someone who had a different perspective on the challenges the company faced and could find creative ways to generate profitable growth.

During the search, Rob immediately distinguished himself as an attractive, though unlikely, candidate. For nearly ten years, he had been the president of a small insurance company. When he first had taken charge there, the company had been stable but unimpressive; by the end of his tenure, it had grown dramatically. His tack had been to focus and then refocus the company's objectives, always targeting a new goal – reducing whole-life underwriting losses, for instance, or boosting sales of disability policies – before he'd worked the previous one to the bone.

Rob was experimental, a little restless, and an entrepreneur at heart, never happier than when six or eight pots were cooking at once, all at different temperatures. He'd seemed to be the kind of leader Growing Places needed to pull ahead in a field where high accreditation standards meant that most companies worth their salt did things more or less the same way. To the board's delight, Rob had turned out to be a veritable font of ideas.

For starters, he'd suggested, why not carve out a niche and provide on-site care for client companies? It hadn't occurred to the board before, but why not, indeed? To recruit and retain star talent, more and more companies in major

the past four years from six freestanding, garden-variety facilities in Ohio to ten times that number of on-site facilities at companies and universities in five states.

Rob also had a knack for knowing which services his clients really wanted. For example, although market research had indicated, at best, lukewarm interest in Webcams, which allow parents to "visit" their kids over the Internet without leaving their desks, Rob had insisted that Growing Places offer the service. It turned out that more than half of Growing Places' customers were willing to pay \$50 a month for something that cost the company next to nothing to provide.

Even before Rob was hired, though, Evan and the rest of the board had been well aware that Rob's entrepreneurial vision came with an abrasive personality and some disregard for social convention. They'd expected him to cross a line or two – and Rob had delivered. His comment at the end of the tour certainly wasn't his first verbal gaffe; in fact, it echoed earlier remarks he'd made to staff members. For example, when a few senior managers had questioned the wisdom of considering Thrivand as a sponsor because of its aggressive marketing of infant formulas – one of them had asked, "Why associate our brand with a practice that's detrimental to mother and child?" – Rob told them to get over themselves and leave the propaganda at home.

And then there was his comment about lesbian adoptions. Evan felt his shoulders tense up as he recalled the incident. At a recent staff retreat, managers had talked about ways to make sure that adopted children and the children of gay parents didn't feel different from their classmates. Rob stopped the discussion cold: "The point'll be moot if China follows through on its adoption policy and keeps lesbian couples from snapping up its girl babies." Could he be serious? Maybe it was a joke – but no one was laughing.

After that meeting, Evan had told Rob that he needed to find a coach to help him with his emotional intelligence. Rob had laughed but did begin seeing a coach recommended by Growing Places' HR chief. Evan wondered, given recent events, how much progress Rob was making and whether he'd even agree to issue a company apology if his breastfeeding comment got more press.

Choosing Rob had been a calculated risk, Evan thought as he rounded the third corner of the block – and so far, it had paid off. But had Rob crossed one line too many?

If You Don't Have Something Nice to Say...

Evan had agreed to get together with Alex Horowitz, a friend and fellow board member, at a high school gymnastics meet, where Alex's daughter would be competing. It'd been ten days since the *Sentinel* story had come out. Both men had been booked for most of the previous week, and they really wanted to talk in person. This was the only way they could squeeze in a conversation before the board meeting.

Evan pulled into the parking lot of Dublin South High School, right behind the visiting team's bus. He hoped Alex was there already; maybe they could talk before the meet began. But when he made his way into the gym, he couldn't find Alex. He climbed to the top of the metal bleachers to a spot where he could get some perspective on the scene.

If Rob had managed to stay out of trouble after the nursing blooper, Evan

wouldn't have needed to meet with Alex. Yet, even knowing he was on notice, Rob had done it again. At an early childhood education conference a few days after the visit from the Thrivand group, he had given a spirited keynote address on the importance of student-centered preschool curricula. Afterward, he'd fielded questions. A teacher in the audience who'd identified herself as one of Growing Places' own had commented that highly customized instruction was great to strive for but not always possible to implement.

Rob's response? "If you all got off your rear ends and did a little prep work, there wouldn't be a problem. Grade school teachers do it all the time; pre-K shouldn't be any different. I'm not saying it's all on you, of course. Administrators need to pony up, too, and provide some guidelines." He'd said it with a wink and a smile, thinking, Evan supposed, that a spoonful of sugar would help the medicine go down. Of course, that's not how it had worked out.

The Growing Places employees who had attended the conference had been outraged by Rob's suggestion that they weren't pulling their weight. The ones with a lot of experience were especially irked. They didn't just teach; they nurtured. And they used lesson plans that had worked wonderfully for years. How could Rob call them unprepared? Besides, the idea of developing a curriculum based on companywide guidelines—even if it was customizable—grated on many teachers. As child care professionals, they should be trusted to improvise and cater to the mix of children in each class.

In a matter of days, about 50 teachers, most of them highly experienced, threatened to quit. On top of that, a newswire reporter had been at the conference, so the story spread to media outlets across the United States in no time. Online columnists and bloggers had chimed in with headlines like "Kiddie Care Exec Demands Top Quality from His Sweatshop Team."

Evan recalled that Rob had come to the company not just to spur growth but also to whip operations into shape.

Evan had to admit that, under his own leadership, an incredible amount of time was consumed by staff meetings where employees were given a chance to voice their gripes. Rob had put an end to the gripe sessions. As he was fond of saying, "I can't deal with people whose feelings bruise so easily. Are we grown-ups or babies who need coddling?" He argued that the time would be better spent improving the delivery of service. Developing a curriculum that could be used across the organization was Rob's latest initiative in this vein.

Evan's thoughts were interrupted by the sight of a sullen girl wheeling out a balance beam. Gymnasts started to filter in, with nylon bags slung over their shoulders. As Alex came through the double doors with his daughter, Evan caught his attention with a wave. Alex gave his daughter a quick kiss on the head and started his ascent. Evan smiled

to Rob, we'd be stupid not to take the long view, the stock'll bounce back, there wouldn't even be a stock price if it weren't for him—that kind of thing. The others are fed up with his loose-cannon crap, and as much as I hate to say it, I can see their point. If we're getting bad press and our stock is on its way down, the last thing we need is Rob's brand of 'straight shooting.' He doesn't exactly have a history of making nice. What's to say he'll start now?"

Good point, Evan had to admit. Actually, with his hackles up, Rob could get even more outspoken. Evan thanked his friend for the heads-up and, before the gymnastics meet got ramped up, threaded himself through the assembling crowd.

On his way home, Evan remembered the company's early days, when each quarter seemed as though it might be the last. Rob had come along at just the

Rob had put an end to the gripe sessions. As he was fond of saying, "I can't deal with people whose feelings bruise so easily. Are we grown-ups or babies who need coddling?"

as he watched his friend huff his way to the top of the bleachers.

"So what's going on, besides the obvious?" Evan asked when Alex plopped down beside him.

"The board members have been informally caucusing," Alex said. "Some of them are talking ouster, and Gwen's adding an 'external relations' agenda item for the meeting Thursday."

Gwen Larson was a big shareholder. Evan had known that she, among others, would be keen to pounce; the stock price had already taken a meaningful dip since the press coverage of Rob's recent comments had kicked in.

"External relations." Evan shook his head. "I hope Rob has the good sense to leave the room and let other people defend him."

"There are several who will," Alex said. "The board's divided. Half are saying we owe every ounce of our success

right moment, but was his time up? Both Growing Places and its client companies felt the consequences when Rob stuck his foot in it. The clients got angry, of course, because PR gaffes compromised the employee-recruitment power Growing Places was supposed to confer in the first place. And many of the offended teachers would walk unless Rob ate his words. Evan was not going to hold his breath for that.

Everyone on the board respected Evan and trusted his strategic judgment. They'd have their say at the meeting, but, ultimately, they'd follow his lead.

Should Evan try to persuade the board to hang on to Rob, or should he back an ouster for the innovative but abrasive CEO? • Four commentators offer expert advice.

Rob Miranda's case isn't all that unusual. If most managers didn't bring a mixed bag of strengths and weaknesses to their jobs, the entire coaching profession would go out of business.

The first step in resolving the situation is to determine if Rob has the capacity to reflect on his weaknesses. This assessment may involve some trial and error: While one coach

lem. But Rob's poorly packaged comments may contain valuable insights into the organization's strategy that need to be teased out and examined.

For example, when he blunders into his half-joking admonition that teachers had better get off their "rear ends," he may in fact be identifying a basic weakness in the organization's culture. If the board's aim is simply to

Rob's poorly packaged comments may contain valuable insights into the organization's strategy that need to be teased out and examined.

or colleague may conclude that Rob will never admit to a problem, another may be able to get through Rob's defenses and help him see that there's work to be done.

If it becomes clear that Rob can get past this threshold of self-reflection, there are a number of possible approaches—all of which are about more than just changing Rob's behavior. My experience is that all first-rate executives in business or politics need a constellation of trusted partners—formal and informal, members of the top team or outsiders—who can complement their strengths and compensate for their weaknesses. In Rob's case, such partners would be able not only to keep him out of trouble by bluntly telling him when to shut up but also to take on some of his more sensitive communication tasks.

We often look for a technical solution to this kind of problem—hiring a coach to "fix" the person, as if he's a piece of faulty software—when the solution involves the organization itself. Very rarely are you going to turn someone into a leader for all seasons. But you can help her maximize her strengths and minimize her weaknesses in the context of the organization she leads.

Evan Breyer needs to diagnose Rob's situation to determine if the turmoil reflects complex organizational issues that Rob has intuitively spotted but ham-handedly addressed. Yes, Rob has a communication prob-

eliminate the disturbance prompted by Rob's comments, it may overlook the variety of possible causes for the turmoil, the validity of the turmoil, and the need to help Rob develop a better strategy for managing it productively.

The same goes for Rob's comment about Coke and breast milk. It obviously touches a raw nerve in some people and certainly was ill considered in this setting (although, you might ask, doesn't anyone have a sense of humor here?). But the howls of outrage also undoubtedly reveal women's conflicted feelings about their ability to nurture their children in a fast-paced working world. Embedded in his offhand comment is the suggestion of perhaps a new type of service, revenue generating or not, that Growing Places might offer: classes or discussion groups, possibly led by veteran parents, in which new parents could share their anxieties and questions about—even laugh about—such charged topics as how long to breastfeed or when to let your children sleep in your bed.

Rob needs to work on his communication skills. But a fabulous communicator with well-honed diplomatic skills may end up masking organizational issues and missing opportunities to generate something truly new. A terrific coach would help Rob not only manage his weaknesses better but also articulate the strategic insights embedded in some of his remarks, and turn them into new product and service ideas.



Ronald A. Heifetz (heifetz@cambridge-leadership.com) is the King Hussein Bin Talal Lecturer in Public Leadership at Harvard University's John F. Kennedy School of Government in Cambridge, Massachusetts, the cofounder of the school's Center for Public Leadership, and a principal at Cambridge Leadership Associates. He is the coauthor of "The Work of Leadership" (HBR January–February 1997) and "A Survival Guide for Leaders" (HBR June 2002).



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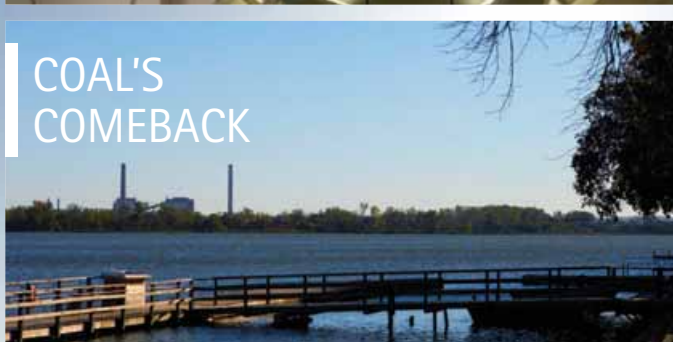
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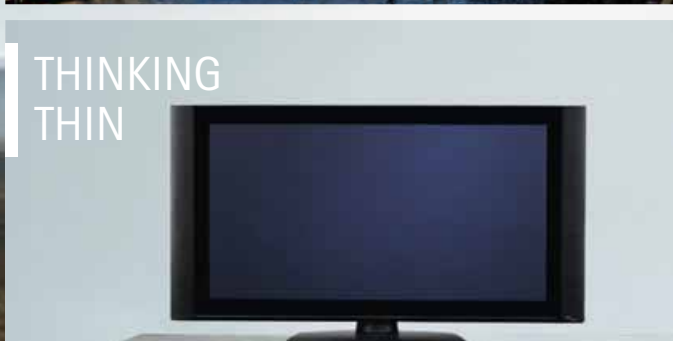
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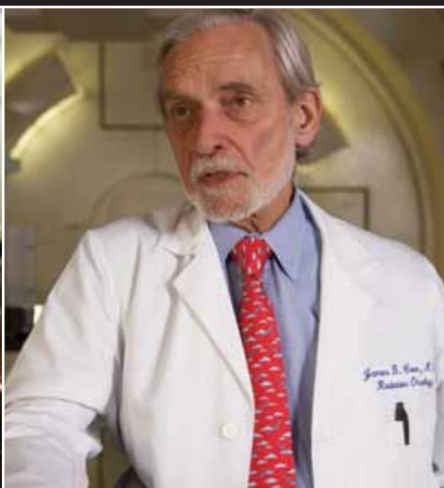
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John H. Biggs (jbiggs@tiaa-cref.org), the former chairman and former CEO of fund manager TIAA-CREF, is a member of the boards of Boeing and JPMorgan Chase. He is based in New York.

It's clear that Rob, despite the coaching he's receiving, could use additional counsel on how to improve his communication style. The person who may really need a coach in this case, however, is the chairman of the board.

Evan doesn't seem like the kind of person who's naturally going to get tough with Rob. Consequently, he needs someone – it might be an acting instructor rather than a coach – to help him forcefully display his indignation and convey to Rob his concern about the effect of Rob's actions on the company. Indeed, Evan may need to display even more indignation than he actually feels if he wants to make Rob understand the seriousness of the situation.

When Evan does deliver his stern warning, it should focus not on Rob's failings – “Can't you see how boneheaded it was to say those things in front of a reporter?” – but instead on the consequences of his mistakes. Evan's message to Rob: “I'm proud of

ing that I fire him, succeeded in engaging the entire board in the matter. Part of my role in defusing the situation involved defending the executive and his value to the company. It also involved a heated conversation with the executive about his misstep. Because he was a good friend, I had to work myself into a completely different role – as I think Evan needs to in this case – in order to get across to him my displeasure.

But protection can go only so far. I once hired a brilliant young analyst who had the unfortunate tendency to let colleagues know, either directly or indirectly, how stupid he thought they were. I spoke with him numerous times about this, and he was always contrite. But then he would lose his temper a few weeks later and make the same mistake. I kept him on for a couple of years. But finally, I had to say, “Enough is enough,” and I fired him.

The tragedy of situations like these is that a single mistake can undo a career of good

Evan may need to display even more indignation than he actually feels if he wants to make Rob understand the seriousness of the situation.

the company that I founded. I'm terribly upset about the potential damage to its reputation.”

I've faced numerous situations in which an extremely talented contributor for one reason or another didn't get along with people. Almost inevitably, part of my task was to act as the high performer's protector. People will gang up against an abrasive personality, and you have to shield him or her from their animosity – at least long enough to give the person a chance to apologize or change course.

When I was at TIAA-CREF, an exceptionally valuable senior executive made a thoughtless comment about the outstanding performance of black athletes – to an African-American member of the board. The board member was outraged and, besides demand-

works. Harry Stonecipher resigned as Boeing's CEO for what was arguably an awkward personal situation but not a cause for termination. While married, he had a romantic relationship with a Boeing employee. After a full investigation by an outside lawyer hired by the company, it was clear he had not used his position to help the woman in her work within the company. But at the time, Harry was leading a campaign to improve the ethical climate at Boeing following a scandal over the award of Air Force contracts. Although board members were pleased with the job he was doing as CEO, in the end the board and Harry himself concluded that, given the company's current focus on living by its own code of ethics, he would have difficulty continuing to be the standard-bearer of that initiative.

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In today's information environment, it's hard for one person—no matter how charismatic, articulate, or media savvy—to be a company's sole public face.



Torie Clarke (torie@torieclarke.com), a former assistant secretary of defense for public affairs under Secretary Donald H. Rumsfeld and former press secretary for Senator John McCain, is a senior adviser to Comcast, an analyst for CNN, and the author of *Lipstick on a Pig: Winning in the No-Spin Era by Someone Who Knows the Game* (Free Press, 2006). She is based in Washington, DC.

Let's get this straight: Being honest and direct is generally a good thing. I've been the communications chief for both Donald Rumsfeld and John McCain, both of them very blunt people who like to engage aggressively with audiences of all kinds. The overwhelming majority of the time, their approach works.

Any time you adopt such a forward-leaning stance—whether you're an athlete or a public official or a business leader—occasionally you're going to look back and say, "Maybe I shouldn't have done or said that." In that case, you apologize quickly and unequivocally. But usually the pluses of a straightforward style outweigh the minuses. Take Rumsfeld's infamous comment about the attitudes of "Old Europe." While it created a minor furor at the time, it was widely if not publicly viewed as a pretty accurate assessment of most of the Western European democracies. Even some of my counterparts in those countries, while they had to fuss about the comment in public, agreed with it in private.

So what to do about Rob? Evan has to lead a frank discussion with the board about whether Rob's strengths outweigh his obvious weaknesses and then choose either marriage counseling or a divorce. My sense is that it's not too late to save the company's relationship with its CEO.

If the board members choose marriage counseling, they should demand that Rob apologize to the teachers. Not some carefully couched statement—"If I've offended anyone, I'm sorry"—but a formal public apology that makes clear that he understands his thoughtless comments hurt others and himself. Rob should also begin spending more time with the teachers and other employees—something senior managers need to do even in the best of times—thereby going beyond damage

repair to the building of a positive environment. In fact, Evan himself should spend more time with the teachers to get a sense of their mood.

A crucial component of marriage counseling would be to examine Rob's role as well as his behavior. Growing Places took a long time finding Rob, and he's clearly doing good things for the company. The solution might be to let him play to his strengths and steer clear of his weaknesses. Because Rob has a tendency to spout off and say outrageous things, the board may want to find other people in the company who can play a public role.

Certainly, CEOs need to be out there representing the company to customers, shareholders, analysts, and the public at large. But in today's information environment, it's hard for one person—no matter how charismatic, articulate, or media savvy—to be a company's sole public face. Increasingly, a company needs a lot of senior people to share responsibility for telling its story.

This is particularly true when the person at the top has a tendency toward the loose-cannon syndrome. Consider Ted Turner. Over the years, he has been known for his sometimes outrageous comments that became public relations disasters—calling his marginalization as a leader at AOL Time Warner the equivalent of Third World female genital mutilation, for instance, and comparing the popularity of Fox News, which is a rival of his own CNN, with that of Adolf Hitler. Turner is a creative genius with enormous energy. Getting rid of him simply wasn't an option. So over the years his organization worked very hard to prepare other senior executives—members of the management team and heads of divisions—to act as spokespeople for the company.

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Roger Brown (rhbrown@berklee.edu), president of Berklee College of Music in Boston, is the cochairman and cofounder of Bright Horizons, the world's largest provider of employer-sponsored child care and an organization frequently cited on lists of employee-friendly workplaces. He is the author of "How We Built a Strong Company in a Weak Industry" (HBR February 2001).

It's time for Evan and his board to tell Rob that he's the wrong person to be leading Growing Places. I say that for two reasons, both of which have to do with the managerial context of this case.

For one thing, child care, more than almost any field you can imagine, requires a humane, caring, and values-centered management style. Because the care of young children evokes strong passions in nearly everyone, you have to be unusually sensitive to the needs of the children, the parents, and the teachers, and to the nurturing relationships among them all. Hand in hand with such sensitivity must be an engaged and participatory management style – something that Rob clearly lacks – throughout the organization. You can't expect Rob's kind of autocratic leadership style to morph into a participatory, child-centered approach as you move down the organization and into the classroom.

Think about it. If you're in a business where extreme confidentiality is required – a defense contractor, say – and the senior leader can't keep a secret, you can be sure there will be breaches throughout the system. If you're in a business like medical

The other reason Rob has to go relates not to his weaknesses but to his strengths. Clearly, there's a role for creativity in this business. Child care is a tough industry with low margins; everyone has explored add-on services like dry cleaning that people might be willing to pay extra for. Rob's innovative programs have helped the business grow.


But an approach focused on customer transactions can't drive the culture or the business of Growing Places. Child care is a huge expense for most parents, and if financial success is the only aim of your business, this will come back to haunt you. Ninety-five percent of your revenue comes from the core service of providing child care. And you aren't going to keep your centers full with clever marketing or add-on services. You're going to achieve that through word-of-mouth recommendations across the ultimate social network: the parents of young children. Rob's business innovations mean little if he's offending the parents who serve as his marketers or the teachers in whom parents place enormous trust.

One other thought: Evan acts as if Rob is the only one who can bring a creative approach to the business. It feels almost as if

An approach focused on customer transactions can't drive the culture or the business of Growing Places.

equipment manufacturing, where manufacturing tolerances are in the micrometers, you don't want senior leaders regularly showing up late for meetings or missing deadlines. In software development, by contrast, a few big ideas are often more important than manufacturing precision, so the industry is often marked by a freewheeling culture—a culture that would be a little scary in the case of a medical equipment manufacturer.

None of these management styles is inherently better than the others. Rob might be an excellent leader – in fact, he apparently was – in another setting. But he's unlikely to be one here over the long term.

he's working for Rob. This often happens in the case of a blustery, autocratic, alpha-male leader. Evan has to stop and ask himself, Is this the kind of organization I wanted to create and be associated with? Do I have to live with Rob's mistakes and insults? Is there no one else in the world who has Rob's business talents *and* values that are consistent with the organization? The answer to all three questions is no. 

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Certain industries breed a type of professional for whom get-a-life dedication is a badge of honor. The phenomenon is on the rise, but is it sustainable?

Extreme Jobs The Dangerous Allure of the 70-Hour Workweek

by Sylvia Ann Hewlett and Carolyn Buck Luce

A FINANCIAL ANALYST we'll call Sudhir emigrated five years ago from Mumbai, India. He works at a major commercial bank in New York. Summertime, when he puts in 90 hours a week, is his "light" season. The rest of the year, he works upwards of 120 hours per week—leaving only 48 hours for sleeping, eating, entertaining, and (he smiles) bathing. Sudhir stays late in the office even when he has nothing particularly pressing to do. His get-a-life existence is a hazard of the profession—but worth it: As a 23-year-old with a first job, he is in the top 6% of earners in America.

Higher up the totem pole, Joe (not his real name) has risen through the corporate ranks to become a managing director at a major bank. Joe thought his workload would become lighter as he moved up, but the opposite has occurred: He now works six or seven days a week, from multiple locations. He keeps an apartment in New York, where he works two days, and is on the road another three or four days. Only on weekends does he see his wife and three children—who live in Connecticut. Even then, he gets calls in the middle of the night on Saturdays and Sundays, and flies out to see clients on a moment's

notice. “The first year we were married,” Joe’s wife recalls, “we had to rearrange my grandmother’s funeral so that he wouldn’t miss a meeting.”

Ming Mei is a managing director and a member of the executive committee at ProLogis, a fast-growing real estate investment trust with extensive operations in Asia. Mei is in charge of expansion in China, where he’s built ProLogis’s portfolio base from zero to 10 million square feet of properties over the past three years. The demands of his job are immense. Negotiating with Chinese government officials, he routinely packs five cities into six-day business trips. These trips can be grueling—back-to-back meetings spill over into late dinners where key relationships are cultivated and cemented. Despite the pressure and the pace, Mei describes his job in glowing terms: “Building this business in markets where no one has done anything like this before is enormously exciting. And important. We’ve built distribution centers that are vital for China’s growth—they contribute to the overall prospects of the economy.”

Jonelle Salter is similarly enthusiastic about her job. An offshore installation manager (OIM) at BP, Jonelle knows what it’s like to be in charge of the health and safety of 80 workers on an oil platform in the North Sea. On top of pressures that would face anyone in this job, she has some unique management challenges. As the first black woman to become an OIM at BP, Jonelle has sometimes had to go to extra lengths to establish her authority in this male-dominated environment. But she loves being a pioneer and credits BP for going out on a limb and finding a female mentor (Gro Kielland, a managing director for BP Norway) to help her through the rough patches. Jonelle talks eloquently about the thrill that comes with the challenges of her job. “You train and train, but you still don’t know whether you’ll come through when

Researching Extreme Jobs

In 2004 the Center for Work-Life Policy launched a private-sector task force consisting of 33 global companies devoted to stemming attrition in their female executive ranks—a problem referred to as the “hidden brain drain.” Task force discussions and survey data showed that one challenge facing women was a trend toward more extreme work in corporate managerial positions. In 2005 and 2006, we focused specifically on that issue. This research consists of two surveys—one of high earners across various professions in the U.S. and the other of high-earning managers in large multinational corporations—as well as 14 focus groups and 35 one-on-one interviews. The survey of U.S. workers targeted the top 6% of earners in the country and garnered responses from 1,564 full-time employees (844 men, 720 women) ages 25 to 60. The survey of managers at global companies included 652 men and 323 women, ages 25 to 60, at the director level or above; 54% were from the United States or Canada, and 46% were from Europe, the Middle East, or Africa. Survey statistics cited throughout this article refer to the U.S. high earners unless specifically attributed to the multinational management population. The surveys were conducted online by Harris Interactive from November 1, 2005, through April 6, 2006.

an emergency happens—and whether you can conjure up the right kind of leadership,” she says. “It’s a kind of test. And when you pass, you feel quite wonderful.”

Sudhir, Joe, Mei, and Jonelle are succeeding in what we have come to term “extreme jobs,” and they’re not alone. Across the economy, there are high-earning professionals whose work has become all consuming. The outrageous hours they put into their careers are matched only by the over-the-top rewards they receive.

Do these professionals constitute a new breed? Not entirely. Highly demanding and important jobs have always been around—along with the workaholics who created them where they didn’t need to exist. Yet there is a difference. No longer the pitiable drones and graspers of society, today’s overachieving professionals are recast as road warriors and masters of the universe. They labor longer, take on more responsibility, and earn more ex-

travagantly than ever before—and their numbers are growing.

Our research on extreme jobs is a project of the Hidden Brain Drain Task Force, which we launched in February 2004 and now head up. In late 2005, four of the task force’s member companies—American Express, BP, ProLogis, and UBS—sponsored two large surveys with the intent of “mapping” the shape and scope of high-level, high-impact jobs these days. We also conducted in-depth qualitative research—focus groups and interviews—to get at the attitudes and motivations that lie behind the extreme-work model (the sidebar “Researching Extreme Jobs” provides more detail). We then considered the data in relation to the large-scale structural shifts that have made high-stakes employment a more prominent feature of the U.S. economy and culture. What emerges from this inquiry is a complex picture of the all-consuming career—rewarding in many ways, but not without danger to individuals and society.

Sylvia Ann Hewlett is the president of the Center for Work-Life Policy, a New York-based nonprofit organization. She also heads the Gender and Policy Program at Columbia University’s School of International and Public Affairs, in New York. Carolyn Buck Luce is the chair of the Hidden Brain Drain Task Force and the global pharmaceutical sector leader at Ernst & Young, in New York.

The Elements of Extremity

How do we define extreme jobs? For the purposes of data analysis, we've said that survey respondents have such jobs if they work 60 hours or more per week, are high earners, and hold positions with at least five of these characteristics:

- Unpredictable flow of work
- Fast-paced work under tight deadlines
- Inordinate scope of responsibility that amounts to more than one job
- Work-related events outside regular work hours
- Availability to clients 24/7
- Responsibility for profit and loss
- Responsibility for mentoring and recruiting
- Large amount of travel
- Large number of direct reports
- Physical presence at workplace at least ten hours a day

Our two surveys of high-earning professionals have revealed the four characteristics thought to create the most intensity and pressure: unpredictability (cited by 91% of respondents), fast pace with tight deadlines (86%), work-related events outside business hours (66%), and 24/7 client demands (61%).

The American Dream on Steroids

The first thing that becomes clear is that successful professionals are working harder than ever. The 40-hour workweek, it seems, is a thing of the past. Even the 60-hour workweek, once the path to the top, is now practically considered part-time, as a recent *Fortune* magazine article put it. Our data reveal that 62% of high-earning individuals work more than 50 hours a week, 35% work more than 60 hours a week, and 10% work more than 80 hours a week. Add in a typical one-hour commute, and a 60-hour workweek translates into leaving the house at 7 AM and getting home at 9 PM five days a week. If we focus on the subset of those workers who hold what we consider extreme jobs (a designation based on responsibilities and other attributes beyond pay), the hours are even more punishing. The majority of them (56%) work 70 hours or more a week, and 9% work 100 hours or more.

How dramatic a jump is this from the past? Without longitudinal data on ac-

tual behavior, we must rely on our respondents to gauge the increase. Of the extreme jobholders, 48% say they are working an average of 16.6 more hours per week than they did five years ago. That finding is consistent with other studies of the expanding workweek, including, most recently, one by Peter Kuhn and Fernando Lozano of the National Bureau of Economic Research. (Among college-educated men working full-time in the United States, Kuhn and Lozano report, those putting in 50-hour weeks rose from 22.2% to 30.5% between 1980 and 2001.)

Vacations, meanwhile, seem to be shrinking. Among the extreme-jobs crowd, 42% take ten or fewer vacation days per year—far less time off than they are officially entitled to—and 55% claim they have had to cancel vacation plans “regularly.” Moreover, they say no one is forcing them to do this. The long hours and months without breaks are discretionary. Jay (not his real name), a creative executive at a major entertainment company, is a case in point. He can’t remember the last time he

had a vacation, and he has all but delegated his social life to handlers. He is driven by a vision of taking his company into a new creative space—video games—and his heart and soul are wrapped up in this mission, which has become the defining element of his identity. “If I can get this to work for the studio,” he told us with unalloyed enthusiasm, “I’ll be the first guy to figure it out. Everyone else who has tried has failed. It’s my Everest.”

Let us back up for a moment and clarify the distinction we are making between run-of-the-mill long-hours jobs and extreme jobs. Our definition, which grew out of extended focus group discussions, takes into account not just hours (and, of course, pay) but also the pressures that make these positions particularly stressful. We identified ten common characteristics of extreme jobs and decided to classify a respondent as an extreme jobholder if he or she is confronted by at least five of them, on top of working 60 hours or more per week (see the sidebar “The Elements of Extremity”). By this standard, 21% of the high earners in the U.S. whom we surveyed have extreme jobs. (In our separate survey of professionals working in global companies, this figure rises to 45%.)

The fact is, extreme jobs are no longer a rarity. Our data reveal an enormous increase in work pressure for high-caliber professionals across ages, genders, sectors, and continents. Extreme jobs, we’ve found, are distributed across the economy—in large manufacturing companies as well as on Wall Street, in entertainment and media, in medicine and law, in consulting and accounting.

Given this increasingly extreme work model, one might imagine that our study has also uncovered a great many burned out and bitter professionals. In fact, quite the opposite is true. The overwhelming majority of extreme jobholders in our U.S. sample (66%) say they love their jobs—and in the global companies survey, this figure rises to 76%. Far from seeing themselves as workaholics in need of rescuing, extreme workers wear their commitments like

badges of honor. To use the words of the cultural critic Catherine Orenstein, these jobs constitute “the American Dream on steroids.” There is very little sense of victimization. Almost two-thirds (64%) of extreme workers admit that the pressure and the pace are self-inflicted—a function of a type A personality. By and large, extreme professionals don’t feel exploited; they feel exalted.

Why the Rise in Extreme Work?

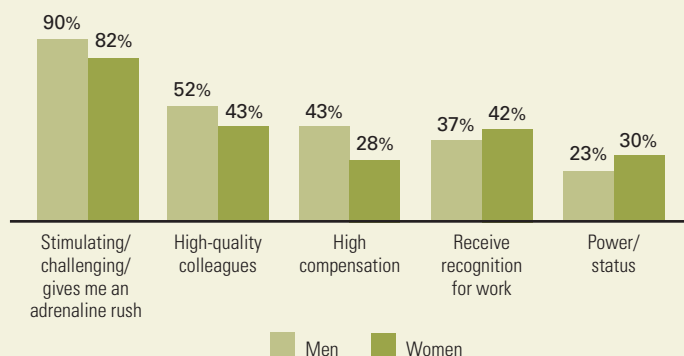
Every extreme worker has his or her own reasons for putting in the effort. Many people love the intellectual challenge and the thrill of achieving something big. Others are turned on by the oversize compensation packages, brilliant colleagues, and recognition and respect that come with the territory. When we asked our survey respondents what motivated them, most cited a number of factors. (See the exhibit “Why Do You Do It?”)

Note how gendered the responses are. For men, compensation comes in third on the list of motivators, after stimulation/challenge and high-quality colleagues. For women, compensation comes in fifth, or last. The following comments by Debra Langford are typical of what we heard in interviews: “It’s not that compensation isn’t a top priority – it clearly is important. As an African-American single woman with financial responsibilities, I must be strategic in my career choices. When I accepted this position with Time Warner, in which I am responsible for identifying diverse candidates for high-level positions at the company, I knew the benefits would be beyond the purely financial. This is an important position because of the value of what I do – and the recognition and support I receive for my efforts are incredibly rewarding.”

Similarly, Susan Sobbott, president of the OPEN division of American Express, chose AmEx because she wanted to be part of a mission she believed in – and part of a dedicated team. “I used to be a financial analyst on Wall Street,” she said. “After my MBA, I weighed going back into investment banking and

Why Do You Do It?

Holders of extreme jobs indicated what motivates them to work long, stressful hours. They answered the question “What are the main reasons you love your job?” Multiple responses were allowed.



considered consulting. I thought about the big paycheck that typically comes with working in these fields. But for me, the most important thing in choosing a path – more important than zeros after a dollar sign – was to find an organization where I could work with talented people to create leading business strategies that further a great brand.”

Interesting as these motivations are, it should be pointed out that individual decisions about work are not made in a vacuum. At a macro level, the reasons behind the rise of the extreme job are structural; it’s the outcome of sweeping changes in the global economic environment. These changes—which include increased competitive pressures, vastly improved communication technology, and cultural shifts – intersect in powerful ways.

Competitive pressures. To begin with, competition has become more intense, both at the level of the individual professional and at the level of the corporation. Within companies, the combined effect of merger mania and substantially flattened hierarchies has been to pit a bigger pool of workers against one another for any given promotion. Catalyst reported that in 2005 there were 368 fewer corporate officer posi-

tions in the *Fortune* 500 than there had been ten years earlier (the number declined from 11,241 to 10,873) – which means the competition for high-level positions has become that much fiercer. Add to this the influx of talent that has come about through women’s large-scale movement into the workforce and companies’ ongoing diversity efforts. Both factors heighten the level of competition. As companies grow leaner and meaner, we see the declining job security that Louis Uchitelle describes in *The Disposable American*. Meanwhile, more responsibility falls on the shoulders of fewer individuals. Paul, a vice chairman at one of the big four accounting firms, told us his job has gotten so huge that each day more things are left undone. “The clincher,” he said, “is that the importance of the things I’m not getting to is greater than it used to be.”

The economists Robert Frank and Philip Cook have argued that, more and more, our economy operates by “winner take all” rules. This is the kind of dynamic that exists in flatter hierarchies. Because a slight performance edge yields outsized rewards (culminating in the gargantuan salaries awarded to CEOs these days), there is a powerful incentive to work incrementally more

than one's rivals. Hours and effort ratchet up accordingly. Consider how different this is from the days of TV shows like *Leave It to Beaver* and *Ozzie and Harriet*, when a professional man who was reasonably productive between the hours of 9 and 5 could count on a steady if unspectacular ascent through the ranks. The 1950s professional model was in many ways kinder and gentler, but for any young Turk willing to work harder and eager to be rewarded, it was a source of intense frustration. Today's model operates by the young Turks' rules: The American Dream isn't about being Ozzie Nelson. It's about being Donald Trump.

Increasingly, the young Turks are actually young Indians or young Chinese—or whatever smart and hardworking population offers a labor cost advantage. The threat of losing jobs to outsourcing arrangements is another driver in the rise of extreme work. Finally, the climbing costs of health care insurance and other benefits—and the fact that “nonexempt” professionals do not earn overtime pay in the U.S.—make companies eager to squeeze as many hours of work as possible out of their employees before springing for another fully loaded salary.

The “extreme” ethos. While competitive pressures in corporations are making extreme jobs more necessary, other changes in the broader society are making them more attractive. Orenstein points to signs in the popular culture of the widespread embrace of the “extreme” ethos. Extreme sports in particular have become wildly popular—they have their own version of the Olympics, known simply as the X Games, created in 1995 by ESPN. The reality TV show *Fear Factor* gives couch potatoes vicarious thrills by putting ordinary people to the test in extreme stunts. Neighborhood health clubs now offer rock-climbing walls and kickboxing classes for those who abhor the dull routine of exercise.

We first heard the word “extreme” applied to white-collar work four years ago in an interview with Marilyn, a senior banker at a London-based investment



bank. Marilyn was captivated by extreme sports: skydiving, snowboarding, triathlons, bungee jumping, surfing, mountaineering—anything that provided a rush of adrenaline and an element of danger. She eagerly recommended Jon Krakauer's *Into Thin Air* (an account of an ill-fated trip by amateur mountain climbers) as a window into why people push themselves to the limits of their physical endurance. Marilyn saw parallels between extreme sports and her life as an investment banker. First, there were the extraordinary time demands and performance stressors. Seventy-hour workweeks, grueling travel requirements, and relentless bottom-line pressures constantly pushed her to her limits—both physically and intellectually. Second, there was the allure of the job. Much like extreme sports, investment banking was exhilarating and seductive. Marilyn told us, “It gives me this rush. Like a drug, it's addictive.”

In the world of extreme sports, the more daring, demanding, and—this is

telling—gratuitous the feat, the greater our awe of the athlete. We appreciate the extreme athlete's talent, skill, and courage, but also the hubris that sets him or her apart from the crowd. High stakes and danger define the extreme-sports challenge, which in the end is less about the physical than about the existential—less about mountain peaks or big waves than about inner strength and testing one's limits. In a popular culture that lionizes such athletes, it is not surprising that the extreme ethos has worked its way into other endeavors. And so, our most intense jobs are seen not as exploitative but, rather, as glamorous, desirable, and virtuous. (Witness *The Apprentice*.) From ER doctors to tax lawyers to management consultants to hedge fund salespeople, many professionals are wearing their outside work commitments on their sleeves; they consider their over-the-top efforts—and often voluntary sacrifices and risks—a reflection of character. They brag about pulling all-nighters and about flying

Something's Gotta Give

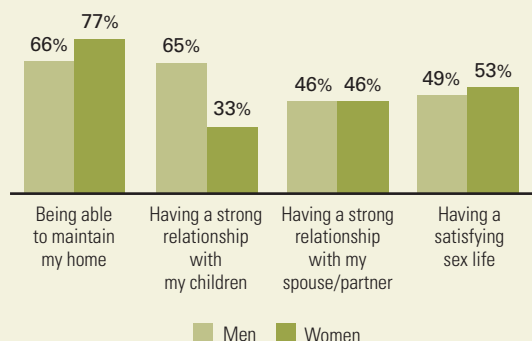
Extreme jobs may be deeply alluring, but they are certainly not cost free. Our data show that the extreme-work model is wreaking havoc on private lives and taking a toll on health and well-being.

Housework and home care seem to be among the first things to go. Over three-quarters (77%) of the women we surveyed and two-thirds

extreme jobs said their work interferes with their ability to have strong relationships with their children—compared with one-third (33%) of women. In a focus group targeting the teenage children of extreme workers, a fresh-faced 16-year-old we'll call Ellen said her dad had promised he'd work less when he made partner at a major accounting firm. "But instead,

Repercussions of Extreme Jobs for Family, Home, and Intimate Life

U.S. Survey
Extreme Jobholders Saying Job Interferes with the Following



(66%) of the men said they can't properly maintain their homes. One executive in a London-based focus group told us that although he had lived in his South Kensington flat for two years, a mattress and a sleeping bag were the sum total of his furnishings. His schedule was such that he hadn't been able to make a commitment to be home to accept a delivery.

Health is also an issue. More than two-thirds of professionals we surveyed don't get enough sleep; half don't get enough exercise; and a significant number overeat, consume too much alcohol, or rely on medications to relieve insomnia or anxiety.

Moms with extreme jobs tend to do better than dads in terms of coming through for their children. Almost two-thirds (65%) of men with

he works more....My dad's always exhausted. He's gone when I get up, and not back when I go to sleep." But her father's absentee parenting seemed normal to her since, in her world, all the fathers she knew worked such long hours.

Spouses and partners also suffer from the extreme-work model. Extreme workers dramatically underinvest in intimate relationships. Some of the data are quite startling. For example, at the end of a 12-hour or longer workday, 45% of all respondents in our global companies survey are too tired to say anything at all to their spouses or partners. Focus group conversations were sprinkled with half-joking references to four in bed these days: oneself, one's partner, and two BlackBerrys or Treos.

300,000 miles in a year. To them, a 70-hour workweek is about proving their worth. It's akin to going up against the elements.

New levels of connectivity. Extreme work is also the result of the key technologies that facilitate it. Modern communication devices have prompted a shift in expectations and behavior. We see it all around us: people glued to their cell phones or BlackBerrys, no matter the day, time, or occasion. Professionals tap so incessantly at their wireless devices that a new medical ailment has arisen—"BlackBerry thumb"—and Hyatt hotel spas now offer a "BlackBerry Balm hand massage."

Communication technology seems to have both liberated and shackled extreme professionals. In our U.S. survey, 67% of people with extreme jobs said that being available for clients 24/7 is a critical part of being successful. According to one young investment banker, "When you're an analyst, even when you're in a meeting, waiting an hour to respond to an e-mail is just not acceptable." This kind of availability, not possible before the advent of BlackBerrys and cell phones, is a curse as well as a blessing. A Dallas-based accountant in one of our focus groups described how her boss had tracked her down at a five-year-old's birthday party the previous weekend and insisted she join a 90-minute conference call because something had blown up with a client. Of the U.S. survey respondents, 72% said that technology helps them do their jobs well, 59% said that it lengthens their working day, and 64% noted its encroachment on family time.

The workplace as social center. Perhaps most profound among the cultural shifts we've been describing is the fact that the workplace is now the center and source of many people's social lives. When one's best friends and most stimulating encounters are at the office—as is increasingly the case—the prospect of working late into the evening becomes less onerous. Robert Putnam famously decried the loss of social capital in American cities as more people "bowled alone." But it can be argued that the

kinds of personal connections once made through civic organizations are now made in workplaces. In a far less positive light, this is a theme that Arlie Russell Hochschild has explored in her book *The Time Bind*, which gets inside the relationships of some dual-career couples and reveals how home life can become seriously depleted when both men and women work long hours. As households and families are starved of time, they become progressively less appealing, and both men and women begin to avoid going home. Returning to a house or an apartment with an empty refrigerator and a neglected teenager might prove to be a little bleak at the

the hours. It is probably not wrong to assume that more knowledge work means that people simply like their jobs more.

This surely seems true of Alex, a federal prosecutor who focuses on securities fraud. He works long hours, typically arriving home around 11 PM and routinely skipping meals. Instead of eating dinner, he will have a PowerBar at his desk—or a peanut butter and jelly sandwich when he gets home late at night. He never makes it home before his two young children are in bed, although he does make a point of taking his daughter to preschool in the morning. He laments that in trying to salvage

Professionals tap so incessantly at their wireless devices that a new medical ailment has arisen – “BlackBerry thumb.”

end of a long working day—so why not look in on that networking event or put that presentation through one more draft? Hochschild shows that for many professionals, “home” and “work” have reversed roles. Home is the source of stress and guilt, while work has become the “haven in a heartless world”—the place where successful professionals get strokes, admiration, and respect.

More knowledge-based work. Part of the reason that workplaces have become more sociable is that the nature of work has undergone a transformation. “Knowledge work” is increasingly important, and corporations are now full of people employing their brains more than their brawn. One thing’s for sure: There’s no need to lay down tools at the end of a shift; to the extent that knowledge work requires capital equipment, the equipment is highly portable communications devices rather than plant machinery. Knowledge-based enterprises also tend to attract employees who are on a par intellectually. The exchange of ideas and knowledge that now characterizes most workplaces is without doubt a source of stimulation—again, making it less painful to put in

as much family time as possible, he is neglecting his relationship with his wife. On a rare recent “date,” the couple went to a jazz club, only to have Alex doze off after one drink. It’s not hard to imagine why: His average workweek is 75 hours—and in the midst of a trial, he can put in 95 hours.

Nevertheless, Alex derives enormous satisfaction from his work. Last year, for example, he prosecuted an accounting fraud case. “Enron writ small,” he calls it. For him, the case exemplifies what motivates him to work so hard. He not only made sure a criminal was punished for breaking the law; he also helped secure compensation for those who were wronged. The problem with this great job is its size. “In a nutshell, it’s undoable,” says Alex. “We’re underfunded and painfully understaffed....Over the last five years, I’ve built up some great relationships with our FBI agents, who often bring me compelling cases—but the fact of the matter is, I can only take a small proportion of them. It’s disappointing and frustrating, but I just can’t drive myself any harder.”

Global operations. As companies gain global spans of operation, there are

continued on page 58

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Is There a Gender Issue Here?

Our research shows that extreme jobs are much more common among men than among women. The exhibit “Who Has Extreme Jobs?” tells the tale. Among high earners in the United States, 21% hold such jobs, and less than a fifth of those are women. Among high earners at global companies, 45% are working extremely, and women make up a third of that group.

Why aren’t more extreme workers women? Part of the answer emerges from finer cuts of the data. In the global companies survey, we found that young, talented women are well represented in jobs that have reasonable hours (fewer than 60 a week) but high performance requirements (fast pace with tight deadlines, 24/7 client demands, and so on). Of the respondents holding these jobs, 39% are women. By contrast, of those meeting high performance requirements and putting in longer hours, only 30% are women. The data suggest that women are not afraid of the

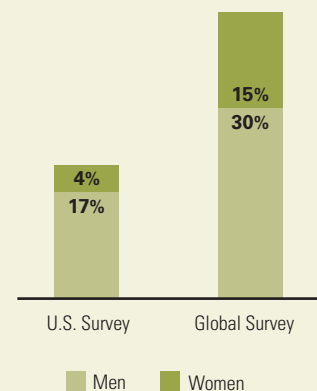
pressure or responsibility of extreme jobs—they just can’t pony up the hours.

The U.S. survey, too, demonstrates that the number of hours worked is where women fall short. Consider the exhibit “How Many Hours and How Much Responsibility?”—which divides the high earners we surveyed into four quadrants, according to the length of the workweek and the demands of the job. Positions that involve long hours but little in the way of performance pressure are particularly shunned by women: Only 2% of the women in our sample work long hours in positions with few extreme-job responsibilities. Men are somewhat more tolerant of such jobs.

Perhaps women are less tolerant of high-hours, low-impact work because they are more aware of the “opportunity costs.” They seem particularly tuned into—and pained by—the fallout on their children. They see a direct link between their long workweeks and a variety of distressing

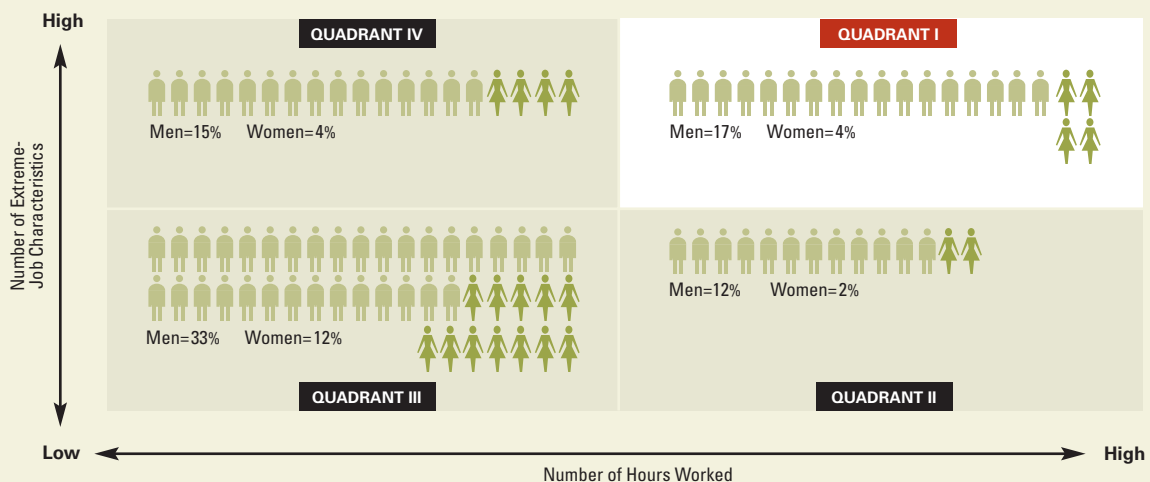
behaviors in their children. As the research literature attests, it’s extremely rare for parents to admit to having problems with their children. (There are serious problems in society, but never in one’s own home.) Thus, the data in the exhibit “Extreme Jobs Affect Well-Being of Children” constitute a veritable portrait of guilt. That women

Who Has Extreme Jobs?



How Many Hours and How Much Responsibility?

Extreme jobs demand a high number of responsibilities (five or more out of ten specific challenges, such as tight deadlines and 24/7 availability to clients) as well as a high number of work hours (60 or more a week). The matrix below illustrates where the men and women in our U.S. survey fall. Each figure represents 1% of the total population of high earners surveyed.



worry about the implications for their children is probably not because mothers are more caring than fathers but because, as our survey data show, more men in extreme jobs (25%) than women (12%) have the support of an at-home spouse or partner.

These dynamics play out in homes around the world every day. In a focus group held at Canary Wharf in London, a woman lawyer put it succinctly: "When I walk out the door in the morning, leaving my two-year-old with the nanny, there's usually a bit of a scene. Tommy clings, pouts, and whips up the guilt. Now, I know it's not serious—he's a happy kid, and he likes his nanny. But it sure makes me think about why I go to work—and why I put in a ten-hour day. It's as though every day I make this calculation: Do the satisfactions I derive from my job (efficacy, recognition, a sense of stretching my mind) justify leaving Tommy? Some days it's a close run."

Indeed, for many women, the equation is not balancing out. A clear majority (57%) of the women in extreme jobs in the United States told us they don't want to continue working at this pace for more than a year. Less than half the men (48%) felt the same way. Only 13% of the women (versus 27% of the men) want to be working at this pace in five years. The numbers were far more dramatic in our global companies survey, in which 80% of the women (versus 58% of the men) said they don't want to keep working this many hours for more than a year, and only 5% of the women (and 12% of the men) said they want to do so for the next five years.

The key question, of course, is whether all this creates a barrier for ambitious women and for companies that want to achieve more gender diversity in their upper ranks. The answer is yes to the extent that extreme workers constitute the talent pool from which top leadership will be drawn. If this group of high-octane workers represents

the "A team"—and we think it does—it's very disturbing to see so few women in it.

The silver lining is that employers face a real opportunity here. We know of several companies that are beginning to tap into the talents of women who are willing to commit to hard work and take on responsibility but cannot do the long hours. For

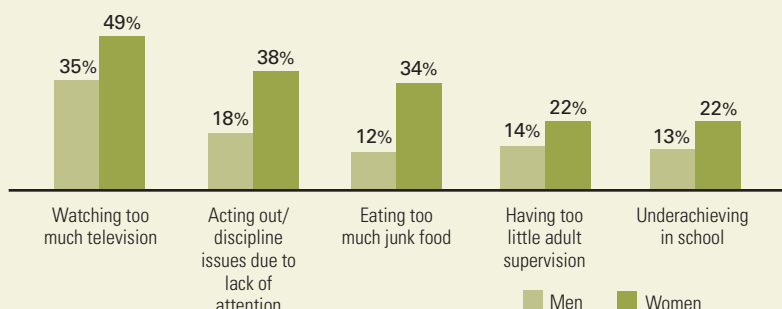
"new compass" for returning women, showing them a way back into their careers.

Heidi Yang, an investment banker in Hong Kong, illustrates the edge some global companies are developing as employers of choice for young, talented women. Heidi is definitely a "high-potential manager." During her three and a half years in the

Extreme Jobs Affect Well-Being of Children

Global Survey

Respondents answered the question "Has your child ever experienced any of the following because of the number of hours you work?"



example, Booz Allen Hamilton and American Express are beginning to "chunk out" work in different ways. AmEx has created an internal consulting pool that provides flexible career paths for high-performing employees. A working mom, for instance, might choose to arrange her workday so that she's able to pick her children up from school. "We're sharpening our approach to creating flexible work models," says L. Kevin Cox, executive vice president of human resources at American Express. In a similar vein, Lehman Brothers and Goldman Sachs are beginning to create flexibility over the arc of a career. Lehman's Encore program welcomes talented women who have off-ramped and are looking for a road back into the financial sector—reaching out with networks, mentors, and flexibility. Goldman Sachs's New Directions program provides reskilling and a

investment division of UBS in Hong Kong, she has been promoted twice; she now runs a team of 25. When we first met with her in November 2005, she was pregnant with her first child and pleased with UBS's parent-friendly policies—which she considered as generous as any "on the street"—but she worried about whether those policies were "for real." If, for instance, she availed herself of her full maternity leave, would she be seen as not serious, and subtly derailed from the fast track? Happily, when we last interviewed her, in July 2006, her fears had not been realized. "There's been a real change at this firm," she observed. "The culture is shifting. They're allowing me to work flexibly. As long as I come through for my clients, I can work wherever I want. There's none of this face-time stuff. My bosses seem to understand the importance of keeping women."

additional reasons for jobs to become extreme. The need to oversee work in multiple time zones increases not only the travel requirements of a job but also the length of the workday. One oil company executive we interviewed ran a global team composed of colleagues in Angola, the United States, and China. As he put it, this “did a number” on his working day. Other professionals in our focus groups told anecdotes about pulling all-nighters and defying jet lag to attend back-to-back meetings in Singapore and New York. The difficulty of waking up to participate in global

We believe that these are the key trends underlying the rise in extreme work. There may be others. The point, however, is that they represent a mix of positive and negative pressures. Long workweeks cannot simply be chalked up to the crushing effects of a heartless and unchecked capitalist system, as some commentators have argued. The extreme professionals who find their work enormously alluring are not deluded. Recognizing trends like the rise in knowledge work and society’s general embrace of the extreme ethos makes it easier to understand the attitudes of

the way of strong relationships with their children; 46% think it gets in the way of good relationships with their spouses; and 50% say their jobs make it impossible to have a satisfying sex life. (For more data on the personal costs of extreme work, see the sidebar “Something’s Gotta Give.”)

These statistics are underscored by the stories shared by focus group participants. In one session, which took place at a financial services company, an executive described how he had lost all credibility with his elderly wheelchair-bound father by canceling so many promised weekend visits. Another executive, striking a more positive note, described the transformative recent experience of taking, for the first time in his 14-year career, two consecutive weeks of vacation: “It was a revelation. I had no idea I even had it in me to enter into this other zone, where I was able to focus on my nine-year-old son, and I mean really focus. By the second week, I was listening to meandering stories of a tiff he’d had with a best friend and his description of what had happened in the last episode of his favorite TV show without urging him to get to the point, or wrap it up. And we spent hours playing Ping-Pong – a game he loves but I generally have no patience for.” The other participants listened intently, clearly trying to wrap their minds around what a two-week vacation would be like.

These are poignant examples of the costs of extreme work to individuals, but there can be costs at the company level, as well – for instance, when burn-out occurs. Half of our extreme jobholders don’t want to continue working under this kind of pressure for more than a year. Moreover, the next generations of management – the so-called Gen X and Gen Y cohorts – seem less enamored of their jobs than baby boomers. In the 45-to-60 age group, only 19% of extreme jobholders say they are likely to leave their jobs within two years; this figure rises to 30% in the 35-to-44 age group and to 36% in the 25-to-34 age group. The ultimate price may be paid in succession planning if maxed-out

Long workweeks cannot simply be chalked up to the crushing effects of a heartless and unchecked capitalist system.

conference calls in the middle of the night was a common refrain.

Because many companies are expanding globally, senior managers have a larger scope of responsibility. Take Gwen (not her real name), who manages a supply chain for a large DIY retailer. The pressures of her job are enormous – involving quick decisions on inventory levels that can have huge consequences for her company’s bottom line. Just three years ago, most of her suppliers were in South Carolina and Georgia; now her supply chain reaches to Eastern Europe and China. Gwen operates in three different time zones and seven different countries. She says, “The challenges are intense – and I like that. But being away from home half the time – and I mean *away* away – is really hard on my ten-year-old.” Compounding the overload problem is the fact that managers these days are less able to delegate low-value but necessary tasks (like compiling the expense reports for all that travel Gwen does). Secretaries seem to have been replaced by do-it-yourself technology – 71% of extreme workers have no dedicated administrative assistant, and more than a third (37%) don’t even have a shared assistant.

people like Madeleine (not her real name), the chief operating officer of a major global bank. As she detailed the demands of her job for us, we found her to be downright exuberant. She had recently transferred from the bank’s New York headquarters to London, where her responsibilities were expanded tenfold: She now travels between three time zones. The pressure is undeniable, but we heard no complaint. Instead, Madeleine described the thrill of managing a large international business and being “a global player on top of my game.”

Life on the Edge

If people in extreme jobs are uncomplaining and their employers are happy to have their services, is it reasonable to claim there is a problem? Arguably, the trend toward more extreme work is a boon to national competitiveness.

Yet there are, even in the responses to our survey, hints of the dangers afoot. Asked about the effects of their extreme jobs on their health and relationships, most respondents readily noted the downsides. More than 69% believe they would be healthier if they worked less extremely; 58% think their work gets in

professionals stop striving for top jobs. In our survey, 65% said they would decline a promotion if it were even more demanding of their energy.

Beyond the level of any single company, the costs of the extreme-job phenomenon become far more troubling. The common observation about a job category that is demanding to the point of exhaustion is that it is “a young man’s game.” But more jobs are falling into this category – and more than young men need to be in the game. The societal costs of income disparity and winner-take-all economics are huge, as many before us have argued.

Women in particular stand to lose from the extreme-work model. Our research finds that while women don’t shirk the pressure or responsibility of extreme work, they are not matching the hours logged by their male colleagues. This is especially true of mothers, who are also dealing with an increasingly extreme parenting model; they simply can’t – or don’t choose to – work exceedingly long hours. Of all the high earners we classified as extreme jobholders, only 20% are women. The women who do hold extreme jobs, meanwhile, are somewhat less likely than the men to love their work. (The sidebar “Is There a Gender Issue Here?” offers an extensive analysis of the implications for women executives and the companies that strive to retain them.)


Cultures of Midnight Oil

Of all the high earners we surveyed (not just the extreme-job subset), 44% feel that the pace of their work is extreme. Professionals these days are putting in longer hours, taking on more responsibility, and facing more pressure than ever before. Their intensity and investment may serve companies well in the short run but will pose risks in the long run. The extreme-work model threatens to cull real talent, particularly female talent, that otherwise could have reached the top.

It’s hard to offer solutions. Many companies are encouraging more work/life balance; a few go to some lengths to

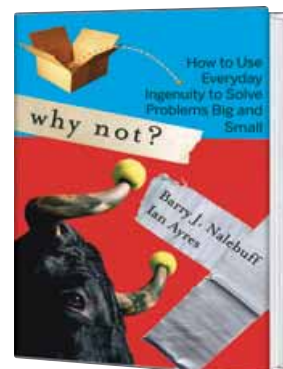
ensure that the policies they’ve put on paper are reflected in reality. For every company that does so, however, there are others afraid of creating a work atmosphere that is unattractive to “A players.” If an effort to establish a more measured work style means that extreme achievement will no longer be rewarded, they reason, then some extreme workers will seek opportunities with firms more likely to appreciate their outsize contributions. Colleagues may be happy to see extreme workers go; workaholics can be highly demanding and critical of their less dedicated coworkers. But some management teams think there are worse things than having an ultraperformer around – like having that person join the competition.

Indeed, some organizations – certain management-consulting and investment-banking firms come to mind – attract talent in the first place with their famously tough environments. The importance of company culture in setting the pace of work was strongly affirmed by our survey, in which 74% of respondents agreed that extreme jobs emerge from companies’ particular value sets. Shane, a young man who participated in a focus group, put his finger on it. Having spent his weekend jumping through hoops for a demanding boss, only to discover that he’d wasted his time, he pinned the problem on the “tone at the top.”

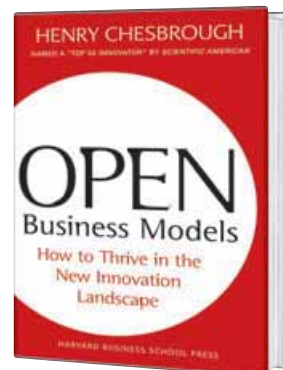
Senior leadership of organizations should take note: The attributes that give a workplace an advantage in recruiting and retention can change dramatically over time. The culture that celebrates the extreme ethos today may tire of it – quite literally – tomorrow. At a minimum, senior executives should think carefully about the work behaviors they are rewarding, encouraging, or requiring. More than anything, the signals they send will determine whether jobs become extreme – and if so, whether those jobs remain exhilarating or simply become exhausting. 

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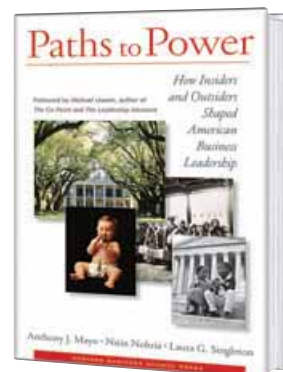
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AND JUST LIKE THAT, THE LAWS OF CHEMISTRY CHANGE. A world that includes

the Human Element, along with hydrogen, oxygen and the other elements, is a very different world



indeed. Suddenly, chemistry is put to work solving human problems. Bonds are formed

between aspirations and commitments. And the energy released from reactions fuels a



boundless spirit that will make the planet a safer, cleaner, more comfortable place for generations to

come. A world that welcomes change is about to meet the element of change: the Human Element.

Profitability or growth? Short term or long? Synergy or stand-alone unit performance? All companies struggle to reconcile these tensions. But in any given company, one is more important than the others – and that’s the one to manage.

by Dominic Dodd and Ken Favarro

Managing the Right Tension

Every leader and every company faces the problem of how to make progress on seemingly conflicting objectives at the same time. And of all the competing objectives, three pairs stand out: profitability versus growth, short term versus long term, and the whole organization versus the parts. In each case, more progress on one front usually comes at the expense of progress on another: Going for more growth damages profitability, and working toward higher profitability slows growth. Efforts to build for tomorrow distract everyone from producing results today, but when managers shift the focus to today’s results, they compromise the future strength of the company. Attempts to create companywide benefits hold back individual business units, then attempts to unleash the individual potential of the business units bar the way to capturing the benefits of being one company. It’s like squeezing a balloon in one place only to find that it expands elsewhere.

SHOUT



Three years ago, we set out to examine these three tensions systematically. We wanted to understand how prevalent they were, how much they mattered to overall company performance, and what managers should do about them. We researched the 20-year performance of more than 1,000 companies worldwide, commissioned a survey of 200 senior executives, and conducted in-depth discussions with 20 chairmen and CEOs of large corporations – all wrestling with different tensions in different ways.

Our research shows that most companies struggle to succeed in managing the three tensions. Between 1983 and 2003, only 38% of the companies we studied achieved both positive profitability and real revenue growth in the same year more often than they failed to do so. On the short-term/long-term tension, the results were little better: In a typical year, only 44% of companies grew earnings over the previous year while also being on the path toward economic profit growth over the next five years. Finally, we found that fewer than 45% of companies were able to add value to their divisions and business units through both synergy and improving stand-alone performance at the same time.

The problem is not so much that managers don't recognize these tensions – they are all too familiar to anyone who has ever run a business. Rather it is that managers are often not focused on the tension that matters most to their company. Although companies have to manage all three tensions all of the time to some extent, at any point in time only one of them is critical to unlocking better performance. More often than not, executives pick the wrong tension as their priority. This is hardly surprising because the tensions often masquerade as one another. A business's apparent problem reconciling short term with long term, for example, may actually reflect a growth versus profitability issue.

Even if managers do identify the right tension, they usually make the mistake of designating a "lead" objective within it – for example, focusing on profitability over growth or vice versa. As a result, the company often ends up moving first in this direction, then in that direction, then back again, never quite resolving the tension. We found that the best-performing companies adopted a very different approach. Instead of setting a lead objective from which all decisions followed, they looked at how they could best strengthen the factor that unites the two sides of each tension. For the profitability/growth tension, that common bond is customer benefit. For the short-term/long-term tension, it is sustainable earnings. For whole and parts, the common bond is something we call

diagonal assets, particular organizational resources and capabilities that help the company act as both a single company and many different businesses at the same time.

In the following pages, we will describe how companies can select the right lead tension, and we will demonstrate the results that doing so can unlock. We will describe the traps that companies can fall into when they focus on one side of a tension over the other and show how they can escape these traps by managing with an eye to the common bond between the two objectives within each tension. First, though, let's take a look at how companies can determine how well they are currently managing the three tensions.

Calculating Your Batting Average

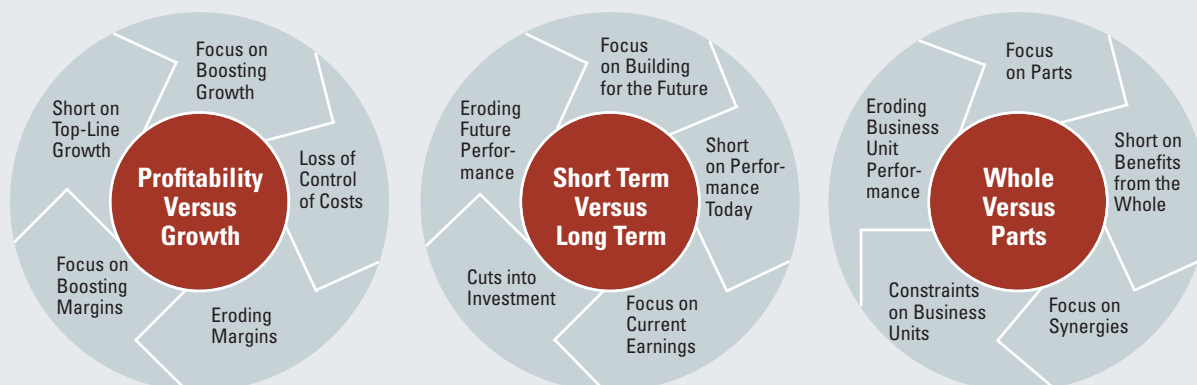
We borrow the baseball concept "batting average" to measure how often a company is able to succeed at two competing objectives at the same time in any given year. For example, between 1983 and 2003, General Motors achieved positive real growth in revenue and a positive economic profit margin during the same year only six times. In the other 14 years, the company either didn't grow in real terms, or was unprofitable, or failed on both fronts. GM's batting average on the profitability/growth tension was .300 – in essence, six hits in 20 at bats. In baseball, of course, a batting average of .300 is quite good, but in business, the bar is set much higher. (The exhibit "Batting Average: A Measure of Success in Overcoming Tensions" describes the calculations required to estimate the average for each of the three tensions.)

You might expect batting averages to reflect what's going on in the industry environment, and that is true to some extent. Certain industries, by their very natures, present managers with stark choices between performance objectives, whereas others do not. For instance, companies in capital-intensive industries are forced to accept short-term losses for long-term gains to a greater extent than companies in low-capital industries are. The headroom to grow and be profitable at the same time is more limited in industries like automotive, oil, or steel.

But the batting averages of individual companies vary more *within* an industry than *across* industries. It is possible to have a high batting average in a very challenging industry. Conversely, companies can get stuck with low averages even in the most promising industries. Take the automotive industry: GM's performance was about average for the sector in terms of the profitability/growth tension: a batting average of .300, or 30%, for GM compared with a 34% industry average. German carmaker

Dominic Dodd (ddodd@marakon.com) is a director of Marakon Associates, an international management consulting firm headquartered in New York and London. *Ken Favaro* (kfavaro@marakon.com) is Marakon's cochairman and was recently the firm's chief executive. They are the authors of *The Three Tensions: Winning the Struggle to Perform Without Compromise* (Jossey-Bass, forthcoming).

The Three Tensions Every Company Faces



Symptoms of Being Trapped by the Tension

- | | | |
|---|---|---|
| <ul style="list-style-type: none"> > Swinging between a growth push and a productivity push > Giving priority to reducing costs in difficult times and to boosting growth in boom times > Low or falling share or price relative to competitors > Falling market growth > Reduction in volume per line; increasing complexity > High unit costs relative to competitors | <ul style="list-style-type: none"> > Swinging between a focus on strategy and a focus on execution > Increasing reliance on profitability rather than growth to achieve earnings growth, or vice versa > Difficulty in hitting earnings targets without delaying investments > Low or falling investment compared with competitors and relative to earnings growth > Investment following earnings; investing at same times and on same things as competitors | <ul style="list-style-type: none"> > Swinging between centralization and decentralization > Debates about accountability versus authority versus ownership > Few voluntary interactions among business units or between business units and the corporate center > Strong separate cultural identities across business units or functions > A culture of blame and finger-pointing |
|---|---|---|

BMW, in contrast, achieved both positive economic profitability and real revenue growth in ten years out of the 20—a batting average of 50%. At the other end of the scale, Japanese automotive company Daihatsu managed to achieve both at the same time in only five years: a batting average of 25%.

Why does your batting average matter? Performing well on different objectives at the same time is necessary to serve the competing interests of different stakeholders. For instance, a company that is growing will find that it is able to provide fulfilling jobs; and a company that is profitable will be able to pay higher wages and benefits; only a company that is growing *and* profitable will be able to serve both interests simultaneously. But are *shareholders* really better off when companies reconcile such objectives at the same time? Doesn't it make sense to grow, then consolidate and work on profitability, then go for the next phase of growth? Isn't accepting losses now part of creating profits later?

It turns out that there is a close positive relationship between batting average and total shareholder returns (TSR). We found that for each tension for which we could measure performance at all of our 1,000-plus companies, batting average is a better proxy for TSR than any other measure in common use today, such as earnings, earnings per share, EBITDA, economic profits, price-to-earnings multiple, or return on capital. For example, the differences we saw in batting average for the profitability/growth tension in the automotive industry line up with differences in TSR. BMW, with the highest batting average, earned the highest TSR at 14%; Daihatsu, with the lowest batting average, earned 4%; and GM stood in the middle with 8%.

As you move up the quartiles on batting average, TSR increases accordingly. In general, a 10% increase in batting average—hitting both objectives one additional year every ten years—equals about two percentage points more in annual TSR. This is a big amount lost in a small

number: An investment of \$1,000 made in 1983 in the average S&P 500 company was worth around \$5,600 20 years later; with a return two percentage points higher each year, that investment would have been worth more than \$8,000.

This result flies in the face of conventional thinking about company performance. A company's long-term market value fluctuates on the basis of changes in market expectations of profits. But batting average is a retrospective measure, and it does not account for the amount of profits expected. The fact that batting average correlates with TSR, despite these differences, suggests that a track record of avoiding compromises between performance objectives is much more important than at first might be imagined. If companies can achieve batting averages of above 50% – meeting both objectives at the same time *more often than not* – they will be likely to finish in the top quartile of their industry by TSR.

Why then do so many companies score such consistently low batting averages? The first explanation is that many leaders worry about the wrong tension.

Picking the Right Tension

The problem here is that the three tensions are not independent of each other. A low batting average on one can cause a low batting average on another. A company's failure to create synergies across the organization might result in duplication in back-office costs, which would reduce profitability and act as a drag on new growth projects. Thus a low batting average on the whole/parts tension can lead directly to a low batting average on the profitability/growth tension. Similarly, a culture of business-unit autonomy can act as a barrier to open interactions with the corporate center, making it difficult for the senior team to see how results are being generated and whether short-term earnings are coming at the expense of investment needed for long-term performance.

Moreover, companies often manage the tensions in lockstep. When the priority is today's earnings, managers tend to push for higher profitability rather than faster revenue growth because they are confident they can increase profitability more quickly and with less investment than they can influence revenue growth. Companies that give priority to revenue growth often seek it by freeing up the individual parts of the company to stimulate new ideas, more experimentation, and greater adaptation to local markets.

Because the three tensions interact in these ways, it is difficult to disentangle cause from effect and problem from symptom. But despite the close relationships among them, each tension raises different questions and prompts managers to take a different focus. The tension between profitability and growth focuses the leader on the company's *business model*: what it does for customers and how

it configures its costs to support that. In other words, it prompts questions of strategy. The tension between the short term and long term requires that leaders examine the company's *management model*: how the company manages performance and investment. It prompts managers to think about the company's targets, processes, and routines. The tension between the whole versus the parts steers leaders toward considering the company's *organizational model*: its structure, culture, and people.

This means that managers need to carefully think through their companies' problems to make a diagnosis. A good way to begin is to ask, "What is our batting average for each tension relative to our peers?" If, as is often the case, the company's batting average is low or falling for more than one tension, then the next step is to unravel whether the cause is related to the company's business, management, or organizational model. To illustrate, let's look at the case of Coca-Cola.

Most current assessments of Coca-Cola focus on the tension between today's performance and tomorrow's. The company's management has missed progressively lower targets for annual earnings growth. Its preoccupation, therefore, has been on restoring short-term earnings growth. But if you look more closely at Coca-Cola's performance, you will find that the company has also generated more of its earnings growth from profitability than from revenue growth, whereas archrival PepsiCo's earnings growth is generated to a greater extent from both. The more a company's earnings come from either profitability improvement or revenue growth but not both, the more likely it is that there is a fundamental strategy problem lurking behind the short-term earnings numbers.

Coca-Cola had a profitability/growth batting average of 91% between 1985 and 1995, achieving both objectives in all but one year (1987). Between 1996 and 2004, the company's batting average fell to just 11%. Although the earnings growth was healthy in 1996 and 1997, it stemmed from margin increases, not revenue growth. Coca-Cola's real problem, therefore, may be that its core business model for carbonated soft drinks is broken. The relative price of products in this category versus other categories may be an indicator: "Starbucks can charge \$2 for a cup of coffee, and [Coca-Cola] can barely sell a 12-pack of Coke for that amount," notes one commentator. Slow market growth in the carbonated drink category is perhaps another indicator, as could be mounting concerns about obesity. Coca-Cola remains reliant on soft drinks for 80% of its revenue, compared with around 20% for PepsiCo, and is not perceived as having adapted as much or as well to changes in consumer attitudes and concerns. The symptom of Coca-Cola's problem might be its struggle to reconcile performance today with performance tomorrow – a management model challenge. But the real issue for the company – which was apparent in the plummeting of the profitability/growth batting average several years

Batting Average: A Measure of Success in Overcoming Tensions

A company's batting average is a measure of how often a company is able to succeed at two competing objectives at the same time in any given year.

PROFITABILITY/GROWTH BATTING AVERAGE

The proportion of years in which a company achieves both positive real revenue growth and a positive economic profit margin. For example, a company that achieves both in three out of five years has a profitability/growth batting average of 60%.

SHORT-TERM/LONG-TERM BATTING AVERAGE

The proportion of years in which a company has positive single-year earnings growth and is on the path to positive multiyear economic profit growth. We use a period of five years to gauge multiyear performance because it is a planning horizon that many companies use (and not far off the six- to seven-year average tenure for CEOs of large companies).

WHOLE/PARTS BATTING AVERAGE

The proportion of years in which a company improves the performance of its business units irrespective of their relationships with the other units and creates net positive one-company benefits by coordinating across them. This is hard to measure from outside a company, so we look at the proportion of years in which a company trades at a higher value than the sum of its parts on a stand-alone basis. This overstates the batting average because for some companies a positive on one objective more than offsets a negative on the other, but otherwise we have found it to be a reasonable proxy.

before the short-term/long-term average faltered – may well be its business model.

Making an accurate diagnosis of the root cause of underperformance is a real problem for business leaders. But it is not insurmountable. Jim Kilts of Gillette and Lewis Campbell of Textron give us two examples of how shifting a company's focus from the wrong tension to the right one can deliver tremendous improvements in performance.

Focusing on the profitability/growth tension at Gillette. In February 2001, Jim Kilts took over as chairman and CEO of Gillette. The company's market value was \$34 billion. Four and a half years later, in October 2005, Procter & Gamble bought the company for \$57 billion. What was behind the surge in numbers? Kilts shifted the company's focus from worrying about the tension between short term and long term to worrying about the tension between profitability and growth.

Historically, Gillette's short-term/long-term batting average had been high – averaging 77% from the mid-1980s to the mid-1990s. But then the company started to struggle. By 2000, its annual earnings were falling and its multiyear economic profit trajectory turned negative. Consistent with a focus on managing to the short-term/long-term tension, executives were pulling levers within the company's management model: setting challenging earnings-per-share targets, managing the timing of investment to ensure the right earnings profile, tying cost disciplines to earnings outcomes, and so on.

These measures, however, did little to solve the company's underlying problems. From the mid-1990s until Kilts's arrival, Gillette had allowed product lines to proliferate. By 2001, it was managing more than 25,000 stock keeping units, many with very low sales volume and poor profitability. Gillette had resorted to extensive use of price promotions and coupons to try to keep share and

BATTING AVERAGE VERSUS SLUGGING PERCENTAGE

Batting average measures the frequency of achieving two performance objectives within a tension at the same time but not the degree to which each objective is achieved. We refer to that as slugging percentage. Thus a company with a profitability/growth batting average of 50% but an average revenue growth of 5% and an average economic profit margin of 4% has a lower slugging percentage – is generating lower levels of economic profit – than a company with the same batting average but 10% revenue growth and an average economic profit margin of 8%. Clearly, slugging percentage matters to a company's total shareholder returns (TSR). But if that were all that mattered, we might expect to find no relationship between batting average and TSR. This is not the case. In fact, the correlation between TSR and total economic profit growth – a component of slugging percentage – was less than that between TSR and batting average for the profitability/growth tension and the short-term/long-term tension.

earnings up. When times got harder, the company resorted to trade loading—pushing hundreds of millions of dollars of stock onto retailers at one point—in an effort to hit its earnings targets. From 1996 to 2001, Gillette failed to generate both real growth in revenue and a positive economic profit in any year. Its profitability/growth batting average was 0%.

In 2001, Kilts and his team shifted focus away from relying on Gillette's management model to keep earnings going toward improving its business model to achieve high profitability and faster growth at the same time. EPS targets were jettisoned; Kilts stopped giving earnings guidance; spending on trade promotion was slashed as a proportion of total spending and in absolute terms; trade loading was prohibited on threat of immediate dismissal; and extending product lines became a cardinal sin.

Kilts's philosophy for upgrading the company's business model was this: "The way to have growth at a premium return is to grow productivity and brand value at the same time. The way we operate is to drive functional excellence to drive productivity growth to pay for innovation to drive brand value." According to Kilts, high brand value to Gillette meant "having a small number of relevant and differentiated benefits that in combination no other competitor can match."

Gillette began its functional excellence campaign by comparing the costs of each function with those at relevant peers. Kilts's team discovered, for example, that the company's finance function cost 30% to 40% more than comparable functions elsewhere and that its human resource department cost 15% to 20% more. The team also learned that Gillette was the fastest payer and the slowest collector of debts, one of the main reasons the company had a 36% working-capital-to-sales ratio at the end of the 1990s. (P&G had an equivalent ratio of 1%, and Colgate-Palmolive, 2.5%.) Next, Kilts set a standard for continuous productivity improvement. Overhead costs fell 4% within the first year. Pretax procurement costs were cut by some \$200 million. And further savings were found from closing seven manufacturing facilities, reducing inventory, and cutting working capital over four years.

Gillette retained some of those savings in the form of higher profitability and reinvested others. "As a rule, we reinvested 50 to 60 cents of every productivity dollar into growing brand value," says Peter Klein, former senior vice president of strategic planning and a longtime associate of Kilts. The priorities included getting new products quickly to market and outspending competitors on consumer brand marketing for core brands. For example, the company brought its M3Power razor to market earlier than planned; it became the top-selling razor in the United States in its first three months. Gillette had had the technology for putting a battery in a razor for a decade. Under the old management model, it had made more sense to "save it for later" for fear of disrupting the

earnings line and cannibalizing current brands. When Kilts first saw the product demo, he immediately asked that it be launched as fast as possible. Kilts accelerated other major product launches as well: an upgrade of the women's shaving brand Venus Divine, a battery-operated toothbrush, and the Hummingbird dental-flossing tool.

From 2002 to 2005, Gillette scored a batting average of 75% on the profitability/growth tension. It missed revenue growth only once, in Kilts's first full year, 2002, when the halt in trade loading hit sales. Since 2003, Gillette's aggregate performance has also been impressive: Revenue growth has picked up to double-digit levels and economic profit margins are nearly twice the company's long-term average. As a result, annual TSR, which between 1997 and 2001 had been ten percentage points below peers', outstripped competitors by five percentage points in the years between 2002 and 2005.

Focusing on the whole/parts tension at Textron. When Lewis Campbell became CEO at Textron in 1998, he could have been forgiven for bringing with him the assumption that the primary tension he needed to manage was between the short term and long term. Top managers at the \$10 billion conglomerate had the usual levers at their disposal to manage that tension: targets for annual earnings growth coupled with a traditional strategic-planning process for prioritizing investments for the long term. But the company was struggling to keep earnings growth going while finding the room for investment to build stronger positions in its most profitable markets. When the company's share price dropped by half between 1999 and 2003, Campbell and his team undertook a major transformation to shift the company to what proved to be a much more productive focus: overcoming the tension between the value of each individual business unit and that of the company as a whole.

According to Campbell, "The issue all companies face is that the corporate center wants every business unit to be the same, but every business unit wants to be different. I want to keep every business unit focused on customers and to be state-of-the-art on common processes: payroll, health care, talent development, IT, receivables, accounts payable. This can be done either by centralizing or through 'commonizing'—adopting the same language, textbook, tools, and so on, without actually creating a central function." Campbell believed that every business has "core" and "context" processes and activities. Context processes are common across all the businesses, like getting the paychecks out on time. Core processes are specific to the customer value-added equation in each business and drive the value of that business. "I look for the group to add value to the context processes by either centralizing them or commonizing them and to focus the business units on becoming customer satisfaction machines."

Textron centralized a number of context functions, such as payroll processing and employee benefits, taking



all responsibility for them away from the business units. This has allowed the company to reduce costs significantly—for example, by reducing the number of data centers from 88 internally operated centers to two, which are now operated by a third party, and by cutting the number of health insurance plans from 154 to just one.

In other areas, such as manufacturing, Textron takes the other approach. Rather than creating a central function, it boosts performance by applying well-known enterprise management processes such as six sigma, lean manufacturing, and integrated supply chain management. The aim here is to build what Textron calls a “networked enterprise”: a portfolio of businesses that do not share customers, costs, or competitors, but do shared enterprise management processes. Says Campbell: “We’re now at a stage where we can take specialists in many of our enterprise management processes out of any business and drop them into another business and they can be immediately effective.”

Campbell reinforces the new focus by aligning pay with the whole/parts tension. “We now split bonuses into a per-

sonal performance rating and a company performance rating, and these are multiplied. So if Textron does really well, and if a manager has done something on behalf of other businesses that helped them and possibly hurt his business, that manager can get a big bonus even if it wasn’t a great year for his business.” Campbell is using the new organizational model to shape M&A strategy as well. Textron guides its acquisitions by concentrating on its capability of continuously improving manufacturing. “The ability to ‘commonize’ some processes, centralize others, and focus the businesses on their core processes gives you the basis for tangible benefits from making acquisitions. So instead of being woolly about ‘synergies,’ we can be specific about how we, Textron, will add value to the company we are acquiring. If you have businesses that have the same operational characteristics in terms of customers to be served, products to be made, employees to be paid, and receivables to be managed, you have the potential to manage the tension between whole and parts.”

Investors have been well rewarded under Textron’s new focus: Its annual TSRs of 54% from March 2003 to March

2006 are more than double the World Diversified Index (25%) after falling short of this same index by 12 percentage points, annually, in the prior four years.

The Dangers of Picking Lead Objectives

When leaders have identified the tension that is most important to unlocking better performance, the question becomes how to manage it. A proverb tells us that if we chase two rabbits, both will escape. Much intuition about management reinforces the belief that it is next to impossible to succeed at both competing objectives within a tension at the same time. Our survey confirmed that most companies choose a lead objective within each tension: Of the executives we surveyed, 60% said their company

tently on customers. You do this by increasing the difference between your company's products and services and those of competitors; tailoring products and services to reflect differences across customers; finding new and different marketing and sales approaches to increase the appeal and reach of your offerings; splitting the company into smaller autonomous businesses closer to their customers; and entering new and fast-growing customer segments. Revenue growth responds. But these actions create side effects that make it harder to increase profitability at the same time: They lead to a proliferation of lines and increased complexity and reduced volume per line; they tempt you into discounting, price promotion, and "push" sales techniques; they cause duplication and overlap across units; and they lure you into occupying weak positions in apparently attractive markets.

The common factor behind the bad numbers is that managers tend to use effective management tools to focus on only one side of a tension.

chooses to prioritize either growth over profitability or the reverse, rather than place equal emphasis on both; for short-term/long-term, 70% prioritize one objective or the other; and for the whole/parts tension, the figure is 72%.

The trouble is that managing to objectives in this way can very easily lure companies into traps where improvement in one objective ultimately comes at the expense of another.

The tying-costs-to-earnings trap. If your lead objective is to improve profitability, you set your cost budget with earnings in mind and tie pricing decisions to margin requirements. But engineering costs to hit target earnings soon blurs the distinction between costs that are important for growth and those that are not. In particular, it encourages you to manage costs more closely in bad times than in good times. Then in the good times, you tolerate cost increases because they are more than covered by revenue increases and because overall earnings growth meets target. But this allows costs not needed for growth to rise unchecked and become locked in. Such costs eventually become an anchor on growth. The funds available for growth are lower than they could be, and the sales volumes at which new investments start to be justified are higher than they could be. When the bad times come, as they inevitably do, the imperative is to cut costs across the board—including the costs needed for growth.

The customer-focus trap. When your lead objective is more growth, a first port of call is often to focus more in-

The annual-earnings-growth trap. When short-term performance is the priority, you deliberately set a stretch target for annual earnings growth. You link company incentives to it, sharpen budgeting disciplines, work on creating a culture of "execution excellence," and institute the standard of a fast payback on new investments. Collectively, this builds a powerful engine for meeting your target for annual earnings growth. But this system doesn't dictate how numbers are to be hit and how they are not to be hit. After the low-hanging fruit has been plucked, pressure mounts to delay important investments for the long term, cut into the quality of customer service, push stock onto customers, and raise prices to improve short-term earnings. Doing this generates the desired short-term numbers but undermines the company's ability to grow earnings in the future. In our survey, we found that 77% of executives said they would often or sometimes be prepared to delay a project to meet a short-term earnings target, even if the project would be profitable in the long term.

The present-value trap. You want to build for long-term profits. You set up the objective of maximizing net present value—that is, following whatever path of investment and earnings will deliver the highest cash flow for the company. But when you ask your managers to give you plans that maximize net present value, they all come back with the same familiar investment profile: one that requires a lot of up-front investment and promises a lot of return later—the "J-curve" or "hockey stick." Although

the plans are sincere and sometimes warranted, no CEO wants to have all the company's options for investment generating profits only in the distant future—and you are no exception. You risk investing behind an ever-receding promise of future earnings. Your difficulty is compounded by the fact that most of your managers will move on before their long-range forecasts come home to roost. In trying to set high standards for long-term performance, you have let people off the hook for today's results.

The centralization trap. You see the benefit of acting more as one company. You decide that the most important task is to increase synergies across the organization. You emphasize collective benefits over business unit autonomy. You combine units. You centralize the main functional responsibilities into shared units to remove duplication and create advantages of scope (such as in hiring talent); you refocus the decision rights of the business units and adjust their rewards to account for their membership in a wider enterprise; and you add in intermediate levels of oversight and coordination to manage sharing and collective benefits. But your business unit managers start to argue that their own performance is too dependent on that of central units for their businesses to be held accountable. Their motivation to perform better is weakened. The distance between where decisions are made and where the consequences are felt becomes too great. Efforts to increase coordination create more layers in the organization. Accountabilities blur. Benefits of customizing each business unit to its market are lost.

The autonomy trap. Your priority is to sharpen the individual performance of your business units. You reach for some familiar levers: You split the company into as many stand-alone units as is viable. You devolve to these units the functions that an autonomous entity would have and confer on them substantial decision rights. You set up incentives that mirror the kind of rewards they would receive if they were stand-alone businesses. You remove bureaucratic interference by reducing layers between the units and the corporate parent and by reducing the size of the head office. These tools shine a spotlight on the differences between the business units. They improve the ability to adapt companywide approaches according to those differences. And they create an effective context for motivating performance improvement. But the more you free up the parts to act independently in pursuit of their own performance, the more your business unit managers cite “accountability” as a defense against the “interference” that managing synergy requires. They are quick to equate accountability (being responsible for outputs) with authority (having decision rights over inputs) and to equate authority with possession (running their inputs themselves).

These six traps are the unintended side effects of sensible management practices. They are as prevalent as the practices that give rise to them, and their prevalence ex-

plains why the batting averages are so low for most companies across the three tensions. The common factor behind the bad numbers is that managers tend to use effective management tools to focus on only one side of a tension, and, as we've seen, creating better performance for one objective creates collateral damage to a company's ability to perform on other objectives. So what should companies do instead? Rather than use these tools to manage one or the other objective in a tension, the answer is to focus on the common bond that can unite the competing objectives.

Strengthening the Common Bond

If the common bond underlying a tension is ignored, good performance on one objective will inevitably lead to poor performance on the other. But if it is nurtured, then both objectives within a tension can be achieved at the same time.

Customer benefit: The common bond between profitability and growth. Customer benefit is the reward that customers receive through their experience of a product or service. It varies by customer and by context. The primary benefit of a mobile phone for one person might be feeling secure in the event of a breakdown; for another, it might be more akin to that of a fashion accessory. If a product has high customer benefit, customers will be willing to share a greater burden of making it profitable for the company. They are likely to consent to a high price for a high benefit; they will be happy to do some of the marketing and advertising to new customers for you through word-of-mouth recommendation; you will not need to persuade them so aggressively to keep buying. High customer benefit usually means higher market share, which in turn brings greater opportunities for capturing economies of scale. Without high or increasing customer benefit, the only way to acquire and retain new customers is for the company to keep paying all such costs itself. Growth based on customer benefit is clearly more likely to be compatible with profitability. What's more, reducing the costs that are unnecessary for improving customer benefit—“bad costs”—will deliver higher profitability without damaging growth.

Different leaders have adopted different tactics to keep their companies' focus squarely on customer benefit. After the 2003 acquisition of the Adams confectionery business, Cadbury Schweppes CEO Todd Stitzer asked the team to give him a strategy to grow the market rather than just the company's market share. Thinking about share makes you look to competitors; asking about market growth makes you look to the fundamental customer benefit of the category. Cadbury used this approach in the U.S. chewing gum market to develop a product development and marketing strategy that would deliver new consumer benefits beyond breath freshening, for example,

teeth whitening, stain prevention, and cavity repair. It also stretched the market by introducing new fruit flavors that offered benefits more akin to other confectionery categories. This has boosted market innovation and growth rates, with higher consumption and higher price points—a combination indicating more consumer benefit. Meanwhile, Cadbury's share has grown five percentage points.

All the leaders we spoke to emphasized the importance of excising bad costs, such as those identified by Gillette, on a continuous basis. When he was chief executive of Barclays, Matt Barrett (now chairman) would ask a business to disaggregate its economic profits by product line, customer group, channel, and geography. He would also request more granular detail within each of those dimensions until managers found areas in which the company was losing money. "The problem was, when I first saw the numbers, everything looked profitable. The charts came back with everything over the line. So I told them to keep going until they found something negative. We found some real opportunities that way."

Sustainable earnings: The common bond between short and long term. Given the external pressures for immediate results and the internal pressures for project funding and investment spending, the short-term/long-term tension accounted for the majority of "share of voice" in our discussions with CEOs. The way to resolve this tension, we found, is to focus on sustainable earnings. Sustainable earnings are not borrowed from the future by cutting necessary long-term investment or borrowed from the past by exploiting a business model that is past its time or loaned to the future in the form of excess investment. They are repeatable. If the management of results for today and investment for tomorrow is designed to grow sustainable earnings, then companies will be much more likely to avoid unnecessary choices between the short and long term.

In a cyclical industry with one of the lowest short-term/long-term batting averages (28%), oil giant BP has scored 40%. Consistent with that, since 1995, its 13% average annual TSR has beaten the sector by four percentage points, a huge number when applied to the scale of its industry and the companies that compete in it. According to CEO John Browne, "The first thing we think about is the overall value generation of all investments. Having considered that, we then move on to the timing of investments. It would be value destroying to start with the timing." BP uses a "control matrix" in its effort to avoid under- and overinvestment across the cycle. Browne amplifies: "We look at gross margin, operating expenditure, spending on safety and integrity, revenue expenditure, overhead, and capital expenditures down the side [of the matrix] and different control mechanisms across the top, including oil prices. This gives us the set of oil prices and refining margins we should consider along with our overall capacity for investment."

As a result, BP has largely ducked a common tendency of large businesses to overinvest during good times and underinvest during bad times. For most oil companies, capital expenditure tracks current oil prices. But when the price of oil fell to \$10 a barrel in the mid-1990s and many expected it to fall further, BP massively increased capital expenditures on exploration and production. Now, with money from high oil prices pouring in, Browne has maintained a steady pace of capital expenditure and is continuing to put pressure on costs. BP's judgment has not been perfect. It assumed – incorrectly, as it turned out – that refining would be an unattractive business and therefore invested less than competitors did. But BP's discipline is the impressive point.

Another way to reduce tension between the short term and the long is to spend more time considering what separates them: the medium term. Barclays chairman Matt Barrett and its CEO, John Varley, replaced the traditional single-year and five-year planning horizons with three time frames: long-term direction, short-term priorities, and medium-term themes. According to Varley, "The short term focuses minds on the results that will build a track record with investors and the long term on where you want to participate and the portfolio options you are prepared to defend. It turned out that the medium-term themes for us centered on creating value for customers – sustaining franchise health."

Several leaders felt that companies can easily lose sight of sustainable earnings due to the targets they set for themselves. According to Gillette's Jim Kilts, "If you achieve just above median performance year in and year out, you will be number one over five to ten years. If you seek to be number one year in and year out, you will do things that wreck the business. People get this wrong all the time."

Diagonal assets: The common bond between whole and parts. A company's diagonal assets are resources and capabilities that help the company act as both a single company and many different businesses at the same time. Diagonal assets can be tangible – a shared IT network, for instance – but the most powerful are usually intangible: for example, a sense of shared purpose and values that underpin a company culture. These assets foster a sense of connectedness between people in different parts of the organization, which is essential if any company is to be more than the sum of its parts. Lewis Campbell's new focus for Textron has been to prioritize three diagonal assets for the company: standardized business processes, a shared language and approach for making and executing strategic decisions, and a new pay system that values individual and collective performance.

Unless companies can build strong diagonal assets, efforts to create value through synergy will inevitably go awry. Suppose you planned to capture synergies by centralizing logistics. In theory, that should reduce those costs and also give business unit managers more time to focus

The Three Common Bonds

For each of the three tensions, there is a necessary ingredient that must be nurtured in order for the two objectives to act as complements rather than as rival forces. If this element is ignored, good performance on one objective will inevitably lead to poor performance on the other.

Tension	Common Bond	Questions Managers Should Ask to Nurture Bonds
Profitability versus growth	Customer benefit: The reward customers receive through their experience of choosing and using a product or service	<p>What are the customer benefits of our products and services?</p> <p>How is this project or investment intended to grow customer benefit?</p> <p>What could we do to grow market size rather than just market share?</p> <p>Are we as tough on growing productivity in the good times as in the bad times?</p> <p>For which of our costs are our customers (most) willing to pay?</p> <p>Where are there bad costs and low customer benefits in our business?</p> <p>How does our scale generate customer benefits?</p> <p>How do our acquisitions create new or more customer benefits?</p>
Short term versus long term	Sustainable earnings: Earnings that are not influenced by borrowing from the future (cutting long-term investment) or lending between time frames	<p>What proportion of our current earnings are sustainable?</p> <p>What is our long-term outlook on the key variable in our industry?</p> <p>Do we think of our business boundaries by benefits or products?</p> <p>Does the corporate center have visibility into sustainable versus transitory earnings across the business units?</p> <p>Are we giving a clear line of sight to investors on sustainable earnings?</p> <p>What are our medium-term priorities—and how do they link to our shorter- and longer-term priorities?</p> <p>What level of earnings growth is just above median?</p>
Whole versus parts	Diagonal assets: Capabilities and resources that help companies improve stand-alone business-unit performance and create corporate synergy at the same time	<p>What are our diagonal assets, and what are we doing to strengthen them?</p> <p>Where could we standardize rather than centralize?</p> <p>What behavioral norms define our identity as a company?</p> <p>Do we have a compelling story about how we are going to win as a company?</p> <p>Can we better pair decentralization with centralization?</p> <p>What companywide processes should be cultivated?</p> <p>Can we use physical proximity as a diagonal asset?</p>

on other activities for improving customer benefits where the units can add more value. But if the corporate center charges back the costs of logistics through an opaque transfer-pricing mechanism, or if the businesses suspect that the head of logistics is slacking on his job, then any benefit of a sharper business unit focus from centralization will be swallowed up in argument and mistrust. Shared logistics might well be a source of new synergy value. A

sharper management focus, trained on the more important points of leverage for the business unit, could be a source of new stand-alone value. However, it takes diagonal assets in the form of trust and transparency to realize both types of value at the same time. The same is true for other kinds of synergy. A shared belief in a higher-order purpose can be an important diagonal asset. According to Andrew Cosslett, CEO of InterContinental Hotels, “People

need to know why we are here and how we are going to win. Asking them to be motivated by financial goals just doesn't cut it. They need a higher-order quest. Without a compelling story, leadership becomes exhortation."

Fostering diagonal assets allows companies to pair decentralization with centralization rather than choose one over the other. Companies might, for example, decentralize decision authority but at the same time centralize goals, culture, leadership development, and enterprise-wide standards for things like how strategies are developed and what "good" means with respect to strategies, execution, and performance. Carefully constructed, this can result in a common understanding of "how we do things around here" and a common sense of mission. Financial services group BBVA has recently looked to empower its regional businesses in Europe and the Americas and has decided, at the same time, to strengthen the group's central control in certain areas. According to José Ignacio Goirigolzarri, president and chief operating officer, "We come from a past of acting within a single harmonized model for going to market. There arrives a moment when you realize that increasing diversity will improve

Sometimes simple physical proximity is all that's needed to create a diagonal asset. Dow Jones's chairman, Peter Kann, recalls: "When I became publisher for the *Wall Street Journal Asia* early in my career, it was very siloed: News, production, ad sales, circulation never talked to each other, even though everything they did had an effect on each other. I was the first to bring together all of these into one room of a warehouse in Asia. It worked, and I brought this model back with me to the United States."

...

It is natural to want to focus on certain performance objectives rather than others, depending on how well a company is currently performing – growth over profitability, for example, or current earnings over long-term health. Yet our research tells us that emphasizing one performance objective at the expense of another – except in special cases such as start-ups, exits, or performance crises – is not the route to better performance. Good performance on one objective does not automatically result in good performance on others. If anything, the odds are in the other direction: It is easier to end up with "either" or "neither" than with "both." Furthermore, by prioritizing

Good performance on one objective does not automatically result in good performance on others. If anything, the odds are in the other direction.

performance." But today, two things make BBVA more than just the sum of the parts: its ability to recreate revenue synergies across the group by leveraging the company's brand and knowledge-sharing processes and its ability to derive cost synergies from four shared services: compliance and procedures, funding, IT, and people. "We will, if anything, be increasing our grip in these areas. The local CEO receives support and needs to be aligned with the Group on these. To make decentralization work, very strong leadership from the center is needed."

In a similar way, the U.S. health care company Cardinal Health complements the more traditional bottom-up planning process – whereby the company's plan is largely the sum of its business units' plans – with a top-down process that sets strategic direction for the company as a whole. The executive committee identifies a series of issues and opportunities that cross or transcend the business units, calling them "horizontals." For instance, generic products are an ongoing focal point for companywide (top-down) activities that complement and reinforce the efforts of any business within Cardinal for which generics are important.

between objectives, many companies end up swinging back and forth between them: 52% of executives in our survey said their companies swing from one objective to the other within at least one of the three tensions.

Our advice, therefore, is not to prioritize between *objectives* but to prioritize between *tensions*. Leadership teams should debate and carefully pick the right lead tension for their company. Then they should focus their organization's energies on strengthening the common bond that unites the two sides.

This is no easy task. The decision of which tension should be the lead is as much a matter of judgment as of analysis. And the three common bonds are hard to measure. You can't touch or feel them. What's more, apparently sensible management practices can weaken performance on the three common bonds. But no matter how difficult it is to do, working hard to strengthen the common bond in your company's lead tension is the only truly reliable route to improving performance for all your stakeholders. ▢

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Two distinguished strategists from Harvard Business School,

working with equally distinguished collaborators from the social sector, weigh in here on a pair of vexing – and increasingly pressing – questions. The first: How should executives frame their thinking about corporate social responsibility? The second: Why is it that the billions of dollars funneled through social sector institutions haven't even started to solve our most basic social problems? Both articles have smart, original things to say about how business managers can make a real, positive difference in the world.

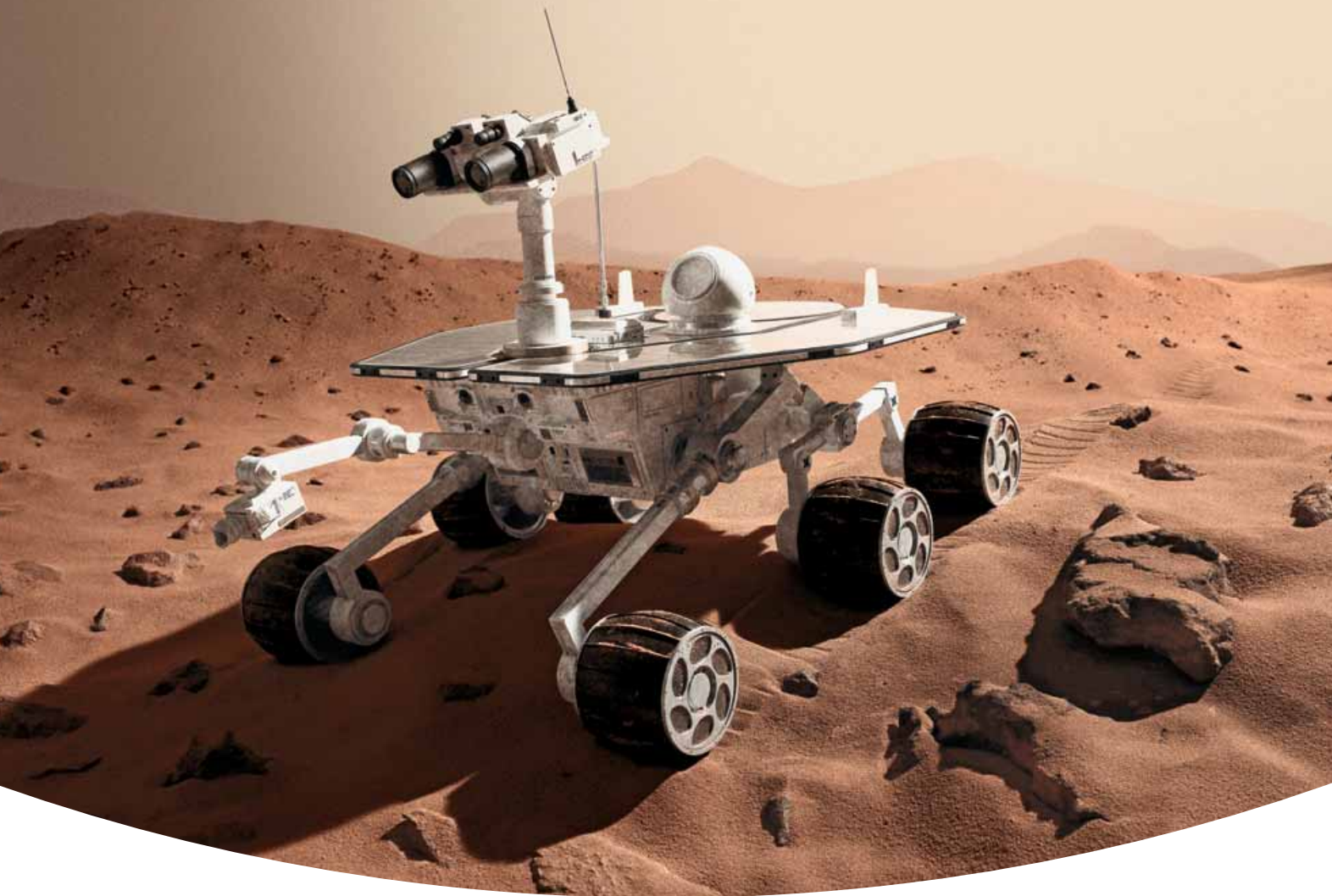
In “Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility,” Michael E. Porter and Mark R. Kramer extend an earlier HBR article (“The Competitive Advantage of Corporate Philanthropy,” December 2002) by dividing the landscape of corporate social responsibility initiatives into two fundamental parts. The first is “responsive” CSR, wherein the business acts as a good corporate citizen in general (for example, supporting local schools) and also mitigates the harm arising from its value chain activities (as UPS does in its alternative fuels program). The second is “strategic” CSR, wherein the business pioneers innovations that benefit both society and the firms’ own competitiveness (such as Microsoft’s large investment in community colleges in the United States,

which train much-needed technical employees of the future).

Clayton Christensen, Heiner Baumann, Rudy Ruggles, and Thomas Sadtler tackle questions about social-sector effectiveness from a different direction in “Disruptive Innovation for Social Change.” Why, they wonder, do we collectively spend so much money and yet see so little fundamental improvement in areas as diverse as health care delivery, public education, and economic development? Applying Christensen’s disruptive innovation lens turns up an interesting answer: Most of that funding goes to already rich foundations, hospitals, and other established organizations. Like all established organizations, they have no incentive to disrupt their own business models. But an entrepreneur or a start-up nonprofit has no such limitations. It can dream up “catalytic innovations” that may deliver a lower level of service but cost far less and reach many, many previously underserved people. In the process, it will overturn the business-as-usual approach to social problems.

We’ve paired these articles partly as a thought experiment: Wouldn’t it be fascinating if a company adopted the Porter/Kramer approach – essentially marrying its strategy and its CSR investments – but invested in disruptive social sector innovations? That company might just change the world, for the better.

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by Michael E. Porter and Mark R. Kramer

Strategy & Society

The Link Between Competitive Advantage and Corporate Social Responsibility

Governments, activists, and the media have become adept at holding companies to account for the social consequences of their activities. Myriad organizations rank companies on the performance of their corporate social responsibility (CSR), and, despite sometimes questionable methodologies, these rankings attract considerable publicity. As a result, CSR has emerged as an inescapable priority for business leaders in every country.

Many companies have already done much to improve the social and environmental consequences of their activities, yet these efforts have not been nearly as productive as they could be—for two reasons. First, they pit business against society, when clearly the two are interdependent. Second, they pressure companies to think of corporate social responsibility in generic ways instead of in the way most appropriate to each firm's strategy.

DOUG FRASER



The fact is, the prevailing approaches to CSR are so fragmented and so disconnected from business and strategy as to obscure many of the greatest opportunities for companies to benefit society. If, instead, corporations were to analyze their prospects for social responsibility using the same frameworks that guide their core business choices, they would discover that CSR can be much more than a cost, a constraint, or a charitable deed—it can be a source of opportunity, innovation, and competitive advantage.

In this article, we propose a new way to look at the relationship between business and society that does not treat corporate success and social welfare as a zero-sum game. We introduce a framework companies can use to

companies discovered that they were expected to respond to the AIDS pandemic in Africa even though it was far removed from their primary product lines and markets. Fast-food and packaged food companies are now being held responsible for obesity and poor nutrition.

Activist organizations of all kinds, both on the right and the left, have grown much more aggressive and effective in bringing public pressure to bear on corporations. Activists may target the most visible or successful companies merely to draw attention to an issue, even if those corporations actually have had little impact on the problem at hand. Nestlé, for example, the world's largest purveyor of bottled water, has become a major target in the global debate about access to fresh water, despite the fact

The prevailing approaches to CSR are so disconnected from business as to obscure many of the greatest opportunities for companies to benefit society.

identify all of the effects, both positive and negative, they have on society; determine which ones to address; and suggest effective ways to do so. When looked at strategically, corporate social responsibility can become a source of tremendous social progress, as the business applies its considerable resources, expertise, and insights to activities that benefit society.

The Emergence of Corporate Social Responsibility

Heightened corporate attention to CSR has not been entirely voluntary. Many companies awoke to it only after being surprised by public responses to issues they had not previously thought were part of their business responsibilities. Nike, for example, faced an extensive consumer boycott after the *New York Times* and other media outlets reported abusive labor practices at some of its Indonesian suppliers in the early 1990s. Shell Oil's decision to sink the *Brent Spar*, an obsolete oil rig, in the North Sea led to Greenpeace protests in 1995 and to international headlines. Pharmaceutical

that Nestlé's bottled water sales consume just 0.0008% of the world's fresh water supply. The inefficiency of agricultural irrigation, which uses 70% of the world's supply annually, is a far more pressing issue, but it offers no equally convenient multinational corporation to target.

Debates about CSR have moved all the way into corporate boardrooms. In 2005, 360 different CSR-related shareholder resolutions were filed on issues ranging from labor conditions to global warming. Government regulation increasingly mandates social responsibility reporting. Pending legislation in the UK, for example, would require every publicly listed company to disclose ethical, social, and environmental risks in its annual report. These pressures clearly demonstrate the extent to which external stakeholders are seeking to hold companies accountable for social issues and highlight the potentially large financial risks for any firm whose conduct is deemed unacceptable.

While businesses have awakened to these risks, they are much less clear on what to do about them. In fact, the most common corporate response has been neither strategic nor operational but cosmetic: public relations and

Michael E. Porter is the Bishop William Lawrence University Professor at Harvard University; he is based at Harvard Business School in Boston. He is a frequent contributor to HBR, and his most recent article is "Seven Surprises for New CEOs" (October 2004). Mark R. Kramer (mark.kramer@fsg-impact.org) is the managing director of FSG Social Impact Advisors, an international nonprofit consulting firm, and a senior fellow in the CSR Initiative at Harvard's John F. Kennedy School of Government in Cambridge, Massachusetts. Porter and Kramer are the cofounders of both FSG Social Impact Advisors and the Center for Effective Philanthropy, a nonprofit research organization.

media campaigns, the centerpieces of which are often glossy CSR reports that showcase companies' social and environmental good deeds. Of the 250 largest multinational corporations, 64% published CSR reports in 2005, either within their annual report or, for most, in separate sustainability reports – supporting a new cottage industry of report writers.

Such publications rarely offer a coherent framework for CSR activities, let alone a strategic one. Instead, they aggregate anecdotes about uncoordinated initiatives to demonstrate a company's social sensitivity. What these reports leave out is often as telling as what they include. Reductions in pollution, waste, carbon emissions, or energy use, for example, may be documented for specific divisions or regions but not for the company as a whole. Philanthropic initiatives are typically described in terms of dollars or volunteer hours spent but almost never in terms of impact. Forward-looking commitments to reach explicit performance targets are even rarer.

This proliferation of CSR reports has been paralleled by growth in CSR ratings and rankings. While rigorous and reliable ratings might constructively influence corporate behavior, the existing cacophony of self-appointed scorekeepers does little more than add to the confusion. (See the sidebar “The Ratings Game.”)

In an effort to move beyond this confusion, corporate leaders have turned for advice to a growing collection of increasingly sophisticated nonprofit organizations, consulting firms, and academic experts. A rich literature on CSR has emerged, though what practical guidance it offers corporate leaders is often unclear. Examining the primary schools of thought about CSR is an essential starting point in understanding why a new approach is needed to integrating social considerations more effectively into core business operations and strategy.

Four Prevailing Justifications for CSR

Broadly speaking, proponents of CSR have used four arguments to make their case: moral obligation, sustainability, license to operate, and reputation. The moral appeal – arguing that companies have a duty to be good citizens and to “do the right thing” – is prominent in the goal of Business for Social Responsibility, the leading nonprofit CSR business association in the United States. It asks that its members “achieve commercial success in ways that honor ethical values and respect people, communities, and the natural environment.” Sustainability emphasizes environmental and community stewardship. An excellent definition was developed in the 1980s by Norwegian Prime Minister Gro Harlem Brundtland and used by the World Business Coun-

The Ratings Game

Measuring and publicizing social performance is a potentially powerful way to influence corporate behavior – assuming that the ratings are consistently measured and accurately reflect corporate social impact. Unfortunately, neither condition holds true in the current profusion of CSR checklists.

The criteria used in the rankings vary widely. The Dow Jones Sustainability Index, for example, includes aspects of economic performance in its evaluation. It weights customer service almost 50% more heavily than corporate citizenship. The equally prominent FTSE4Good Index, by contrast, contains no measures of economic performance or customer service at all. Even when criteria happen to be the same, they are invariably weighted differently in the final scoring.

Beyond the choice of criteria and their weightings lies the even more perplexing question of how to judge whether the criteria have been met. Most media, nonprofits, and investment advisory organizations have too few resources to audit a universe of complicated global corporate activities. As a result, they tend to use measures for which data are readily and inexpensively available, even though they may not be good proxies for the social or environmental effects they are intended to reflect. The Dow Jones Sustainability Index, for example, uses the size of a company's board as a measure of community involvement, even though size and involvement may be entirely unrelated.¹

Finally, even if the measures chosen accurately reflect social impact, the data are frequently unreliable. Most ratings rely on surveys whose response rates are statistically insignificant, as well as on self-reported company data that have not been verified externally. Companies with the most to hide are the least likely to respond. The result is a jumble of largely meaningless rankings, allowing almost any company to boast that it meets some measure of social responsibility – and most do.

1. For a fuller discussion of the problem of CSR ratings, see Aaron Chatterji and David Levine, “Breaking Down the Wall of Codes: Evaluating Non-Financial Performance Measurement,” *California Management Review*, Winter 2006.

cil for Sustainable Development: “Meeting the needs of the present without compromising the ability of future generations to meet their own needs.” The notion of license to operate derives from the fact that every company needs tacit or explicit permission from governments,

communities, and numerous other stakeholders to do business. Finally, reputation is used by many companies to justify CSR initiatives on the grounds that they will improve a company's image, strengthen its brand, enliven morale, and even raise the value of its stock. These justifications have advanced thinking in the field, but none offers sufficient guidance for the difficult choices corporate leaders must make. Consider the practical limitations of each approach.

The CSR field remains strongly imbued with a moral imperative. In some areas, such as honesty in filing financial statements and operating within the law, moral considerations are easy to understand and apply. It is the nature of moral obligations to be absolute mandates, however, while most corporate social choices involve balancing competing values, interests, and costs. Google's recent entry into China, for example, has created an irreconcilable conflict between its U.S. customers' abhorrence

Philanthropy may contribute to the "sustainability" of a society. However true these assertions are, they offer little basis for balancing long-term objectives against the short-term costs they incur. The sustainability school raises questions about these trade-offs without offering a framework to answer them. Managers without a strategic understanding of CSR are prone to postpone these costs, which can lead to far greater costs when the company is later judged to have violated its social obligation.

The license-to-operate approach, by contrast, is far more pragmatic. It offers a concrete way for a business to identify social issues that matter to its stakeholders and make decisions about them. This approach also fosters constructive dialogue with regulators, the local citizenry, and activists – one reason, perhaps, that it is especially prevalent among companies that depend on government consent, such as those in mining and other highly regulated and extractive industries. That is also why the approach is

The vehemence of a stakeholder group does not necessarily signify the importance of an issue – either to the company or to the world.

of censorship and the legal constraints imposed by the Chinese government. The moral calculus needed to weigh one social benefit against another, or against its financial costs, has yet to be developed. Moral principles do not tell a pharmaceutical company how to allocate its revenues among subsidizing care for the indigent today, developing cures for the future, and providing dividends to its investors.

The principle of sustainability appeals to enlightened self-interest, often invoking the so-called triple bottom line of economic, social, and environmental performance. In other words, companies should operate in ways that secure long-term economic performance by avoiding short-term behavior that is socially detrimental or environmentally wasteful. The principle works best for issues that coincide with a company's economic or regulatory interests. DuPont, for example, has saved over \$2 billion from reductions in energy use since 1990. Changes to the materials McDonald's uses to wrap its food have reduced its solid waste by 30%. These were smart business decisions entirely apart from their environmental benefits. In other areas, however, the notion of sustainability can become so vague as to be meaningless. Transparency may be said to be more "sustainable" than corruption. Good employment practices are more "sustainable" than sweatshops.

common at companies that rely on the forbearance of their neighbors, such as those, like chemical manufacturing, whose operations are noxious or environmentally hazardous. By seeking to satisfy stakeholders, however, companies cede primary control of their CSR agendas to outsiders. Stakeholders' views are obviously important, but these groups can never fully understand a corporation's capabilities, competitive positioning, or the trade-offs it must make. Nor does the vehemence of a stakeholder group necessarily signify the importance of an issue – either to the company or to the world. A firm that views CSR as a way to placate pressure groups often finds that its approach devolves into a series of short-term defensive reactions – a never-ending public relations palliative with minimal value to society and no strategic benefit for the business.

Finally, the reputation argument seeks that strategic benefit but rarely finds it. Concerns about reputation, like license to operate, focus on satisfying external audiences. In consumer-oriented companies, it often leads to high-profile cause-related marketing campaigns. In stigmatized industries, such as chemicals and energy, a company may instead pursue social responsibility initiatives as a form of insurance, in the hope that its reputation for social consciousness will temper public criticism in the event

of a crisis. This rationale once again risks confusing public relations with social and business results.

A few corporations, such as Ben & Jerry's, Newman's Own, Patagonia, and the Body Shop, have distinguished themselves through an extraordinary long-term commitment to social responsibility. But even for these companies, the social impact achieved, much less the business benefit, is hard to determine. Studies of the effect of a company's social reputation on consumer purchasing preferences or on stock market performance have been inconclusive at best. As for the concept of CSR as insurance, the connection between the good deeds and consumer attitudes is so indirect as to be impossible to measure. Having no way to quantify the benefits of these investments puts such CSR programs on shaky ground, liable to be dislodged by a change of management or a swing in the business cycle.

All four schools of thought share the same weakness: They focus on the tension between business and society rather than on their interdependence. Each creates a generic rationale that is not tied to the strategy and operations of any specific company or the places in which it operates. Consequently, none of them is sufficient to help a company identify, prioritize, and address the social issues that matter most or the ones on which it can make the biggest impact. The result is oftentimes a hodgepodge of uncoordinated CSR and philanthropic activities disconnected from the company's strategy that neither make any meaningful social impact nor strengthen the firm's long-term competitiveness. Internally, CSR practices and initiatives are often isolated from operating units – and even separated from corporate philanthropy. Externally, the company's social impact becomes diffused among numerous unrelated efforts, each responding to a different stakeholder group or corporate pressure point.

The consequence of this fragmentation is a tremendous lost opportunity. The power of corporations to create social benefit is dissipated, and so is the potential of companies to take actions that would support both their communities and their business goals.

Integrating Business and Society

To advance CSR, we must root it in a broad understanding of the interrelationship between a corporation and society while at the same time anchoring it in the strategies and activities of specific companies. To say broadly that business and society need each other might seem like a cliché, but it is also the basic truth that will pull companies out of the muddle that their current corporate-responsibility thinking has created.



Successful corporations need a healthy society. Education, health care, and equal opportunity are essential to a productive workforce. Safe products and working conditions not only attract customers but lower the internal costs of accidents. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Good government, the rule of law, and property rights are essential for efficiency and innovation. Strong regulatory standards protect both consumers and competitive companies from exploitation. Ultimately, a healthy society creates expanding demand for business, as more human needs are met and aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary.

At the same time, a healthy society needs successful companies. No social program can rival the business sector when it comes to creating the jobs, wealth, and innovation that improve standards of living and social conditions over time. If governments, NGOs, and other participants in civil society weaken the ability of business to operate productively, they may win battles but will lose the war, as corporate and regional competitiveness fade, wages stagnate, jobs disappear, and the wealth that pays taxes and supports nonprofit contributions evaporates.

Leaders in both business and civil society have focused too much on the friction between them and not enough on the points of intersection. The mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of *shared value*. That is, choices must benefit both sides. If either a business or a society pursues policies that benefit its interests at the expense of the other, it will find itself on a dangerous path. A temporary gain to one will undermine the long-term prosperity of both.¹

To put these broad principles into practice, a company must integrate a social perspective into the core frameworks it already uses to understand competition and guide its business strategy.

Identifying the points of intersection. The interdependence between a company and society takes two forms. First, a company impinges upon society through its

Not only does corporate activity affect society, but external social conditions also influence corporations, for better and for worse. These are *outside-in linkages*.

Every company operates within a competitive context, which significantly affects its ability to carry out its strategy, especially in the long run. Social conditions form a key part of this context. Competitive context garners far less attention than value chain impacts but can have far greater strategic importance for both companies and societies. Ensuring the health of the competitive context benefits both the company and the community.

Competitive context can be divided into four broad areas: first, the quantity and quality of available business inputs—human resources, for example, or transportation infrastructure; second, the rules and incentives that govern competition—such as policies that protect intellectual property, ensure transparency, safeguard against corruption,

An affirmative corporate social agenda moves from mitigating harm to reinforcing corporate strategy through social progress.

operations in the normal course of business: These are *inside-out linkages*.

Virtually every activity in a company's value chain touches on the communities in which the firm operates, creating either positive or negative social consequences. (For an example of this process, see the exhibit "Looking Inside Out: Mapping the Social Impact of the Value Chain.") While companies are increasingly aware of the social impact of their activities (such as hiring practices, emissions, and waste disposal), these impacts can be more subtle and variable than many managers realize. For one thing, they depend on location. The same manufacturing operation will have very different social consequences in China than in the United States.

A company's impact on society also changes over time, as social standards evolve and science progresses. Asbestos, now understood as a serious health risk, was thought to be safe in the early 1900s, given the scientific knowledge then available. Evidence of its risks gradually mounted for more than 50 years before any company was held liable for the harms it can cause. Many firms that failed to anticipate the consequences of this evolving body of research have been bankrupted by the results. No longer can companies be content to monitor only the obvious social impacts of today. Without a careful process for identifying evolving social effects of tomorrow, firms may risk their very survival.

and encourage investment; third, the size and sophistication of local demand, influenced by such things as standards for product quality and safety, consumer rights, and fairness in government purchasing; fourth, the local availability of supporting industries, such as service providers and machinery producers. Any and all of these aspects of context can be opportunities for CSR initiatives. (See the exhibit "Looking Outside In: Social Influences on Competitiveness.") The ability to recruit appropriate human resources, for example, may depend on a number of social factors that companies can influence, such as the local educational system, the availability of housing, the existence of discrimination (which limits the pool of workers), and the adequacy of the public health infrastructure.²

Choosing which social issues to address. No business can solve all of society's problems or bear the cost of doing so. Instead, each company must select issues that intersect with its particular business. Other social agendas are best left to those companies in other industries, NGOs, or government institutions that are better positioned to address them. The essential test that should guide CSR is not whether a cause is worthy but whether it presents an opportunity to create shared value—that is, a meaningful benefit for society that is also valuable to the business.

Our framework suggests that the social issues affecting a company fall into three categories, which distinguish be-

tween the many worthy causes and the narrower set of social issues that are both important and strategic for the business.

Generic social issues may be important to society but are neither significantly affected by the company's operations nor influence the company's long-term competitiveness. *Value chain social impacts* are those that are significantly affected by the company's activities in the ordinary course of business. *Social dimensions of competitive context* are factors in the external environment that significantly affect the underlying drivers of competitiveness in those places where the company operates. (See the exhibit "Prioritizing Social Issues.")

Every company will need to sort social issues into these three categories for each of its business units and primary locations, then rank them in terms of potential impact. Into which category a given social issue falls will vary from business unit to business unit, industry to industry, and place to place.

Supporting a dance company may be a generic social issue for a utility like Southern California Edison but an important part of the competitive context for a corporation like American Express, which depends on the high-end entertainment, hospitality, and tourism cluster. Carbon emissions may be a generic social issue for a financial services firm like Bank of America, a negative value chain impact for a transportation-based company like UPS, or both a value chain impact and a competitive context issue for a car manufacturer like Toyota. The AIDS pandemic in Africa may be a generic social issue for a U.S. retailer like Home Depot, a value chain impact for a pharmaceutical company like GlaxoSmithKline, and a competitive context issue for a mining company like Anglo American that depends on local labor in Africa for its operations.

Even issues that apply widely in the economy, such as diversity in hiring or conservation of energy, can have

greater significance for some industries than for others. Health care benefits, for example, will present fewer challenges for software development or biotechnology firms, where workforces tend to be small and well compensated, than for companies in a field like retailing, which is heavily dependent on large numbers of lower-wage workers.

Within an industry, a given social issue may cut differently for different companies, owing to differences in competitive positioning. In the auto industry, for example, Volvo has chosen to make safety a central element of its competitive positioning, while Toyota has built a competitive advantage from the environmental benefits of its hybrid technology. For an individual company, some issues will prove to be important for many of its business units and locations, offering opportunities for strategic corporatewide CSR initiatives.

Where a social issue is salient for many companies across multiple industries, it can often be addressed most effectively through cooperative models. The Extractive Industries Transparency Initiative, for example, includes 19 major oil, gas, and mining companies that have agreed to discourage corruption through full public disclosure and verification of all corporate payments to governments in the countries in which they operate. Collective action by all major corporations in these industries prevents corrupt governments from undermining social benefit by simply choosing not to deal with the firms that disclose their payments.

Creating a corporate social agenda. Categorizing and ranking social issues is just the means to an end, which is to create an explicit and affirmative corporate social agenda. A corporate social agenda looks beyond community expectations to opportunities to achieve social and economic benefits simultaneously. It moves from mitigating harm to finding ways to reinforce corporate strategy by advancing social conditions.

Such a social agenda must be responsive to stakeholders, but it cannot stop there. A substantial portion of corporate resources and attention must migrate to truly strategic CSR. (See the exhibit "Corporate Involvement in Society: A Strategic Approach.") It is through strategic CSR that the company will make the most significant social impact and reap the greatest business benefits.

Responsive CSR. Responsive CSR comprises two elements: acting as a good corporate citizen, attuned to the evolving social concerns of stakeholders, and mitigating existing or anticipated adverse effects from business activities.

Good citizenship is a sine qua non of CSR, and companies need to do it well. Many worthy local organizations rely on corporate contributions, while employees derive

continued on page 88

Prioritizing Social Issues

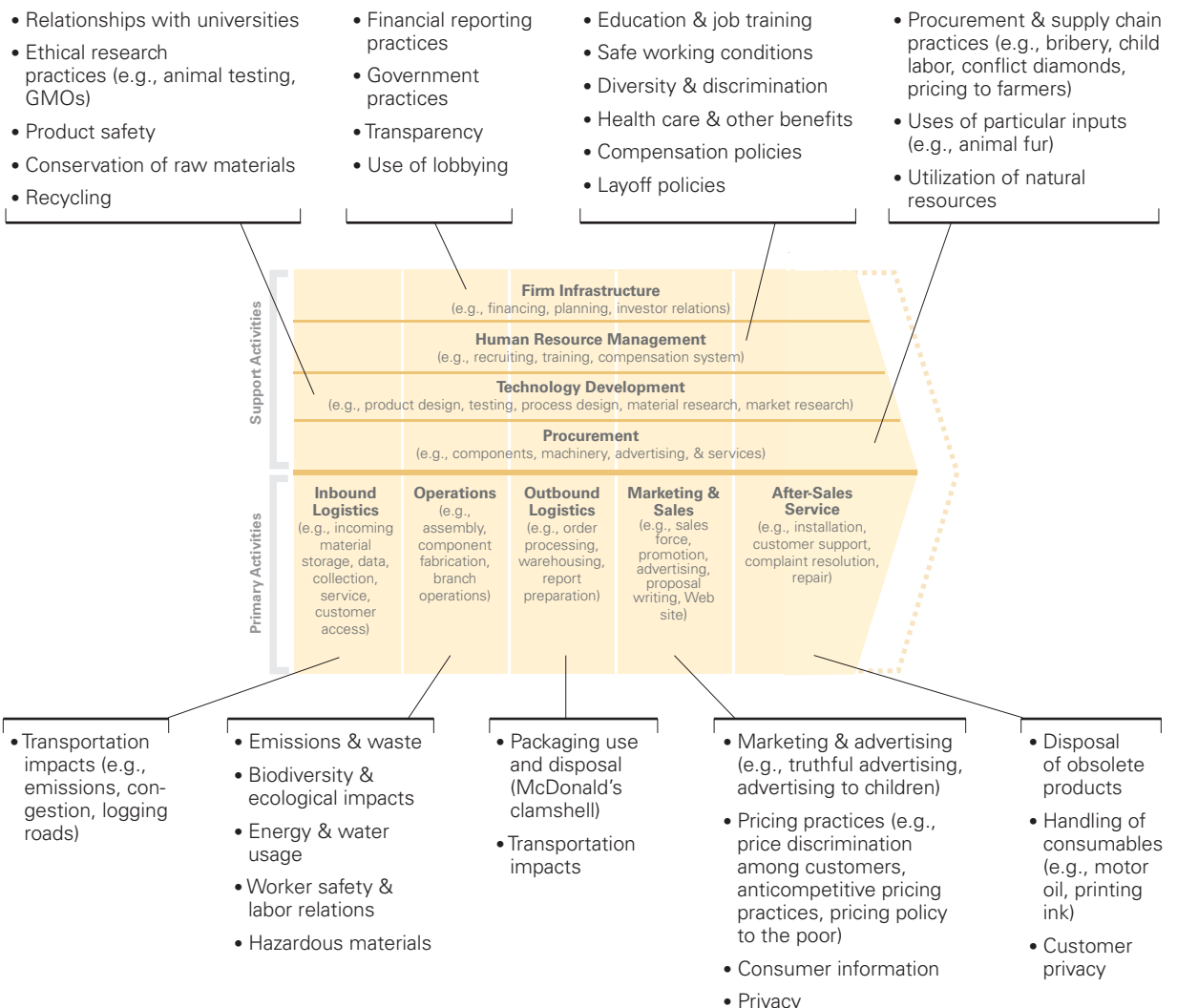
Generic Social Issues	Value Chain Social Impacts	Social Dimensions of Competitive Context
Social issues that are not significantly affected by a company's operations nor materially affect its long-term competitiveness.	Social issues that are significantly affected by a company's activities in the ordinary course of business.	Social issues in the external environment that significantly affect the underlying drivers of a company's competitiveness in the locations where it operates.

Mapping Social Opportunities

The interdependence of a company and society can be analyzed with the same tools used to analyze competitive position and develop strategy. In this way, the firm can focus its particular CSR activities to best effect. Rather than merely acting on well-intentioned impulses or reacting to outside pressure, the organization can set an affirmative CSR agenda that produces maximum social benefit as well as gains for the business.

Looking Inside Out: Mapping the Social Impact of the Value Chain

The *value chain* depicts all the activities a company engages in while doing business. It can be used as a framework to identify the positive and negative social impact of those activities. These “inside-out” linkages may range from hiring and layoff policies to greenhouse gas emissions, as the partial list of examples illustrated here demonstrates.



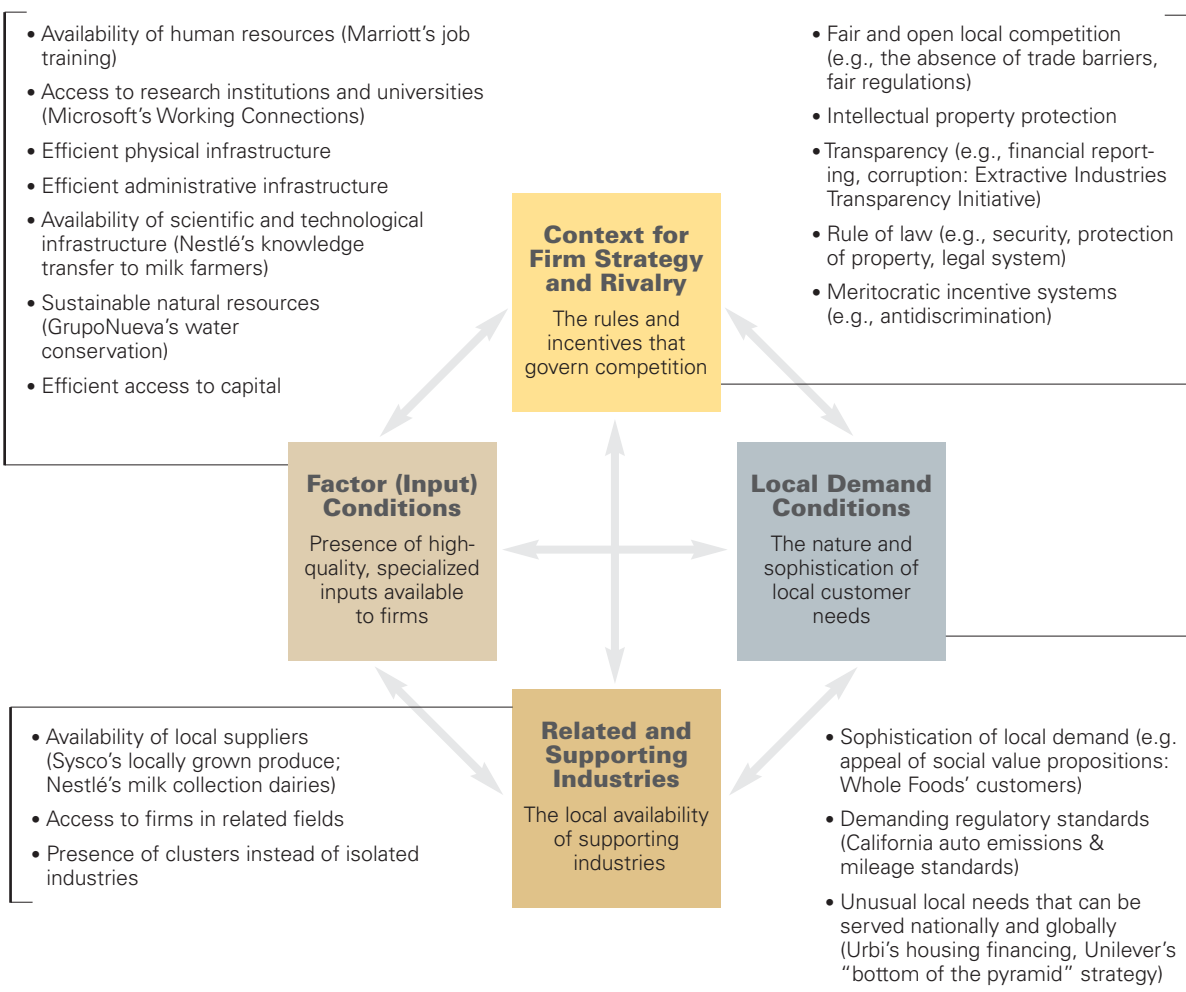
Source: Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, 1985

These two tools should be used in different ways. When a company uses the value chain to chart all the social consequences of its activities, it has, in effect, created an inventory of problems and opportunities – mostly operational issues – that need to be investigated, prioritized, and addressed. In general, companies should attempt to clear away as many negative value-chain social impacts as possible. Some company activities will prove to offer opportunities for social and strategic distinction.

In addressing competitive context, companies cannot take on every area in the diamond. Therefore, the task is to identify those areas of social context with the greatest strategic value. A company should carefully choose from this menu one or a few social initiatives that will have the greatest shared value: benefit for both society and its own competitiveness.

Looking Outside In: Social Influences on Competitiveness

In addition to understanding the social ramifications of the value chain, effective CSR requires an understanding of the social dimensions of the company's competitive context – the “outside-in” linkages that affect its ability to improve productivity and execute strategy. These can be understood using the *diamond framework*, which shows how the conditions at a company's locations (such as transportation infrastructure and honestly enforced regulatory policy) affect its ability to compete.



Source: Michael E. Porter, *The Competitive Advantage of Nations*, 1990

justifiable pride from their company's positive involvement in the community.

The best corporate citizenship initiatives involve far more than writing a check: They specify clear, measurable goals and track results over time. A good example is GE's program to adopt underperforming public high schools near several of its major U.S. facilities. The company contributes between \$250,000 and \$1 million over a five-year period to each school and makes in-kind donations as well. GE managers and employees take an active role by working with school administrators to assess needs and mentor or tutor students. In an independent study of ten schools in the program between 1989 and 1999, nearly all showed significant improvement, while the graduation rate in four of the five worst-performing schools doubled from an average of 30% to 60%.

Effective corporate citizenship initiatives such as this one create goodwill and improve relations with local governments and other important constituencies. What's more, GE's employees feel great pride in their participation.

ters based in England. The company has begun to analyze systematically tens of thousands of products in its hundreds of stores against a list of a dozen social issues—from climate change to working conditions at its suppliers' factories—to determine which products pose potential social responsibility risks and how the company might take action before any external pressure is brought to bear.

For most value chain impacts, there is no need to reinvent the wheel. The company should identify best practices for dealing with each one, with an eye toward how those practices are changing. Some companies will be more proactive and effective in mitigating the wide array of social problems that the value chain can create. These companies will gain an edge, but—just as for procurement and other operational improvements—any advantage is likely to be temporary.

Strategic CSR. For any company, strategy must go beyond best practices. It is about choosing a unique position—doing things differently from competitors in

Typically the more closely tied a social issue is to a company's business, the greater the opportunity to leverage the firm's resources—and benefit society.

Their effect is inherently limited, however. No matter how beneficial the program is, it remains incidental to the company's business, and the direct effect on GE's recruiting and retention is modest.

The second part of responsive CSR—mitigating the harm arising from a firm's value chain activities—is essentially an operational challenge. Because there are a myriad of possible value chain impacts for each business unit, many companies have adopted a checklist approach to CSR, using standardized sets of social and environmental risks. The Global Reporting Initiative, which is rapidly becoming a standard for CSR reporting, has enumerated a list of 141 CSR issues, supplemented by auxiliary lists for different industries.

These lists make for an excellent starting point, but companies need a more proactive and tailored internal process. Managers at each business unit can use the value chain as a tool to identify systematically the social impacts of the unit's activities in each location. Here operating management, which is closest to the work actually being done, is particularly helpful. Most challenging is to anticipate impacts that are not yet well recognized. Consider B&Q, an international chain of home supply cen-

a way that lowers costs or better serves a particular set of customer needs. These principles apply to a company's relationship to society as readily as to its relationship to its customers and rivals.

Strategic CSR moves beyond good corporate citizenship and mitigating harmful value chain impacts to mount a small number of initiatives whose social and business benefits are large and distinctive. Strategic CSR involves both inside-out and outside-in dimensions working in tandem. It is here that the opportunities for shared value truly lie.

Many opportunities to pioneer innovations to benefit both society and a company's own competitiveness can arise in the product offering and the value chain. Toyota's response to concerns over automobile emissions is an example. Toyota's Prius, the hybrid electric/gasoline vehicle, is the first in a series of innovative car models that have produced competitive advantage *and* environmental benefits. Hybrid engines emit as little as 10% of the harmful pollutants conventional vehicles produce while consuming only half as much gas. Voted 2004 Car of the Year by *Motor Trend* magazine, Prius has given Toyota a lead so substantial that Ford and other car companies are

licensing the technology. Toyota has created a unique position with customers and is well on its way to establishing its technology as the world standard.

Urbi, a Mexican construction company, has prospered by building housing for disadvantaged buyers using novel financing vehicles such as flexible mortgage payments made through payroll deductions. Crédit Agricole, France's largest bank, has differentiated itself by offering specialized financial products related to the environment, such as financing packages for energy-saving home improvements and for audits to certify farms as organic.

Strategic CSR also unlocks shared value by investing in social aspects of context that strengthen company competitiveness. A symbiotic relationship develops: The success of the company and the success of the community become mutually reinforcing. Typically, the more closely tied a social issue is to the company's business, the greater the opportunity to leverage the firm's resources and capabilities, and benefit society.

Microsoft's Working Connections partnership with the American Association of Community Colleges (AACC) is a good example of a shared-value opportunity arising from investments in context. The shortage of information technology workers is a significant constraint on Microsoft's growth; currently, there are more than 450,000 unfilled IT positions in the United States alone. Community colleges, with an enrollment of 11.6 million students, representing 45% of all U.S. undergraduates, could be a major solution. Microsoft recognizes, however, that community colleges face special challenges: IT curricula are not standardized, technology used in classrooms is often outdated, and there are no systematic professional development programs to keep faculty up to date.

Microsoft's \$50 million five-year initiative was aimed at all three problems. In addition to contributing money and products, Microsoft sent employee volunteers to colleges to assess needs, contribute to curriculum development, and create faculty development institutes. Note that in this case, volunteers and assigned staff were able to use their core professional skills to address a social need, a far cry from typical volunteer programs. Microsoft has achieved results that have benefited many communities while having a direct—and potentially significant—impact on the company.

Integrating inside-out and outside-in practices. Pioneering value chain innovations and addressing social constraints to competitiveness are each powerful tools for creating economic and social value. However, as our examples illustrate, the impact is even greater if they work together. Activities in the value chain can be performed in ways that reinforce improvements in the social dimensions of context. At the same time, investments in competitive context have the potential to reduce constraints on a company's value chain activities. Marriott, for example, provides 180 hours of paid classroom and on-the-job training to chronically unemployed job candidates. The company has combined this with support for local community service organizations, which identify, screen, and refer the candidates to Marriott. The net result is both a major benefit to communities and a reduction in Marriott's cost of recruiting entry-level employees. Ninety percent of those in the training program take jobs with Marriott. One year later, more than 65% are still in their jobs, a substantially higher retention rate than the norm.

When value chain practices and investments in competitive context are fully integrated, CSR becomes hard to distinguish from the day-to-day business of the company. Nestlé, for example, works directly with small farmers in developing countries to source the basic commodities, such as milk, coffee, and cocoa, on which much of its global business depends. (See the sidebar "Integrating Company Practice and Context: Nestlé's Milk District.") The company's investment in local infrastructure and its transfer of world-class knowledge and technology over decades has produced enormous social benefits through improved health care, better education, and economic development, while giving Nestlé direct and reliable access to the commodities it needs to maintain a profitable global business. Nestlé's distinctive strategy is inseparable from its social impact.

Creating a social dimension to the value proposition. At the heart of any strategy is a unique value proposition: a set of needs a company can meet for its chosen customers that others cannot. The most strategic CSR occurs when a company adds a social dimension to its value

Corporate Involvement in Society: A Strategic Approach

Generic Social Impacts	Value Chain Social Impacts	Social Dimensions of Competitive Context
Good citizenship	Mitigate harm from value chain activities	Strategic philanthropy that leverages capabilities to improve salient areas of competitive context
Responsive CSR	Transform value-chain activities to benefit society while reinforcing strategy	Strategic CSR

proposition, making social impact integral to the overall strategy.

Consider Whole Foods Market, whose value proposition is to sell organic, natural, and healthy food products to customers who are passionate about food and the environment. Social issues are fundamental to what makes Whole Foods unique in food retailing and to its ability to command premium prices. The company's sourcing emphasizes purchases from local farmers through each

store's procurement process. Buyers screen out foods containing any of nearly 100 common ingredients that the company considers unhealthy or environmentally damaging. The same standards apply to products made internally. Whole Foods' baked goods, for example, use only unbleached and unbromated flour.

Whole Foods' commitment to natural and environmentally friendly operating practices extends well beyond sourcing. Stores are constructed using a minimum of

Integrating Company Practice and Context: Nestlé's Milk District

Nestlé's approach to working with small farmers exemplifies the symbiotic relationship between social progress and competitive advantage. Ironically, while the company's reputation remains marred by a 30-year-old controversy surrounding sales of infant formula in Africa, the corporation's impact in developing countries has often been profoundly positive.

Consider the history of Nestlé's milk business in India. In 1962, the company wanted to enter the Indian market, and it received government permission to build a dairy in the northern district of Moga. Poverty in the region was severe; people were without electricity, transportation, telephones, or medical care. A farmer typically owned less than five acres of poorly irrigated and infertile soil. Many kept a single buffalo cow that produced just enough milk for their own consumption. Sixty percent of calves died newborn. Because farmers lacked refrigeration, transportation, or any way to test for quality, milk could not travel far and was frequently contaminated or diluted.

Nestlé came to Moga to build a business, not to engage in CSR. But Nestlé's value chain, derived from the company's origins in Switzerland, depended on establishing local sources of milk from a large, diversified base of small farmers. Establishing that value chain in Moga required Nestlé to transform the competitive context in ways that created tremendous shared value for both the company and the region.

Nestlé built refrigerated dairies as collection points for milk in each town and sent its trucks out to the dairies to collect the milk. With the trucks went veterinarians, nutritionists, agronomists, and quality assurance experts. Medicines and nutritional supplements were provided for sick animals, and monthly training sessions were held for local farmers. Farmers learned that the milk quality depended on the cows' diet, which in turn depended on adequate

feed crop irrigation. With financing and technical assistance from Nestlé, farmers began to dig previously unaffordable deep-bore wells. Improved irrigation not only fed cows but increased crop yields, producing surplus wheat and rice and raising the standard of living.

When Nestlé's milk factory first opened, only 180 local farmers supplied milk. Today, Nestlé buys milk from more than 75,000 farmers in the region, collecting it twice daily from more than 650 village dairies. The death rate of calves has dropped by 75%. Milk production has increased 50-fold. As the quality has improved, Nestlé has been able to pay higher prices to farmers than those set by the government, and its steady biweekly payments have enabled farmers to obtain credit. Competing dairies and milk factories have opened, and an industry cluster is beginning to develop.

Today, Moga has a significantly higher standard of living than other regions in the vicinity. Ninety percent of the homes have electricity, and most have telephones; all villages have primary schools, and many have secondary schools. Moga has five times the number of doctors as neighboring regions. The increased purchasing power of local farmers has also greatly expanded the market for Nestlé's products, further supporting the firm's economic success.

Nestlé's commitment to working with small farmers is central to its strategy. It enables the company to obtain a stable supply of high-quality commodities without paying middlemen. The corporation's other core products—coffee and cocoa—are often grown by small farmers in developing countries under similar conditions. Nestlé's experience in setting up collection points, training farmers, and introducing better technology in Moga has been repeated in Brazil, Thailand, and a dozen other countries, including, most recently, China. In each case, as Nestlé has prospered, so has the community.

virgin raw materials. Recently, the company purchased renewable wind energy credits equal to 100% of its electricity use in all of its stores and facilities, the only *Fortune* 500 company to offset its electricity consumption entirely. Spoiled produce and biodegradable waste are trucked to regional centers for composting. Whole Foods' vehicles are being converted to run on biofuels. Even the cleaning products used in its stores are environmentally friendly. And through its philanthropy, the company has created the Animal Compassion Foundation to develop more natural and humane ways of raising farm animals. In short, nearly every aspect of the company's value chain reinforces the social dimensions of its value proposition, distinguishing Whole Foods from its competitors.

Not every company can build its entire value proposition around social issues as Whole Foods does, but adding a social dimension to the value proposition offers a new frontier in competitive positioning. Government regulation, exposure to criticism and liability, and consumers' attention to social issues are all persistently increasing. As a result, the number of industries and companies whose competitive advantage can involve social value propositions is constantly growing. Sysco, for example, the largest distributor of food products to restaurants and institutions in North America, has begun an initiative to preserve small, family-owned farms and offer locally grown produce to its customers as a source of competitive differentiation. Even large global multinationals—such as General Electric, with its “ecomagination” initiative that focuses on developing water purification technology and other “green” businesses, and Unilever, through its efforts to pioneer new products, packaging, and distribution systems to meet the needs of the poorest populations—have decided that major business opportunities lie in integrating business and society.

Organizing for CSR

Integrating business and social needs takes more than good intentions and strong leadership. It requires adjustments in organization, reporting relationships, and incentives. Few companies have engaged operating management in processes that identify and prioritize social issues based on their salience to business operations and their importance to the company's competitive context. Even fewer have unified their philanthropy with the management of their CSR efforts, much less sought to embed a social dimension into their core value proposition. Doing these things requires a far different approach to both CSR and philanthropy than the one prevalent today. Companies must shift from a fragmented, defensive posture to an integrated, affirmative approach. The

focus must move away from an emphasis on image to an emphasis on substance.

The current preoccupation with measuring stakeholder satisfaction has it backwards. What needs to be measured is social impact. Operating managers must understand the importance of the outside-in influence of competitive context, while people with responsibility for CSR initiatives must have a granular understanding of every activity in the value chain. Value chain and competitive-context investments in CSR need to be incorporated into the performance measures of managers with P&L responsibility. These transformations require more than a broadening of job definition; they require overcoming a number of long-standing prejudices. Many operating managers have developed an ingrained us-versus-them mind-set that responds defensively to the discussion of any social issue, just as many NGOs view askance the pursuit of social value for profit. These attitudes must change if companies want to leverage the social dimension of corporate strategy.

Strategy is always about making choices, and success in corporate social responsibility is no different. It is about choosing which social issues to focus on. The short-term performance pressures companies face rule out indiscriminate investments in social value creation. They suggest, instead, that creating shared value should be viewed like research and development, as a long-term investment in a company's future competitiveness. The billions of dollars already being spent on CSR and corporate philanthropy would generate far more benefit to both business and society if consistently invested using the principles we have outlined.

While responsive CSR depends on being a good corporate citizen and addressing every social harm the business creates, strategic CSR is far more selective. Companies are called on to address hundreds of social issues, but only a few represent opportunities to make a real difference to society or to confer a competitive advantage. Organizations that make the right choices and build focused, proactive, and integrated social initiatives in concert with their core strategies will increasingly distance themselves from the pack.

The Moral Purpose of Business

By providing jobs, investing capital, purchasing goods, and doing business every day, corporations have a profound and positive influence on society. The most important thing a corporation can do for society, and for any community, is contribute to a prosperous economy. Governments and NGOs often forget this basic truth. When developing countries distort rules

and incentives for business, for example, they penalize productive companies. Such countries are doomed to poverty, low wages, and selling off their natural resources. Corporations have the know-how and resources to change this state of affairs, not only in the developing world but also in economically disadvantaged communities in advanced economies.

This cannot excuse businesses that seek short-term profits deceptively or shirk the social and environmental consequences of their actions. But CSR should not be only about what businesses have done that is wrong—important as that is. Nor should it be only about making philanthropic contributions to local charities, lending a hand in time of disaster, or providing relief to society's needy—worthy though these contributions may be. Efforts to find shared value in operating practices and in the social dimensions of competitive context have the potential not only to foster economic and social development but to change the way companies and society think about each other. NGOs, governments, and companies must stop thinking in terms of “corporate social responsibility” and start thinking in terms of “corporate social integration.”

Perceiving social responsibility as building shared value rather than as damage control or as a PR campaign will require dramatically different thinking in business. We are

convinced, however, that CSR will become increasingly important to competitive success.

Corporations are not responsible for all the world's problems, nor do they have the resources to solve them all. Each company can identify the particular set of societal problems that it is best equipped to help resolve and from which it can gain the greatest competitive benefit. Addressing social issues by creating shared value will lead to self-sustaining solutions that do not depend on private or government subsidies. When a well-run business applies its vast resources, expertise, and management talent to problems that it understands and in which it has a stake, it can have a greater impact on social good than any other institution or philanthropic organization. ▢

1. An early discussion of the idea of CSR as an opportunity rather than a cost can be found in David Grayson and Adrian Hodges, *Corporate Social Opportunity* (Greenleaf, 2004).

2. For a more complete discussion of the importance of competitive context and the diamond model, see Michael E. Porter and Mark R. Kramer, “The Competitive Advantage of Corporate Philanthropy,” HBR December 2002. See also Michael Porter's book *The Competitive Advantage of Nations* (The Free Press, 1990) and his article “Locations, Clusters, and Company Strategy,” in *The Oxford Handbook of Economic Geography*, edited by Gordon L. Clark, Maryann P. Feldman, and Meric S. Gertler (Oxford University Press, 2000).

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To order, see page 165.



*“Some men are born great, some achieve greatness,
and some are allowed to work for great men like me.”*

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In the social sector, too much attention is devoted to providing more of the same to narrow populations that are already served. It's time for a fundamentally different approach.

**by Clayton M. Christensen, Heiner Baumann,
Rudy Ruggles, and Thomas M. Sadtler**

Disruptive Innovation

for Social Change

The United States spends more money per capita on health care than any other nation, and it offers some of the most sophisticated care in the world. Yet it lags behind many less affluent countries on basic health indicators such as infant mortality and life expectancy rates. Similarly, the United States ranks second only to Norway among OECD countries in per-student spending on education, yet it comes in 24th out of 29 on the OECD's Programme for International Student Assessment mathematical literacy test. This pattern of aggressive spending and disappointing returns in the social sector isn't limited to the United States, of course. Throughout the world, affluent nations, institutions, and individuals generously fund social services that fail to fully deliver on their promise.

What accounts for this poor showing? It's not a lack of solutions but rather misdirected investment. Too much of the money available to address social needs is used to maintain the status quo, because it is given to organizations that are

MICK WIGGINS



wedded to their current solutions, delivery models, and recipients. Many provide relatively specific, sometimes sophisticated offerings to a narrow range of people. While they may do a good and important job serving those people, and while their services may steadily improve, these organizations are unlikely ever to reach the far broader populations that are in need—and that would be satisfied by simpler offerings if only they were available.

What's required is expanded support for organizations that are approaching social-sector problems in a fundamentally new way and creating scalable, sustainable, systems-changing solutions. Their method, which we call "catalytic innovation," shares principal features with Clayton Christensen's disruptive-innovation model. Like disruptive innovations, which challenge industry incumbents by offering simpler, good-enough alternatives to an underserved group of customers, catalytic innovations can surpass the status quo by providing good-enough solutions to inadequately addressed social problems. Catalytic innovations are a subset of disruptive innovations, distinguished by their primary focus on social change, often on a national scale.

To understand this argument, it's useful to review the disruptive-innovation model first put forward in Christensen and Joseph L. Bower's HBR article "Disruptive Technologies: Catching the Wave" (January–February 1995). The authors divide innovations into two categories: sustaining and disruptive. Most product and service innovations are sustaining. They provide better quality or additional functionality for an organization's most demanding customers. Some sustaining innovations are incremental improvements; others are breakthrough or leapfrog products or services.

By contrast, disruptive innovations don't, by traditional measures, meet existing customers' needs as well as currently available products or services. They may lack certain features or capabilities of the established goods, for example. However, they are typically simpler, more convenient, and less expensive, so they appeal to new or less-demanding customers. Southwest Airlines' low-cost, no-frills flights were a disruptive service innovation that initially attracted leisure travelers whose alternatives were to pay through the nose or not to fly at all. The company rapidly stole market share from established carriers

while also bringing new customers to air travel. Personal computers were a disruptive product innovation because, while they were less powerful than mainframes, they quickly found a huge unserved market for their affordable, if limited, capabilities.

Disruptive innovations have had a major impact on industry structures, from travel to computer retailing to communications, and have often given rise to social change in the process. But the social changes caused by disruptive innovations are largely unintended; they are simply the by-products of pursuing a business opportunity. With catalytic innovations, however, social change is the primary objective.

Thinking Catalytically

The existing players in any sector have resources, processes, partners, and business models designed to support the status quo. This makes it difficult and unappealing for them to challenge the prevailing way of doing things. Organizations are set up to support their existing business models. Because implementing a simpler, less expensive, more accessible product or service could sabotage their current offerings, it's almost impossible for them to disrupt themselves. Therefore, the catalytic innovations that will bring new benefits to the most people are likely to come from outside the ranks of the established players.

It's fairly easy to grasp the disruptive-innovation model when it's applied to commercial products and services. But how, exactly, does the model work in the social sector? Catalytic innovators share five qualities:

1. They create systemic social change through scaling and replication.
2. They meet a need that is either overserved (because the existing solution is more complex than many people require) or not served at all.
3. They offer products and services that are simpler and less costly than existing alternatives and may be perceived as having a lower level of performance, but users consider them to be good enough.
4. They generate resources, such as donations, grants, volunteer manpower, or intellectual capital, in ways that are initially unattractive to incumbent competitors.

Clayton M. Christensen (cchristensen@hbs.edu) is the Robert and Jane Cizik Professor of Business Administration at Harvard Business School in Boston. *Heiner Baumann* (heiner_baumann@newprofit.com) is the chief knowledge officer and a partner at New Profit, a Cambridge, Massachusetts-based venture philanthropy fund that provides financial and strategic support for social entrepreneurs. *Rudy Ruggles* (rudy.ruggles@comcast.net) is the president of Weston, Massachusetts-based Collaborative Innovation Services, a consulting firm that works with organizations to create solutions to social and environmental challenges. *Thomas M. Sadtler* (tom.sadtler@post.harvard.edu) is the vice president of professional services marketing at CA, a management software company based in Islandia, New York, and a New Profit thought partner.

While incumbent organizations may do a good job serving a particular group, they are unlikely ever to reach the far broader populations that would be satisfied by simpler offerings.

5. They are often ignored, disparaged, or even encouraged by existing players for whom the business model is unprofitable or otherwise unattractive and who therefore avoid or retreat from the market segment.

The following examples in health care, education, and economic development show the catalytic innovation strategy in action at both nonprofit and for-profit organizations. People often equate an organization's tax status with its ability to generate positive social change. But, as we'll show, organizations can create catalytic innovations regardless of their ownership structure.

Investing in Health Care

In health care, investments in sustaining innovations enable organizations to treat their challenging patients with the most advanced technologies and therapies. An investment in catalytic innovation, meanwhile, yields simpler products and services that are affordable to a broader population.

Cutting-edge care. Several years ago, a major teaching hospital in Boston received a large donation to further its mission to provide the highest-quality health care, serve regional patients, and pioneer practices for global dissemination. Stakeholders submitted diverse proposals for the use of the funds, and two of those ideas made it through the vetting process to reach the board for final consideration. One proposal recommended that the hospital move beyond its current tertiary care status to become a "quaternary" care provider, combining its tertiary care and research capabilities to extend the boundaries of its clinical excellence. The other proposal recommended funding a nursing fellowship and broadening treatment responsibilities for the best nurses.

The quaternary care proposal promised service innovation that would advance the elite hospital's evolution by offering enhanced treatment capabilities for patients with complicated problems. The nursing fellowship would also promote service innovation, but in a different way. It would train nurses to begin offering care that doctors formerly had provided, but at a lower cost. As disruptive-innovation theory would predict, the hospital board decided not to disturb the status quo. It turned down the proposal to train nurses in providing more so-

phisticated care and used the donation to fuel the hospital's current model: pushing the envelope on providing cutting-edge care to a relatively small population of the sickest patients. It chose sustaining over disruptive innovation.

Walk-in clinics. By contrast, Minneapolis-based MinuteClinic is a catalytic innovator. The for-profit company's 87 clinics are located in ten states in CVS stores and other retail locations and provide fast, affordable walk-in diagnosis and treatment for common health problems, as well as vaccinations. MinuteClinic employs nurse practitioners armed with software-based protocols and applies strict rules that help ensure consistent service. If a patient has a complaint that's not on the list of health issues the clinic treats or has symptoms that indicate a serious problem, he or she is referred to a doctor or an emergency room. Because MinuteClinics are less expensive for many uninsured people than a visit to a doctor's office and are often more convenient for the insured, the model has the potential to bring basic health care to many whose access is otherwise limited.

MinuteClinics may offer "lesser" health services than a doctor's office would, but this reduced scope amounts to a good-enough service that's attractive to a large, underserved population. (In fact, MinuteClinic's surveys of more than 350,000 patients indicated a 99% satisfaction level.) MinuteClinics also provide services that many incumbent health providers resist offering because the services generate limited profits and result in little professional satisfaction. As a result, the growth of MinuteClinic (which was recently acquired by CVS) and other health care-related catalytic innovators, such as RediClinics, Take Care Health Systems, and Wal-Mart's in-store clinics, will come at the expense of the full-service organizations that allow them to thrive.

Affordable insurance. The nonprofit labor organization Freelancers Union is another catalytic innovator in the health care field, providing low-cost health insurance and other services to independently employed contractors, consultants, part-timers, temps, and other workers in the New York area who wouldn't otherwise be able to afford insurance. By handling individual policyholders as if they belonged to a group working for a large employer, Freelancers Union can offer comprehensive health

The community college model is a catalytic innovation that is dramatically changing the shape of higher education.

insurance at prices that are 30% to 40% lower than those charged by incumbent insurers for individual plans that provide comparable coverage. Freelancers Union's actuarial analysis of claims has shown that the workers it covers are not a high-risk demographic, as many incumbents have assumed. With the growing scale of its coverage and the detail of its analysis, Freelancers Union has gained bargaining power with its insurance carrier, allowing the nonprofit to continue to lower its insurance premiums.

Because incumbent insurance companies have aligned their processes, cost structures, and marketing to focus on corporate clients, they have little incentive to try to compete for Freelancers Union's niche business. The catalytic-innovation model, in which the organization acts as a marketer and broker while partnering with an established insurance carrier, is replicable, and Freelancers Union is now expanding to other states.

Investing in Education

Just as catalytic innovations in health care expand the reach of good-enough care, catalytic innovations in secondary schools can make a broader range of good, affordable courses available to people who otherwise would have limited or no access to certain types of course content or degree opportunities.

Online classes. Online learning is an example of one such innovation. Because of tight budgets, many public high schools have ceased to offer classes that cater to small groups of students—classes in certain languages, for instance, and advanced placement courses that count for college credit. Other small or poorer schools have never had the budgets to offer these types of courses. For-profit Apex Learning and nonprofits Virtual High School and Florida Virtual School, among others, have provided these specialized classes to thousands of students through their online learning curricula. They allow school systems to offer good-enough AP and other courses at a fraction of what a live course would cost the school to provide and give students options that would otherwise be unavailable to them. According to the U.S. Department of Education, as of 2005, there were 40,000 to 50,000 secondary school students in 37 states participating in online

courses, through approximately 2,400 online charter schools and state and district virtual schools.

Student attrition is higher in online courses than in live ones, both because participation can be technically challenging and because sticking with an online course requires strong self-motivation. However, in the absence of alternatives, online courses remain an adequate option for an underserved population. What's more, they're based on a profitable, disruptive business model—affordable, widely accessible learning—that the incumbent schools are not structured to pursue.

Community colleges. Though it may at first seem counterintuitive, the community college model is a catalytic innovation—one that is dramatically changing the shape of higher education in the United States by expanding access to and redefining the goals for advanced study.

Community colleges offer a lower-cost alternative to four-year universities and measure quality not by the selectiveness of admissions or the earning power of graduates but rather by factors such as job placement rates and the convenience of access to classes. This has made community colleges an acceptable and even desirable choice for students' first two years. In fact, these schools now enroll some 44% of all undergraduates in the United States. They provide a good-enough alternative for prospective undergraduates who regard the traditional four-year incumbents as overpriced for their initial needs, and they provide a viable option for the unserved: aspiring undergraduates for whom traditional colleges, for a variety of reasons, are out of reach.

Some state colleges and universities have helped create this shift by explicitly pointing prospective students toward community colleges for their first two years. Having freshmen and sophomores attend community colleges eases housing shortages at four-year schools and allows their faculties to teach fewer introductory courses, freeing instructors up to teach more intellectually challenging upper-level courses and seminars. True to the model of disruption, many community colleges are offering upper-division courses as well but without the significant cost burdens of research-oriented faculty. Community colleges serve as feeder schools for the four-year institutions, which in turn have made transfer arrangements more straightforward.

Investing in Economic Development

Historically, organizations such as the World Bank and the International Monetary Fund have promoted economic advancement by applying resources at a scale and scope unmatched by developing economies. However, during the past several decades, microfinance organizations have taken a different approach, making small loans available to latent entrepreneurs who otherwise would have little or no access to capital.

Microlending. Conventional banks are typically unwilling to lend to people without assets, forcing those customers to seek informal loans, often at interest rates of 300% to 3,000% (if they can be obtained at all). Microfinance organizations have stepped in by offering these clients small loans at relatively low interest rates and requiring little or no collateral. In many countries, microlenders (combined) have had a far greater impact than the World Bank, IMF, and conventional banks in raising significant segments of the population from poverty.

One of the best-known microfinance organizations is Grameen Bank. At the end of 2005, it had 5.6 million borrowers in nearly 60,000 villages throughout Bangladesh. Since its inception in 1976, it has lent more than \$5.2 billion with a recovery rate of more than 98%. Owned 93% by its borrowers, 5% by the Bangladeshi government, and 2% by other private Bangladeshi banks, it has been profitable in every year but three since it was founded. Profits from the bank are used to increase the loan fund. In 2005, the entire \$15.21 million profit was transferred to a disaster relief fund, called the Rehabilitation Fund. Accion International, another profitable microfinance organization, reports that between 1996 and 2005, its affiliated programs issued \$9.4 billion in loans in varying amounts to 3.97 million people. More than 97% of those loans have been paid back. According to the Microcredit Summit Campaign, which collects outreach information from nearly 3,000 microfinance organizations, about 80 million people worldwide are receiving credit through this approach.

Rural clinics. While microfinance itself is a catalytic innovation, it is uniquely powerful in its ability to enable other catalytic innovations to flourish as well. Consider the HealthStore Foundation, which has established what might be thought of as the MinuteClinics of Kenya. The Kenyan health care system is hierarchical and has a complex administrative structure and an urban bias. Roughly 80% of Kenya's doctors and den-

tists live in Nairobi and other urban areas, while 70% of the population lives in rural areas. A 1998 study indicated that more than half the population did not visit government-run health facilities because those institutions lacked the needed drugs, were too far away, or were too expensive.

With the help of microloans, the HealthStore Foundation has begun to address these problems by training local residents to provide basic health care and helping them buy and operate their own clinics. These residents turned clinic owners often have experience as nurses or other types of health practitioners, but they lack the formal education and licensing of physicians. The clinics offer essential drugs, health products, and basic health care and health education at affordable prices, and they provide the owners with enough income to ensure the sustainability of the model. Strict standards and regular inspections by the HealthStore Foundation guarantee that the clinics offer uniform quality and prices. The combined buying power of the network is used to obtain medicines at the lowest possible rate, which helps drive the access cost toward a goal of 50 cents per person per visit, compared with roughly \$3 per outpatient visit in government-run hospitals. With their higher capital and personnel costs,



government hospitals would have trouble competing on price. As with MinuteClinics in the United States, the Kenyan clinics' growth will probably come at the expense of the full-service incumbent organizations that currently ignore, disparage, or encourage them.

Capital equipment. KickStart is another business that creates catalytic innovations in Africa. The nonprofit develops and sells low-cost capital equipment to poor entrepreneurs in Kenya, Tanzania, and Mali; develops related supply chains; creates initial markets for the equipment; and adapts the equipment according to market feedback. One of its innovations is the MoneyMaker foot-operated irrigation pump, which dramatically increases the pro-

Identifying Catalytic Innovations

Many mainstream organizations could use additional resources to grow, refine, and revitalize their current valuable offerings, and investing in sustaining innovations can certainly advance social goals. However, when the objective is to get a system unstuck and to create new change models, it is time to go in search of catalytic innovations. While there are many guides to smart investing and philanthropy that focus on identifying traditional sustaining innovations to support, investors seeking catalytic innovations have few sources to rely on. Here are some guidelines they can use.

Many mainstream organizations could use additional resources to revitalize their current offerings. But when the objective is to get a system unstuck, it is time to go in search of catalytic innovations.

ductivity of farmland. The pumps cost between \$38 and \$90 and can increase an average farmer's annual income tenfold, from about \$100 to more than \$1,000, allowing families to send their children to school and make other investments in their futures. The farmer's initial expense is sometimes advanced by a microlender and can usually be paid back in three to six months.

Like other catalytic innovations, KickStart's products may seem to perform less well than competing goods. Compared with motorized pumps, for example, KickStart's pumps are labor-intensive and low capacity. But motorized pumps are more expensive and require electricity or fuel, and labor is a plentiful asset for Kenyan farmers. KickStart provides a good-enough solution that has transformed the lives of thousands of farmers. Since 1993, KickStart has helped generate 41,000 profitable new businesses. Creating new businesses at the rate of 800 per month, KickStart's clients today generate \$47 million in annual profits and wages, which is equivalent to more than 0.5% of Kenya's GDP and 0.2% of Tanzania's GDP.

The success of the HealthStore Foundation, KickStart, and other such organizations depends on the availability of microlenders. In turn, microlending helps sustain borrowers who are paying back loans and creates an economic environment that attracts other lenders looking to start new businesses. Economic development arises as a result of these organizations' catalytic innovation business models, not solely because of their resources.

Look for signs of disruption in processes. Once an investor or organization has chosen a particular social challenge to address, the first step is to look for preexisting catalytic innovators. Because of their nontraditional models and technologies, these organizations may not show up in mainstream news articles, watch lists, or trade magazines. Instead, it is often easiest to detect their presence by noting the patterns of catalytic innovation activity that arise in the sector overall. Dynamics to watch for include the following:

- A relatively new entrant is providing a lower-cost, less-functional alternative to a customer segment that is overserved or not served at all by the dominant provider.
- The dominant provider is moving away from the new entrant's offerings and toward a more profitable segment of the market.
- The new entrant is continuing to improve its offering, expanding its market reach as the dominant player retreats, while others copying its model are beginning to emerge.

These sorts of ripples occurred after MinuteClinic's appearance in 2000 (as QuickMedx) and rapid expansion in the following years. Although MinuteClinic's outlets were initially located only in the Minneapolis-St. Paul area, the social and economic forces that gave rise to it were not location specific. The environmental factors that produced it in Minneapolis-St. Paul created sectorwide opportunities for inexpensive, good-enough care.

Not all sectors are ripe for the rapid growth of catalytic innovations. In the federal government, the judicial system, child welfare services, and other arenas that are heavily regulated or are controlled by politics and other forces outside the market, the innovation process may be slowed down. Still, we have yet to find a social sector that is impervious to disruption by catalytic innovation.

Identify specific catalytic innovations. When sector dynamics indicate that some sort of innovation is starting to come about, donors or social investors should evaluate it against the five qualities (is the innovation designed to create systemic social change, does it meet an overserved or unserved need, and so on) to determine whether the development is in fact a catalytic innovation.

At the identification stage, note that the innovations, not the organizations, are being considered. In the case of MinuteClinic, for example, the innovation is low-cost, walk-in clinics in high-traffic areas such as drug stores and shopping malls and not the MinuteClinic brand itself. It is easy to confuse the two, but a search for catalytic innovations needs to focus on the solution first and then look at how it is, or could be, implemented.

The Five Qualities of Catalytic Innovators


- 1** They create systemic social change through scaling and replication.
- 2** They meet a need that is either overserved (because the existing solution is more complex than many people require) or not served at all.
- 3** They offer products and services that are simpler and less costly than existing alternatives and may be perceived as having a lower level of performance, but users consider them to be good enough.
- 4** They generate resources, such as donations, grants, volunteer manpower, or intellectual capital, in ways that are initially unattractive to incumbent competitors.
- 5** They are often ignored, disparaged, or even encouraged by existing players for whom the business model is unprofitable or otherwise unattractive and who therefore avoid or retreat from the market segment.

Assess the business models. Just because an organization has come up with a good idea for systemic social change doesn't mean that it will succeed in implementing that change. At this third stage in the evaluation of a potential catalytic innovation, assess whether the group's business model can allow it not only to effectively introduce the innovation but also to scale it up and sustain it. Organizations that have aligned their resources, processes, and values according to the five catalytic-innovation criteria to support their innovations are most likely to succeed. That means investors or donors should look for organizations whose work in one location is transferable to other locations and that have produced the same results elsewhere, for example. It also means investors should seek candidates that turn down funders that would require them to alter their models in ways that are incompatible with catalytic-innovation principles.

Keep in mind that tax classification – for profit versus nonprofit – is not a useful criterion for identifying catalytic innovators. While the business models for the two types may differ, neither has an automatic advantage in addressing social challenges. EBay founder Pierre Omidyar recognized this fact when he and his wife, Pam, restructured their grant-making organization, the Omidyar Foundation, as the Omidyar Network so that it could make gifts in support of both for-profit and nonprofit organizations that focus on social change.

Catalyzing Business Models

The screening approach described here can help investors identify groups that have a good chance of creating scalable, sustainable innovations in social change. Using the method won't always be straightforward. Most reporting and marketing materials and funding requests have been developed with specific programs in mind, since that is usually how donors and philanthropic investors want them presented. It is much easier for donors and investors to find requests for resources and process assistance than to find organizations – especially nonprofits – that tout their business models. It is also difficult to compare strengths and weaknesses across many different types of organizations and to identify those that are most likely to be effective catalysts.

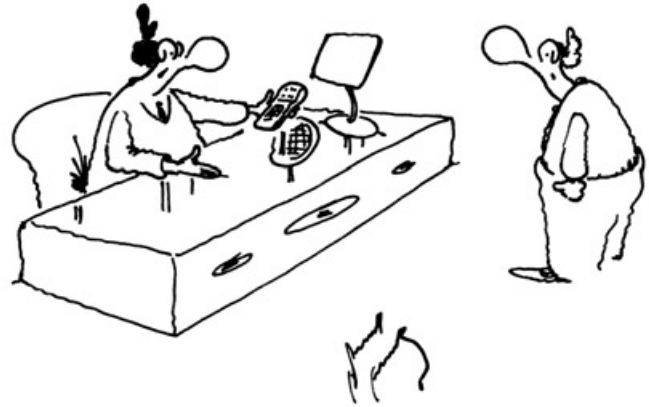
If social investors are frustrated with current solutions, they should seek out and support catalytic innovations. Not only will this have an immediate social impact, but it will also help establish the model and inspire more social entrepreneurs to think catalytically. 

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To order, see page 165.

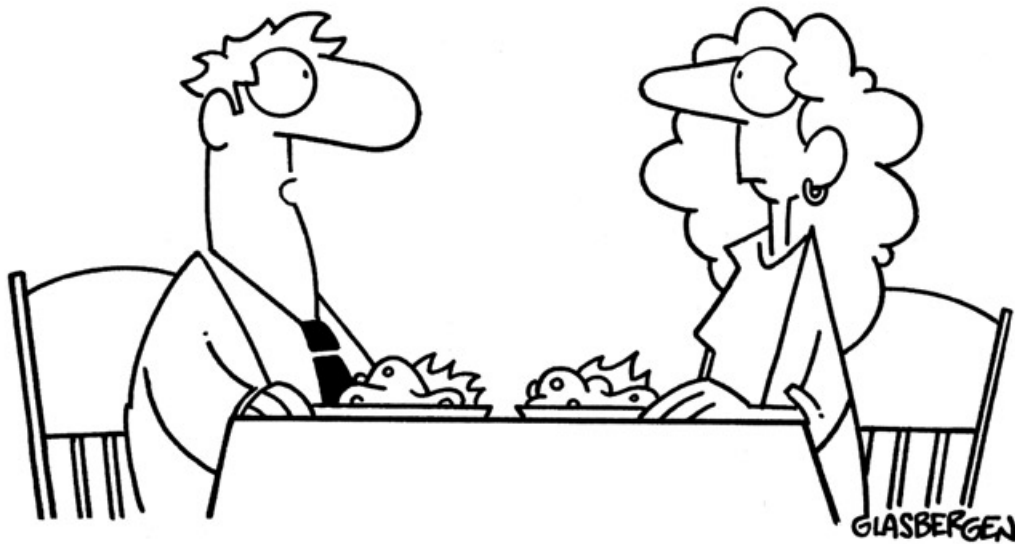
Innovation

“One has only to consider some of the present industrial developments to realize how far the technical front has advanced....”

John Gurney Callan
“Some Relations Between Technical
and Business Training”
Harvard Business Review
October 1922



“Keep in mind, Heath, I can replace you at any time with this standard universal remote.”



“The computers were down, so we spent the day making corn husk dolls, square dancing, and taking buggy rides in the country.”



"Press 7 to admit defeat."



"It concludes with, 'Don't bother to ask. You'll never find out what some of these ingredients do.'"



"What happens in R&D, stays in R&D."



STRATEGIES TO FIGHT LOW-COST RIVALS

by Nirmalya Kumar

Companies have only three options: attack, coexist uneasily, or become low-cost players themselves. None of them is easy, but the right framework can help you learn which strategy is most likely to work.

IT'S EASIER TO FIGHT THE ENEMY YOU KNOW than one you don't. With gale-force winds of competition lashing every industry, companies must invest a lot of money, people, and time to fight archrivals. They find it tough, challenging, and yet strangely reassuring to take on familiar opponents, whose ambitions, strategies, weaknesses, and even strengths resemble their own. CEOs can easily compare their game plans and prowess with their doppelgängers' by tracking stock prices by the minute, if they desire. Thus, Coke duels Pepsi, Sony battles Philips and Matsushita, Avis combats Hertz, Procter & Gamble takes on Unilever, Caterpillar clashes with Komatsu, Amazon spars with eBay, Tweedledum fights Tweedledee.

ASAF HANUKA



However, this obsession with traditional rivals has blinded companies to the threat from disruptive, low-cost competitors. All over the world, especially in Europe and North America, organizations that have business models and technologies different from those of market leaders are mushrooming. Such companies offer products and services at prices dramatically lower than the prices established businesses charge, often by harnessing the forces of deregulation, globalization, and technological innovation. By the early 1990s, the first price warriors, such as Costco Wholesale, Dell, Southwest Airlines, and Wal-Mart, had gobbled up the lunches of several incumbents. Now, on both sides of the Atlantic, a second wave is rolling in: Germany's Aldi supermarkets, India's Aravind Eye Hospitals, Britain's Direct Line Insurance, the online stock brokerage E*Trade, China's Huawei in telecommunications equipment, Sweden's IKEA furniture, Ireland's Ryanair, Israel's Teva Pharmaceuticals, and the United States' Vanguard Group in asset management. These and other low-cost combatants are changing the nature of competition as executives knew it in the twentieth century.

What should leaders do? I'm not the first academic (nor, I daresay, will I be the last) to pose that question. Several strategy experts, led by Harvard Business School's Michael Porter in his work on competitive strategy and Clayton Christensen in his research on disruptive innovations, and Tuck School's Richard D'Aveni in his writings on hypercompetition, have described the strategies companies can use to fight low-cost rivals. But that body of work doesn't make the phenomenon less interesting—or render the threat any less formidable. For, despite the buckets of ink that academics have spilled on the topic, most companies behave as though low-cost competitors are no different from traditional rivals or as though they don't matter.

Over the past five years, I've studied around 50 incumbents and 25 low-cost businesses. My research shows that ignoring cut-price rivals is a mistake because it eventually forces companies to vacate entire market segments. When market leaders do respond, they often set off price wars, hurting themselves more than the challengers. Companies that wake up to that fact usually change course in one of two ways. Some become more defensive and try to differentiate their products—a strategy that works only if they can meet a stringent set of conditions, which I de-

scribe later. Others take the offensive by launching low-cost businesses of their own. This so-called dual strategy succeeds only if companies can generate synergies between the existing businesses and the new ventures. If they cannot, companies are better off trying to transform themselves into solution providers or, difficult though it is, into low-cost players. Before I analyze the various strategy options, however, I must dispel some myths about low-cost businesses.

The Sustainability of Low-Cost Businesses

Be it in the classroom or the boardroom, executives invariably ask me the same question: Are low-cost businesses a permanent, enduring threat? Most managers believe they aren't; they're convinced that a business that sells at prices dramatically lower than those incumbents charge must go bankrupt. They cite the experience of U.S. airlines, which, after the industry's deregulation in the 1980s, succeeded in beating off cut-price providers such as People Express. What they forget is that low-cost airlines soon reemerged. By slashing fares and cutting frills, entrants like Southwest Airlines and JetBlue have grabbed a chunk of America's domestic air travel market. Unlike their predecessors, they're making money hand over fist, too.

Successful price warriors stay ahead of bigger rivals by using several tactics: They focus on just one or a few consumer segments; they deliver the basic product or provide one benefit better than rivals do; and they back everyday low prices with superefficient operations to keep costs down. That's how Aldi, the Essen-headquartered retailer that owns Trader Joe's in the U.S., has thrived in the brutally competitive German market. Aldi's advantages start with the size of its product range. A typical Aldi outlet is a relatively small, 15,000-square-foot store that carries only about 700 products—95% of which are store brands—compared with the 25,000-plus products that traditional supermarkets carry. The chain sells more of each product than rivals do, which enables it to negotiate lower prices and better quality with suppliers. In fact, many of Aldi's private-label products have bested branded products in competitions and taste tests. The small number of products also keeps the company's supply chain agile. Another efficiency stems from the fact that Aldi sets up outlets on side streets in downtown areas and in suburbs, where real estate is relatively inexpensive. Since it uses small spaces, the company's start-up costs are low, which enables it to blanket markets: Aldi now owns 4,100 stores in Germany and 7,500 worldwide.

Aldi doesn't pamper customers. Its stores display products on pallets rather than shelves in order to cut restocking time and save money. Customers bring their own shopping bags or buy them in the store. Aldi was one of the first retailers to require customers to pay refundable

Nirmalya Kumar (nkumar@london.edu) is a professor of marketing at London Business School, where he is also the director of the Centre for Marketing and codirector of the Aditya V. Birla India Centre. He is the author or coauthor of two books, including, with Jan-Benedict E.M. Steenkamp, Private Label Strategy: How to Meet the Store Brand Challenge (Harvard Business School Press, forthcoming in February 2007).

deposits for grocery carts. Shoppers return the carts to designated areas, sparing employees the time and energy needed to round them up. At the same time, Aldi gets the basics right. There are several checkout lines, so wait times are short even during peak shopping hours. Its scanning machines are lightning fast, which allows clerks to deal quickly with each shopper. Most retailers follow local pricing, but every Aldi store in a country charges the same price, which reinforces the chain's image as a consumer champion. In 2006, Germans voted Aldi the country's third most-trusted brand, behind only Siemens and BMW. Aldi sells products far cheaper than rivals do. To suppliers' prices, the company adds about 8% to cover transportation, rent, marketing, and other overhead costs, and about 5% for staff costs. Thus, Aldi's average markup is 13% while that of most European retailers is 28% to 30%. Not surprisingly, 89% of all German households made at

least one trip to an Aldi in 2005, and according to European market research firms, the chain had a 20% share of Germany's supermarket business.

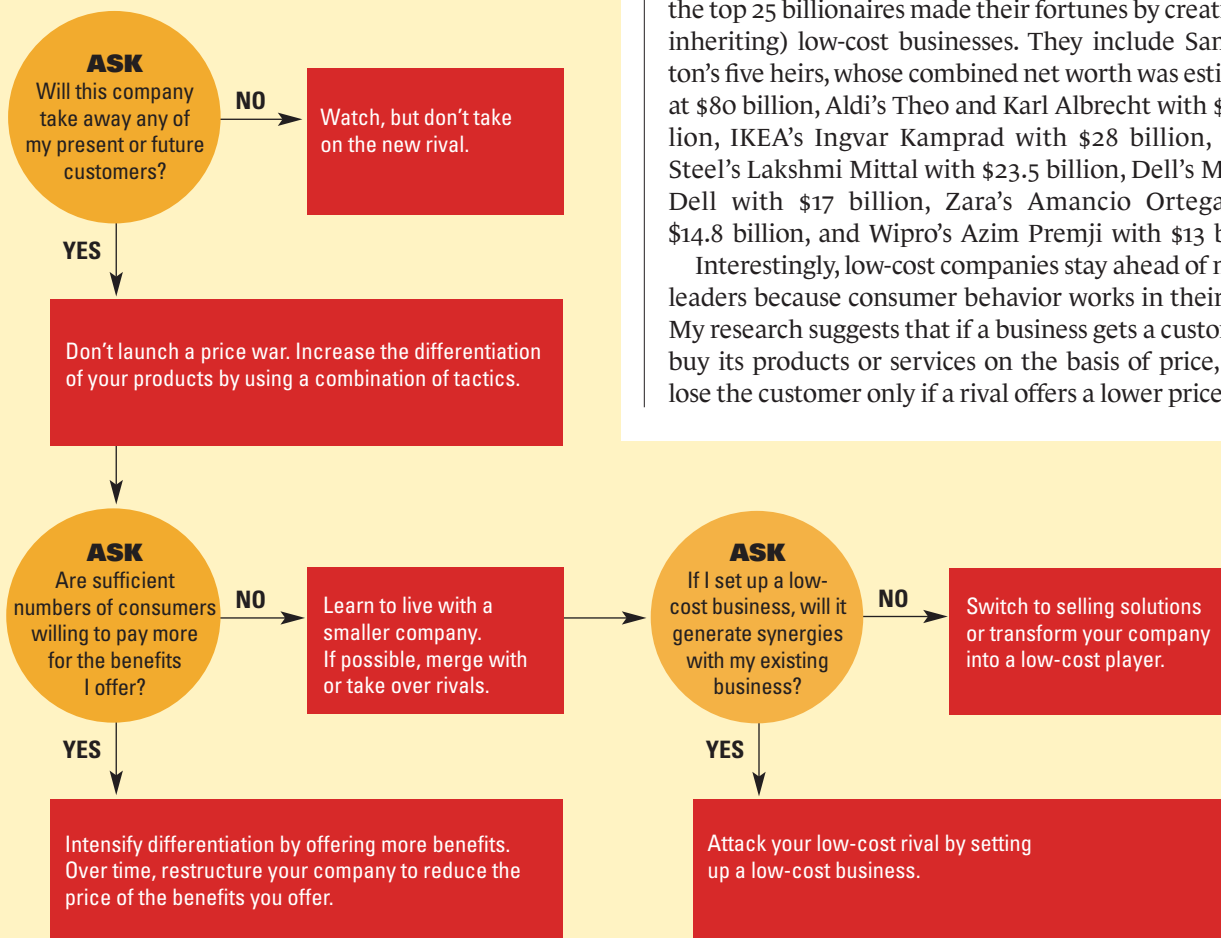
As Aldi's story suggests, the financial calculations of low-cost players are different from those of established companies. They earn smaller gross margins than traditional players do, but their business models turn those into higher operating margins. Those operating margins are magnified by the businesses' higher-than-average asset turnover ratios, which result in impressive returns on assets. Because of those returns and high growth rates, the market capitalizations of many upstarts are higher than those of industry leaders, despite the larger equity bases of the latter. For instance, one of Europe's leading low-cost airlines, Ryanair, is one-seventh the size of British Airways in terms of revenues – \$2.1 billion versus \$15.5 billion in 2006 – but its operating margins, at 22.7%, are three times as large as BA's 7.35%. Not surprisingly, Ryanair's market capitalization of \$7.6 billion (on May 28, 2006) was higher than BA's \$7.3 billion.

Many price warriors don't figure in listings of the biggest companies, but they have created wealth – and pots of it. Look at *Forbes's* list of the world's richest people in 2006, for instance, and you will discover that 12 of the top 25 billionaires made their fortunes by creating (or inheriting) low-cost businesses. They include Sam Walton's five heirs, whose combined net worth was estimated at \$80 billion, Aldi's Theo and Karl Albrecht with \$32 billion, IKEA's Ingvar Kamprad with \$28 billion, Mittal Steel's Lakshmi Mittal with \$23.5 billion, Dell's Michael Dell with \$17 billion, Zara's Amancio Ortega with \$14.8 billion, and Wipro's Azim Premji with \$13 billion.

Interestingly, low-cost companies stay ahead of market leaders because consumer behavior works in their favor. My research suggests that if a business gets a customer to buy its products or services on the basis of price, it will lose the customer only if a rival offers a lower price. Since

A FRAMEWORK FOR RESPONDING TO LOW-COST RIVALS

When a low-cost player enters your industry:



the discounters win all their customers because of the prices they offer, they don't have to worry about traditional rivals that always charge premiums. Only new entrants with even lower cost structures can compete with the price warriors. For instance, until 2000, Southwest Airlines' costs were the lowest in the U.S. airline industry. As its employees grew older, those costs (excluding fuel costs) rose: By 2004, they were 6.2 cents per available seat-mile, which was still nearly 25% lower than the 8 cents per available seat-mile that Delta, Northwest, and United incurred. However, JetBlue, which started flying in 2000, spent only 4.7 cents per available seat-mile in 2004—25% lower than Southwest's costs. Clearly, JetBlue poses a stiffer challenge to Southwest than the traditional airlines do.

The Futility of Price Wars

The moment a company spots a low-cost competitor, it would do well to ask itself this question: Is our new rival targeting a segment we don't want to serve or will it eat into our sales? (The exhibit "A Framework for Responding to Low-Cost Rivals" shows companies' options in various situations.) If the new entrant has set its sights on customers no other business serves, incumbents needn't worry—for the moment. They can observe without engaging the competitor. That wait-and-watch strategy often works for companies that market products for people at the very top of the pyramid, such as wines, perfumes, and cosmetics. For instance, when Europe's supermarket chains launched private-label water, it had little impact on market leaders such as Evian, Perrier, and San Pellegrino. Bottled water is a superpremium product, and store brands serve consumers who rarely buy it.

Sometimes, entrants at low price points can provide a fillip to incumbents' business. Take the case of easyCruise, set up by the London-based serial entrepreneur Sir Stelios Haji-Ioannou, which has boosted Europeans' interest in cruises. The line's ships serve as floating hotels that dock in the afternoon and leave late at night, which allows passengers to entertain themselves at the ports of call. Since easyCruise doesn't offer lavish meals and expensive shows, it is able to charge low prices. Its customers are typically people in their twenties and thirties, many of whom cannot afford the all-inclusive packages other cruise lines offer. Although easyCruise is doing well, incumbents such as Royal Caribbean and Cunard have left this new competitor alone rather than diverting resources to attack it. They believe that when easyCruise's passengers are older and richer, they will turn to the established lines for traditional cruise vacations.

That may be an exception to the rule. Most low-cost players alter customer behavior permanently, getting people to accept fewer benefits at lower prices. EasyCruise's passengers may never switch to the higher-priced

cruise lines. Moreover, low-price warriors are aided by the fact that consumers are becoming cynical about brands, better informed because of the Internet, and more open to value-for-money offers.

When market leaders finally acknowledge the threat from low-cost rivals, they usually try to match or beat their prices. All the available evidence, however, shows that price wars don't work in incumbents' favor. Not only is pricing below cost illegal in many countries, including the United States, but also low-cost business models are designed to make money at low prices—a fact that executives tend to forget. In a race to the bottom, the challengers always come out ahead of the incumbents. For instance, in the late 1980s, Aldi, Dell, E*Trade, and Southwest Airlines more than held their own when Carrefour, Compaq, Fidelity, and United, respectively, triggered price wars that were supposed to drive the challengers out of business.

Even when market leaders copy the critical elements of low-cost players' business models, they are unable to match their prices. That's because the individual elements of the model don't matter as much as the interactions among them. Consider Internet bookings for airline tickets, which don't deliver the kind of cost reductions to traditional airlines that they do to low-cost carriers. First, low-cost players generate 98% of their bookings through their Web sites, while only 20% of incumbents' customers use the Internet to make reservations. Internet bookings are more attractive to the leisure travelers who use low-cost carriers than to business travelers, who often fly to multiple destinations. Consequently, when traditional airlines set up Internet-based booking systems, the impact on their costs is limited. Second, an Internet-based reservation system is inexpensive to develop and maintain when all the aircraft in a fleet are identical, there is only one cabin class, tickets are not refundable, and passengers can't reserve seats. However, the traditional airlines' systems must provide for multiple cabin classes, handle several kinds of tickets, provide several levels of refunds, and reserve seats, making them expensive investments. Third, most incumbents participate in industry-wide reservation systems such as Sabre, which robs them of control over some seats. Finally, the traditional airlines have set up networks of travel agents, which would rebel if the carriers made a complete shift to direct bookings. For all those reasons, traditional carriers are unable to reduce their booking costs to the levels the discount airlines have achieved.

Slashing prices usually lowers profits for all incumbents without driving the low-cost entrant out of business. I learned that firsthand while serving as a consultant to a European telecom-equipment provider that was competing against traditional rivals as well as a low-cost Asian competitor for a multimillion-dollar contract in Africa. All the bidders kept cutting prices in order to best

the Asian rival's offer, which proved to be the lowest after every round of bidding. Eventually, the telecom giants discovered that the Asian company had offered a 40% discount on the lowest price the customer could negotiate with its rivals! Not surprisingly, the low-cost company won the contract. In addition, although the telecom giants would not have made profits on their lowest bids, the Asian contender seemed likely to do so.

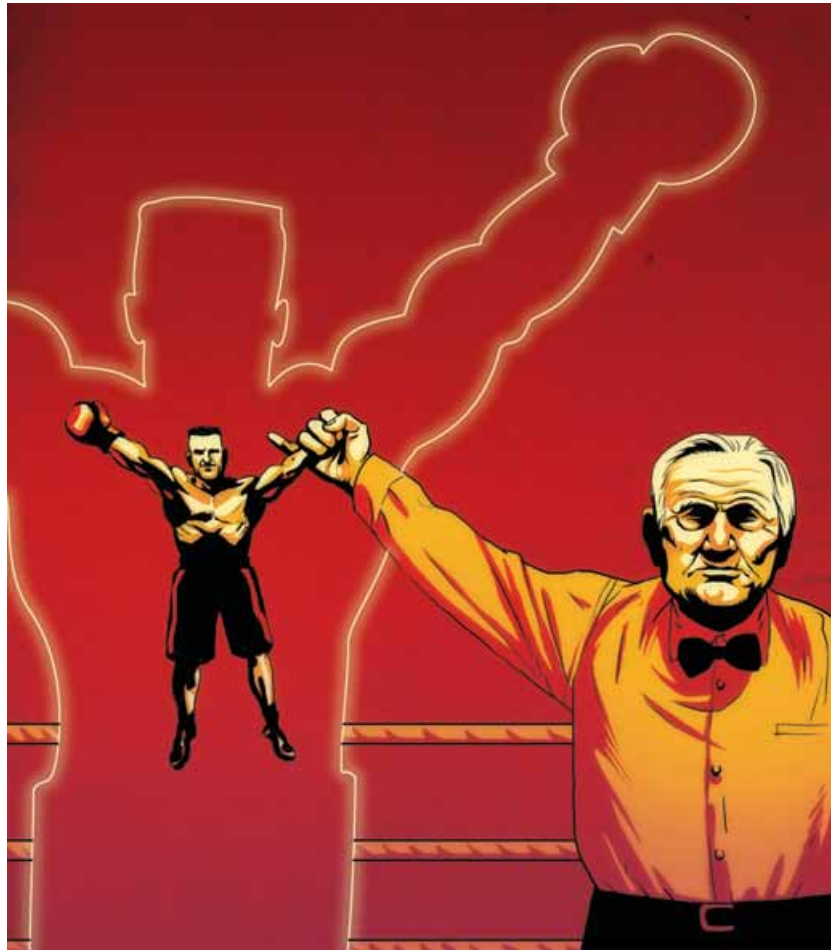
When Differentiation Works

When businesses finally realize they can't win a price war with low-cost players, they try to differentiate their products in a last-ditch attempt at coexistence. This strategy, the consultant's favorite antidote, takes many forms. Companies, we're told, should adopt the following approaches:

- Design cool products, as, say, Apple and Bang & Olufsen do.
- Continually innovate in the tradition of Gillette and 3M.
- Offer a unique product mix, like that of Sharper Image and Whole Foods.
- Brand a community à la Harley-Davidson and Red Bull.
- Sell experiences, as Four Seasons, Nordstrom, and Starbucks do.

Since the tactics I've mentioned are well-known, I will not discuss them in detail. My research shows, however, that three conditions determine their efficacy. First, smart businesses don't use these tactics in isolation. For instance, Bang & Olufsen is able to compete effectively against low-cost electronics manufacturers with its design capabilities. That approach works well because the Danish company also keeps introducing new products, cultivates an upscale brand image, and invests time and money in creating cool-looking retail outlets.

Second, companies must be able to persuade consumers to pay for benefits. The ability to do so usually depends on the products they sell. For instance, Gillette, finding that it can push the "closer shave" envelope for men, has launched the Atra, Atra Plus, Sensor, Sensor Excel, Mach 3, Mach 3 Turbo, and Centro shaving systems at ever higher prices over the past 20 years. However, when the company deployed a similar strategy for Duracell batteries by emphasizing longer life, many consumers balked at paying higher prices after a certain point. That's because they found it almost impossible to notice the better perfor-



mance and longer life of Duracell Ultra batteries. Energizer and Rayovac fought back by offering more batteries for the same price, which negated Duracell Ultra's long-life advantage. Eventually, Gillette had to back away from this differentiation gambit.

Many companies find it tough to persuade consumers to pay for additional benefits. A small premium for greater services or benefits is a powerful defense, as Target and Walgreens have shown. Target stocks inexpensive kitchenware and clothes developed by well-known designers such as Michael Graves and Isaac Mizrahi. It charges a bit more for products of better quality and design than those Wal-Mart sells. In like vein, Walgreens emphasizes convenience by setting up its stores close to shopping centers and providing drive-through windows for pickups, promising short checkout lines, and offering easy navigation because of smart store layouts. Both Target and Walgreens have therefore managed to hold their own against Wal-Mart. All too often, though, incumbents incur huge costs in order to deliver benefits, forcing them to ask for price premiums so large that they drive away consumers.

The third condition necessary for a successful differentiation strategy is simple: Companies must bring costs and

benefits in line before implementing it. That takes time. After years of restructuring, Hewlett-Packard may finally be catching up with Dell in the personal computer business. HP has shrunk Dell's cost advantage from 20% to 10%, and since average PC prices have fallen, the absolute difference in prices is relatively small. Consumers are shopping for HP computers once again because of such benefits as instant delivery and the ability to see, feel, and touch products in stores.

Unless sizable numbers of consumers demand additional benefits, however, companies may have to yield some markets to the price warriors. Take the case of British Airways, which initially ignored low-cost rivals such as easyJet and Ryanair; then set up a low-cost carrier called Go, which it sold in 2002 to easyJet; and finally differentiated its services in several ways. BA now concentrates on long-haul flights, for which there are no low-cost carriers. In the short-haul market, the carrier has held on to some market share by emulating the best practices of low-cost rivals, such as persuading customers to use electronic tickets. On every flight, BA offers a small number of economy class seats at prices close to those that low-cost carriers charge. Because of its stranglehold on landing slots at Heathrow, a convenient and popular airport, it still attracts some short-haul customers. Even so, BA has reduced capacity on several flights to destinations in Europe, effectively conceding victory to low-cost carriers.

Strategies that help an established player coexist with low-cost rivals can work initially, but as consumers become more familiar with low-cost options, they tend to migrate to them. In the airline, PC, and retail industries, the segment choosing to pay less for fewer benefits has grown rapidly—and I'm not talking about Wal-Mart shoppers. Dell's and Southwest Airlines' shares of their industries, for instance, rose from around 3% in the early 1990s to 30% by 2006. That has left the traditional players scrapping with one another for a shrinking market, charging ever higher prices to fewer and fewer customers. These companies have to cope with smaller top lines even though they still have high overhead costs. That wreaks havoc on their bottom lines. They can stop themselves from going under by merging with or acquiring rivals, but, as executives well know, M&A isn't a panacea.

Dealing with Dual Strategies

When companies discover that the low-price customer segment is large, they often set up low-cost ventures themselves. Because of their years of industry experience as well as their abundant resources, incumbents are often seduced into believing that they can easily replicate cut-price operations. Moreover, the business models of such rivals appear to be simpler than their own. In the 1990s, for instance, all the major airlines launched no-frills second carriers—Continental Lite, Delta Express, KLM's Buzz,

SAS's Snowflake, US Airways' MetroJet, United's Shuttle—to take on low-cost competition. All these second carriers have since been shut down or sold off, showing how tough it is for companies to use the dual strategy.

Although most executives don't realize it, companies should set up low-cost operations only if the traditional operation will become more competitive as a result and the new business will derive some advantages that it would not have gained as an independent entity. For example, in the financial services industry, HSBC, ING, Merrill Lynch, and Royal Bank of Scotland have set up low-cost operations in the form of First Direct, ING Direct, ML Direct, and Direct Line Insurance, respectively, because the new and old operations generate several synergies. The low-cost operations offer customers a small number of products—term deposits, savings accounts, and insurance—through cost-efficient distribution channels such as the Internet. Since they reach out to consumers the flagship banks cannot afford to serve, the no-frills businesses protect the parents. The flagship operations combine the funds the subsidiaries raise with their own, which allows them to make investments cost-effectively. That approach helps both parent and subsidiary.

A successful two-pronged approach requires the low-cost business to use a unique brand name such as HSBC's First Direct or at least a sub-brand such as ING Direct. A distinct brand helps communicate that fewer services go along with lower prices. It also allows customers' expectations to form around the low-cost business model rather than the traditional operation. First Direct customers, for example, are more satisfied with their ATM network than HSBC customers are even though both use the same machines. Whereas HSBC customers demand ATMs at every corner, First Direct customers, who don't expect so many machines, are delighted to see them.

Conventional wisdom suggests that because a low-cost operation's sources of competitive advantage aren't the same as those of the parent, the subsidiary should be housed separately. By setting up an independent unit, an established company can create a start-up operation with structures, systems, staff, and values that are different from its own. Because it is independent, the low-cost operation will be more accountable and is less likely to be smothered by the parent business's worry that the subsidiary will cannibalize its sales. However, as the case of the airlines shows, independent units are necessary but not sufficient for the success of a dual strategy. That's because common ownership often imposes constraints on low-cost operations. For instance, the trade unions didn't allow U.S. airlines to pay employees of their low-cost subsidiaries wages as low as those at Southwest Airlines and Jet-Blue. Unsurprisingly, those subsidiaries failed to take off.

Another factor that affects incumbents' low-cost businesses is the allocation of resources. When disruptors are new ventures, they face market tests of their capital

A two-pronged strategy delivers results only when the low-cost operation is launched offensively to make money – not as a purely defensive ploy to hurt low-cost rivals.

needs. Subsidiaries face internal resource-allocation processes that optimize different criteria—both for legitimate reasons, such as higher margins and lower risk, as well as illegitimate ones, such as power and politics. Consequently, the parent may end up starving the new unit. Remember how Bausch & Lomb didn't provide a budding business with enough resources to launch the disposable contact lenses it had developed? The new lenses were cheaper than the permanent lenses B&L then marketed. They also didn't need to be stored in solutions, which contributed to the parent's profits. Therefore, B&L left the field open for Johnson & Johnson to launch a profitable new business.

A two-pronged strategy delivers results only when the low-cost operation is launched offensively to make money—not as a purely defensive ploy to hurt low-cost rivals. Companies should let their old and new businesses compete with one another and incorporate cannibalization estimates into business models and financial projections. Dow Corning's creation of Xiameter is an excellent illustration of how companies should use the two-pronged approach. Despite enjoying a 40% share of the global silicones market in 2000, Dow Corning found low-cost competitors entering the industry. Rather than slashing prices, it decided to set up a low-cost business. Two years later, after segmenting the market and identifying potential customers, Dow Corning created Xiameter. Compared with Dow Corning, which sells 7,000 products, the subsidiary sells only 350, all of which face intense competition from low-cost players as well as from the parent. Xiameter's limited range prevents it from eating up its parent's sales.

Xiameter found that it had to offer products at prices 20% lower than Dow Corning's in order to take on other low-cost players. It uses every tactic in the book to do so. Instead of quick deliveries, Xiameter promises a shipping date seven to 20 days from the order date so that it can schedule the manufacture of its products when Dow Corning's factories are idle. It doesn't offer any technical services, so it hasn't invested in a service facility. To keep its supply chain efficient, Xiameter sells only full truck, tank, or pallet loads of products. Customers either enter orders on a Web site or pay an extra \$250 to order by e-mail or phone. Once set, a shipping date cannot be changed unless the customer pays a 5% fee; a rush order incurs a 10% premium; and an order cancellation fee is 5%. Such rules

make production planning easier. Xiameter offers only 30-day supplier's credit, which helps reduce working capital needs, and it prices products in just six currencies to limit currency risk. In 2001, Dow Corning posted sales of \$2.4 billion; in 2005, the combined sales of Dow Corning and Xiameter were \$3.9 billion. That increase helped the parent company turn a loss of \$28 million in 2001 into profits of \$500 million in 2005. The strategy has also helped customers better appreciate the additional benefits that Dow Corning provides, enabling it to charge premium prices.

Switching to Conquer

If there are no synergies between traditional and low-cost businesses, companies should consider two other options: They can switch from selling products to selling solutions or, radical though it may sound, convert themselves into low-cost players.

Switch to solutions. Since low-cost players turn incumbents' basic products or services into commodities, existing companies may be able to succeed by selling solutions. By offering products and services as an integrated package, companies can expand the segment of the market that is willing to pay more for additional benefits. Solutions offer several advantages: They include a large service component, so it's hard to evaluate the quality of the solutions various companies provide. Over time, the seller develops a deep understanding of the customer's business processes, so the customer finds it difficult and costly to change suppliers. Furthermore, since low-cost players have limited product ranges and service capabilities, they cannot offer solutions.

Despite the popularity of this strategy, making the changeover is difficult. Many companies, such as Boots, Compaq, Xerox, and Unisys, didn't succeed because they assumed that selling solutions required modifying their existing business models rather than transforming them. Most companies see selling solutions as a way to hawk more products at higher prices. They develop combinations of products and services that work more or less seamlessly, and call them solutions. Then they look for customers with problems to fit the solutions. That never works. A good solution provider starts by working with customers to understand their problems before designing solutions.

Selling solutions requires a company to manage customers' processes and increase their revenues or lower their costs and risks. Take the case of Australian giant Orica's mining services division (the erstwhile ICI Australia's explosives business), which sells explosives to stone quarries. To set up a blast, experts drill holes in rock faces over the course of several days. The holes are filled with packaged explosives on the day of the blast, a task that can take up to five hours. Loading the explosives is often a race against the clock since blasting times are restricted. Drilling and blasting costs are a significant component of a quarry's operating costs. Because of strict controls on the storage and handling of explosives, companies used to order just enough explosives for one blast, which Orica would deliver on the appointed day.

When new competitors entered the market, starting a price war that showed no sign of abating, Orica transformed itself into a solution provider. It started out by supplying emulsion explosives in bulk. After the customer placed an order, a mobile manufacturing unit containing intermediate chemicals arrived at the quarry, mixed chemicals on-site, and delivered the explosive down predrilled blasting holes. Orica drew profiles of rock faces with lasers to identify the best places for drilling, converting blasting from an uncertain art to a precise science. The greater consistency of emulsion explosives and better-placed holes required quarries to drill fewer blast holes, which reduced costs. Because of better blasts, rock yields also improved, reducing downstream processing costs. Over time, Orica offered to provide broken rock to customers instead of explosives. It now bills customers according to the quantities of broken rock it delivers.

Becoming a solution provider has yielded significant benefits for the company. Since Orica sells explosives as part of a service, the product's price is less transparent. Furthermore, blasting solutions require the company to integrate several products and services, so its average sales are bigger than when it sold only explosives. Since Orica manages blasts at several customer sites, it has enhanced its competence and knowledge. Customers in the meantime have become more dependent on the company's blasting solutions because they have stopped investing in the process.

Switch to low-cost models. In theory, a company can consider switching from a high-cost to a low-cost business model. In practice, such a transformation is unlikely because the incumbent will have a profitable albeit shrinking business to maintain. Moreover, switching to a low-cost business model means acquiring capabilities that are different from the company's existing competencies. It's hard to imagine many market leaders having the stomach for that.

Never doubt the power of example, though. One company has successfully achieved such a transformation, and your organization could be the second. In 1991,

Michael O'Leary was tapped to turn around Ryanair, an unprofitable, high-cost, traditional airline. The airline had been pursuing a strategy of advertising prices somewhat lower than those of Ireland's flagship carrier, Aer Lingus. O'Leary realized that success depended not on being 10% cheaper but on being 80% to 90% cheaper, and he believed that was possible only if Ryanair transformed itself. O'Leary made several tough decisions to convert Ryanair into one of Europe's leading low-cost airlines. He replaced the entire fleet, which comprised 14 types of planes, with a fleet of Boeing 737s. Rather than operating out of secondary airports, Ryanair started operating from secondary cities, such as Torp, 65 miles from Oslo; Charleroi, 37 miles from Brussels; and Beauvais, 35 miles from Paris. In addition to charging lower fees, some of these airports also paid Ryanair to fly into them. At O'Leary's prompting, Ryanair stopped accepting bookings through travel agents and moved to direct bookings, at first through call centers and later over the Internet.

The airline took several other steps to remake itself. It eliminated business class to concentrate on economy class and leisure customers. It stopped serving free meals and beverages on flights, instead making them available for purchase – a move that allowed the airline to reduce the number of attendants on each flight from five to two. Ryanair eliminated seat assignments to speed up boarding and stopped carrying cargo, which reduced aircraft turnaround times from 45 minutes to 25 minutes. It also simplified ground services, developed extensive guidelines for maintenance services, and outsourced both. At present, Ryanair operates 103 aircraft and flies more than 300 routes from 15 European bases. In 2005, the airline had, at 90%, the highest on-time rate of all European airlines, lost the fewest bags, and had the fewest cancellations. In the 12 months that ended March 31, 2006, Ryanair flew 35 million passengers – up 26% over the previous year. Its revenues, at \$2.1 billion, were 28% higher than the previous year's and generated an after-tax profit of \$387 million. Importantly, Ryanair cut costs (excluding fuel costs) by 6% in 2005–2006, showing that O'Leary is still working his low-cost magic.

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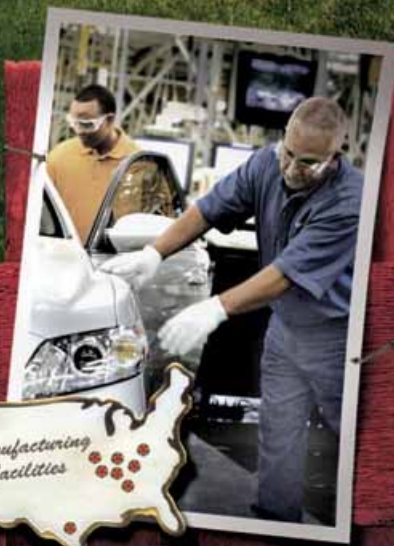
Low-cost players will continue to mushroom, and some will succeed. However, there will always be two kinds of consumers: those who buy on the basis of price and those who are partial to value. Therefore, there will always be room for both low-cost players and value-added businesses. How much room each will have depends not only on the industry and customers' preferences, but also on the strategies traditional businesses deploy. If incumbents don't take on low-cost rivals quickly and effectively, they can blame no one for their failure but themselves. ▢

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A group of cutting-edge manufacturers in northern Italy interpret items for the home, like lamps and teakettles, in ways that initially confound consumers and then convert them. The result is high growth rates and long product lives.

Innovating Through DESIGN

by Roberto Verganti

EVERYONE BY NOW HAS SEEN the whimsical cone-shaped kettle with the little plastic birdie affixed to its spout, designed by the architect Michael Graves. Since its introduction in 1985 by Alessi, the northern-Italian home-furnishings manufacturer, approximately 1.5 million units of what is, as kettles go, an expensive item have been sold.

The success of model 9093 attracted the attention of Target, a retailer known for offering sophisticated designs at popular prices, which in 1999 invited Graves to design a new line of products, including a knockoff of the bird kettle. It is a testament to the mystique of the original that Alessi continues to sell large numbers of model 9093 – for five times the price of Target’s version. Since both original and knockoff were, unusually, designed by

ORLANDO HOETZEL



the same person, the critical variable would appear to be Alessi itself. Although Target's marketing has turned Graves into a design icon, an influential consumer segment seems to prize model 9093 for qualities that happen to pervade all of Alessi's products and those of its peers. The products' originality, aura, and prestige are the outcome of a process that is based in Milan but embraces participants and notions far beyond it. Indeed, the process transcends the discipline of design. What Alessi and its local brethren have devised is nothing less than an engine of innovation. What's more, although Milan is famous as a center of fashion and high style, the maestros of this process are executives, not artists or artisans. Thus any kind of consumer-goods company, located almost anywhere in the world, could adopt the process.

Alessi, the lighting manufacturers Flos and Artemide, the furniture maker Kartell, and many other northern Italian firms make up the Lombardy design discourse, a loose collection of home-furnishings companies that create highly marketable products with distinctive design profiles. These companies do not follow either of the design industry's norms: "tech push," whereby an improvement in performance and functionality dictates a modification in design, or "market pull," whereby the design accommodates consumers' demand for new features or an up-to-date look. Nor do they resort to the open-innovation techniques for which IBM, Procter & Gamble, and Eli Lilly, for example, have become known. That is, they don't rely on an anonymous horde of code writers or the equivalent to perfect an existing product; they don't in-license the patented discoveries of unaffiliated businesses or inventors; and they don't out-license their own discoveries to generate revenues with minimal effort, or to elicit a third party's better-informed reading of the discoveries' marketability so as to spur their own development efforts.

The Lombardy firms' R&D operation, for the most part, can be found neither inside the companies nor in interactions among them. Rather, it comprises a free-floating community of architects, suppliers, photographers, critics, curators, publishers, and craftsmen, among many other categories of professionals, as well as the expected artists and designers. The members of the community are prized as much for their immersion in a discourse as for their originality. In other words, long before any thought is given to the form an item will eventually take, its role, identity, and meaning have been thoroughly explored. Usually the products that at long last result from this

Roberto Verganti (roberto.verganti@polimi.it) is a professor of management of innovation at Politecnico di Milano in Italy, where he teaches in the school of management and the school of design. This article is based on research he conducted that won the *Compasso d'Oro*, Italy's most prestigious design award.

process point toward some new way of living – one that members of the community may already have started to embrace. Because the process is the sociological equivalent of basic research, most of the products it gives birth to represent a dramatic break from their predecessors. In this they differ from products that result when a company in effect outsources the R&D phase to a design studio like IDEO, which explores consumer needs by asking consumers directly what they want and by observing their behavior. In addition, products that are radically innovative *allo Milano* tend to have longer commercial lives than other goods; they create in consumers bolder expectations for the brand and high receptivity to their equally startling successors; and they tend to enjoy especially high margins, because they are so dissimilar to the offerings of competitors (see the exhibit "The Design Cluster Advantage").

Model 9093 may not be the most radical exemplar of what might be called "design-driven innovation," but it's one of the easiest to grasp. Earlier kettles came in various shapes and sizes, but their purpose was, almost without exception, utilitarian. Consequently, their form followed their function (to boil water) – the first precept of modern design. Sensing from his interactions with the Lombardy research community a new spirit of playfulness that reflected a growing disillusionment with modernism's severity, Alessi's CEO and managing director, Alberto Alessi, contacted Graves, a professor of architecture at Princeton, who at that point had never worked on a consumer product but had designed a few notoriously post-modern buildings in the United States (their surfaces were decorative and referred to earlier architectural idioms – modernist taboos).

Although undeniably clever in its synthesis of pop art and art deco references, model 9093 showed its greatest originality in broadening people's expectations of what a kettle was and did and, indeed, the nature of the breakfast experience. This broadening reflected years of discussion and generations of design concepts preceding Graves's realization of model 9093. Far from being an annoyance or merely a signal, the birdlike whistle the kettle emits draws its owners to the breakfast table as powerfully as the aroma of freshly brewed coffee. The little plastic bird visually confirms that beckoning sound, and the delightfulness of the kettle's shape is its own reward. According to an interview he gave *BusinessWeek.com*, Graves once received a postcard from a French poet, who wrote, "I'm always very grumpy when I get up in the morning. But when I get up now, I put the teakettle on, and when it starts to sing it makes me smile – goddamn you!"

A product called Bookworm represents, perhaps, a more fundamental reconceptualization of a traditional object – in this case, a bookshelf. Made by Kartell, which is known for its plastic furniture, including the transparent Louis XIV "ghost" chair, Bookworm is a long, nar-

row band constructed of colored polyvinyl chloride, traditionally a semi-rigid material but here having the flexibility of a sheet of stainless steel, which allows the purchaser to bend it into a sinuous shape of his liking and affix it in that shape to the wall. This bookworm is not studious: It can't hold as many books as its right-angled counterparts. And it is not shy: It outshines the books that it ostensibly exists to support. It was the ingenuity of local mold and chemical manufacturers interacting with Kartell's founder and honorary chairman, Giulio Castelli, a chemical engineer by training; his successor, Claudio Luti; and Ron Arad, an Israeli designer, that turned what had always been a background fixture into an intriguing and somewhat impractical main event.

As model 9093 and Bookworm suggest, one needn't be artistic to contribute to such a design process. Alberto Alessi is a lawyer by training, as is Luca Cordero di Montezemolo, the chairman of the holding company of furniture makers Cassina and Poltrona Frau. Ernesto Gismondi, the chairman of Artemide, is an aerospace engineer. Luti's background is in economics. Nor does one need to be Italian. In addition to Arad and Graves, the Lombardy designers include Philippe Starck, who is French; Richard Sapper (the Alessi designer who first experimented with kettle whistles), who is German; Ettore Sottsass, who is half Austrian; and many others.

Thus innovation, Milan style, combines aspects of the local and the global, another of its key features. While physical proximity is indispensable to establishing a close rapport among people in different companies and disciplines, they are included in the design discourse precisely because they are alert to distant cultural and social currents. Even so, they benefit from an admixture of foreigners based elsewhere who are enticed to participate by the richness of the local community's interactions (see the sidebar "The Experience for Designers").

Though the Milanese approach to innovation remains unique (if only because its management practices have never been written about), aspects of it are already alive



Michael Graves's teakettle for Alessi showed its greatest originality in broadening people's expectations of what a kettle was and did and, indeed, the nature of the breakfast experience.

in other countries and regions. In the United States, a familiar example of how a change in one's understanding of a product's meaning can lead to a change in its design, and ultimately a change in its identity, is the iMac, the creation of Jonathan Ive—a bathroom designer before he joined Apple, where he is now the president of industrial design. Ive and Steve Jobs challenged the received view of PCs as chiefly office products. By wrapping the iMac in friendly, translucent colors and ovoid

forms, Apple declared it to be an appliance for the home. The message contained in the design hastened a transformation in how the public understood the device. The presence of the iMac in home offices then began to alter homeowners' sense of the appropriateness of the objects surrounding it—lighting, furniture, carpets, and so forth—each of which might need to be redesigned in turn.

The repercussions of a shift in an object's design and meaning explain in part why the Lombardy group shows a special preference for architects, who, after all, are in the business of creating environments. Architects also know that most buildings will outlive the tenancy of their present owners, which compels them to envision the way of life of future generations who will take up residence there.

But can such design communities be found anywhere but Milan? Yes: Design clusters exist, for example, in

Finland, London, Sweden, Denmark, Catalonia, and the Rhone-Alps region of France. Helsinki has many small design studios, several associations of designers, a design museum, a university of art and design, and research centers focused on design and heavily underwritten by Nokia, which understands that a key aspect of its mobile phones' appeal is their look and feel. Nokia realized that their small size had turned them into personal accessories, akin to key chains and wallets, thus obliging them to appeal to their owners in an intimate and emotional way. Since the mobile phone is the global device par excellence, connecting its user to foreign people and places, Nokia is sponsoring a student project to look into how product design might be able to express the local cultures of Estonia, Israel, Brazil, and several other countries.

In a study I conducted for the government of Lombardy of the design clusters mentioned above, 26 international design experts agreed that the components of the design system – schools, studios, manufacturers, and so forth – were not significantly better in Lombardy than elsewhere. What did distinguish the region was the number and strength of the links between these components and the quality of the interactions among them. In short, it needn't be a lack of resources that keeps a cluster from forming. The factors that make Lombardy the envy of the other localities are imagination and motivation, which are within the capacities of any group of businesses, whether they be in Toledo, Ohio, or Ljubljana, Slovenia. The eight years I spent studying the inner workings of these firms – from executive decision making to talent management to industrial processes – have convinced me that scores of design systems are just waiting to be ignited.

The Birth of a Product

At roughly the time Michael Graves was just a twinkle in Alberto Alessi's eye, Ettore Sottsass, then in his sixties, started a collective called Memphis with designers less than half his age. An architect by training, Sottsass was born in Austria but based in Milan as a designer at the telecommunications company Olivetti. Memphis cultivated a liking for intense primary colors, balls and triangles resembling children's blocks, the uneasy juxtaposition of cheap materials like plastic with expensive ones like marble, and an irreverent attitude toward what was then considered immaculate good taste. These preferences expressed the upending of norms in the wake of the youth movements of the 1960s and 1970s – in particular, a rejection of the machine and its connotations and imagery, including boxy forms, antiseptic surfaces of ex-

posed metal and white, and evidence of an object's industrial origins. They also represented the conflation of high and low art, luxury and simplicity, into a general democratization of taste. The shapes, colors, and materials Memphis proposed were lighthearted and playful and thus meant to make an emotional rather than a rational, utilitarian appeal to the consumer – a commonplace today, but a novelty two decades ago.

The rise of Memphis inaugurated what was to become a three-phase process of design-driven innovation, which culminated in model 9093.

Phase 1: Absorb. Although far in advance of contemporary fashion, Memphis captured the attention of local entrepreneurs, who understood it to be a genuine research laboratory that could later inform their own innovation efforts. In fact, Artemide's chairman, Ernesto Gismondi, helped subsidize it, while leaving its members free, in his words, "to do what they wanted."

The entrepreneurs met a few times a year to discuss trends, styles, materials, and technology, and gathered at

The factors that make Lombardy enviable are imagination and motivation, which are within the capacities of any group of businesses, whether they be in Toledo, Ohio, or Ljubljana, Slovenia.

exhibitions they jointly sponsored. They also founded an avant-garde design journal in whose pages the future of design was vigorously debated. Though their companies belonged to several different industries, all their product lines revolved around the home.

Drawing on these discussions, Alberto Alessi recognized that a sharply new design language was needed for his company's kitchenware, and he believed that mostly foreign architects who had never designed consumer goods were the ones to invent its vocabulary and grammar. He called the project the Tea and Coffee Piazza and asked a Milanese architect and close friend, Alessandro Mendini, to select ten other architects and coordinate their activities. Mendini's choices included the post-modernists Hans Hollein of Austria and Robert Venturi of the United States as well as Graves. Although Alessi has a rigorous four-dimensional methodology for deciding whether to market a product it has developed, the 11 architects were asked initially to ignore issues of cost and functionality, the company's first two dimensions, and concentrate exclusively on communicativeness and evocativeness, the second two. Once they had received general direction from Alessi, the 11 worked independently. In contrast to the IDEO process, there was no brainstorming by multidisciplinary teams.

Alberto Alessi had an ulterior motive: to discover the next wave of talent in product design. As he says, “It is easy to make a list of the top ten designers of the past ten years. But I’m virtually certain that fewer than half of them will be among the top ten designers of the next ten years. By then, their language won’t be novel anymore, or will be widely imitated. Also, their interest and vitality may fade. Sometimes, too, they are spoiled by success.”

Phase 2: Interpret. Alessi knew that before groundbreaking products could be presented to the public, the ground itself had to be prepared, else the public, which had not been consulted about what kinds of products it wanted, would not know how to make sense of them. He took the following steps:

- The 11 coffee and tea service prototypes the architects produced were exhibited at the San Francisco Museum of Modern Art and the Smithsonian and in other cultural settings.
- They were produced in limited editions of 99 pieces and sold to museums and influential collectors for \$25,000 each.
- Alessi prepared a book about the prototypes and distributed it to the extended design community.
- A traveling exhibit of the prototypes was shown in high-end department stores around the world.
- The press in Italy and abroad was invited to write about the exhibits and the project.

Alessi closely followed the reactions of design aficionados to the prototypes. An incidental benefit of publicizing them and the concepts behind them before an actual product existed was to ensure that the public would forever associate them with the Alessi brand and would view any related development by others as an imitation.

Among the 11 architects, Graves was one of only two who were invited to turn their concepts into cost-effective and functional commercial products. Model 9093 was then rated on Alessi’s four dimensions. Its broad base, which facilitated rapid heating; its visible rivets, which recalled a kind of vintage artisanship; its superimposed plastic handle in cool blue, which was decorative as well as heat-resistant; and its little bird, which flew in the face of modernism’s insistence on abstract form, earned it the highest rating in Alessi’s history. Because of the company’s success with Sapper’s model 9091 kettle, which emits two low, harmonizing whistles evoking ships passing in the night, a whistle was one specification imposed on Graves. Alessi also wanted the bird to be removable, so that the kettle could feature a spout instead of a hole, and he wanted a lower cost of fabrication and a faster boil.

Phase 3: Address. Shortly before and then after model 9093 was launched, Alessi organized another round of exhibitions and publicity. Because advertising is not the ideal explanatory medium, little of it was done. The members of the design discourse, by continuing to talk and write about the kettle’s role and meaning, disseminated

The Design Cluster Advantage

The growth and revenue of seven exemplars of design-driven innovation are listed below. That four of the seven are furniture manufacturers is unsurprising, given that about a quarter of all Italian furniture firms are based in Lombardy, and that Italy is Europe’s largest furniture manufacturer, with 45% of its output exported. Those four—and the design cluster as a whole—surpassed the growth rates of the furniture industry in both Italy and the European Union in the ten years from 1994 to 2003. Also participating in the Lombardy discourse are dozens if not hundreds of smaller companies, including Luceplan and FontanaArte (lighting), Zanotta and Driade (furniture), and Boffi (kitchen fittings).

Financial Performance of Leading Companies in the Lombardy Design Cluster

	Ten-Year Growth (1994–2003)	Revenue (2003, U.S. \$)
Alessi <i>home furnishings</i>	81%	\$104 million
Artemide <i>lighting</i>	59%	\$110 million
◆ B&B Italia <i>furniture</i>	54%	\$165 million
◆ Cappellini <i>furniture</i>	117%	\$29 million
◆ Cassina* <i>furniture</i>	60%	\$163 million
Flos <i>lighting</i>	106%	\$75 million
◆ Kartell <i>furniture</i>	211%	\$70 million

* estimated on the basis of data for the years 2000–2003

TOTAL	76%¹	\$716 million
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Furniture Industry Performance

	Ten-Year Growth (1994–2003)	Revenue (2003, U.S. \$)
EU	11%	\$78 billion
Italy	28%	\$21 billion
◆ Design Cluster 4	75% ¹	\$427 million

1. Average growth weighted by revenue

knowledge of the product to a wider audience. In the end, they acted as amplifiers of a message they had helped to construct. Nowadays, many of the Lombardy companies maintain their own retail outlets as a way of controlling presentation and underlining the traits their products have in common. When third-party retailers carry them, often items of the same brand will be found grouped together in their own showcase, for the same reasons. And, unlike an Armani jacket or a Gucci handbag, these products come with literature elaborating on how they came into existence and the qualities that make them special.

After the Kettle

Alessi initiates a project like the Tea and Coffee Piazza every eight or ten years. Its successor was called Family Follows Fiction. Moving from Sottsass's and Graves's insights to Franco Fornari's theories on the affective impact of form, especially with respect to objects that evoke childhood pleasures and sensations (birds, building blocks, toys, and what psychologists call "transitional" objects, such as security blankets), Alessi in the early 1990s asked a different group of architects, almost all Italians this time, to design objects for grownups that would directly appeal to their impulse to invest possessions with personal meaning. Typically these would be palm-size objects, such as Stefano Giovannoni's nutcracker in the shape of a squirrel and Alessandro Mendini's "dancing" Anna G. corkscrew, with its twisting head and arm-like levers.

Worried that the ideas underlying the items generated by the Tea and Coffee Piazza had become too familiar after being copied by other companies, Alessi launched a new project called Tea and Coffee Towers in 2001. In this case, about 20 architects were enlisted, including three Japanese and one Chinese. Alessi expects computer-assisted design to inspire new forms. He says, "These architects know how to use the computer like a pencil. They are so good with the PC that the design comes directly from the heart, just as a traditional designer's pencil is directly linked to the heart. This permits the creation of a wealth of shapes never seen before in products." Seven of these architects are now at work developing items for consumers, many of whom await them with the anticipation they might feel about the next movie from their favorite director.

Companies that are part of the Lombardy design discourse also partner with large companies that are not. For example, Alessi and the electronics company Philips in 1994 launched a line of appli-

ances such as espresso machines and toasters. According to the chief creative director of Philips Design, the focus of the partnership was to provide consumers with sensory and aesthetic experiences and personal comfort rather than improved functionality. Philips and Artemide together conducted a series of workshops to investigate the affective impact of shifting colored light. Philips has recently released a flat-screen TV with Ambilight, which emanates from the rear of the TV and changes color and intensity in tandem with the images on the screen.

In 1996, Artemide had invented a lamp it called *Metamorfosi*—probably the best proof of my contention that the Lombardy group's inquiries into the changing meanings of objects are only secondarily about the design they ultimately assume. The lamp—that is, the object itself, as opposed to the light it emits—isn't even meant to be seen. Composed largely of translucent materials, it exists to produce colored ambient light, which the owner, using a remote-control device, alters according to his or her mood. The impetus for *Metamorfosi*'s development was Artemide's goal, set in the mid-1990s, of conceiving a variety of products that its encroaching global competitors would never think of first. At the time, Gismondi and his managing director for brand strategy and development, Carlotta De Bevilacqua, noticed among their fellow citizens a growing concern with health and achieving peace of mind. The two convened a research team that included five well-known designers and a professor of design and that was led by a medical doctor who was also a psychiatrist. Their mission was to investigate the biological, psychological, and cultural dimensions of light. After the in-house R&D department perfected the technology, the team moved on to designing the object, whose whole purpose was to generate a light that would produce a sense of well-being in the user. As Alessi

had done with model 9093, Artemide arranged exhibitions and publications to accompany *Metamorfosi*'s introduction. The debut of the Ambilight TV and the marketing muscle behind it, the company found, helped broaden public receptivity to Artemide's older, more specialized product.

Can It Happen Here?

Some may think that such a design process can flourish only in surroundings as visually sophisticated and culturally rich as Milan and its hinterlands. In fact, the potential for a design discourse exists everywhere. Let's take one unpromising candidate: the Finger Lakes region of upstate New York, well over 200 miles northwest of New York

For more information

on the design process as practiced by some members of the Lombardy group, visit:

www.alessi.com
(especially Community/Centro Studi Alessi and Officina Alessi)

www.artemide.com
(especially Publications)

www.kartell.it
(especially the Kartell Museum)

Information about La Triennale, a cultural center for architecture and design in Milan, can be found at www.triennale.it.

Domus, a magazine of Italian architecture, can be found at www.domusweb.it.

City and culturally no more connected to that metropolis than western Pennsylvania. Upstate New York as a whole has a high rate of unemployment and one of the slowest-growing economies in the United States. (Job growth from 1990 to 2003 was only 2.3%, and nearly a third of the region's new residents were prisoners.) But it has the raw material for a design discourse.

Rochester, the largest city in the Finger Lakes region, with a population of 212,000, was once the headquarters of Xerox and the Gannett newspaper chain. It remains the headquarters of Bausch & Lomb, the lens manufacturer, and Eastman Kodak. The fiber-optics maker Corning is based in a nearby town of the same name. Smaller local companies manufacture high-speed digital equipment and do custom printing. The city is also home to the Center for Electronic Imaging Systems, a New York State-funded center for advanced technology that involves a collaboration among Xerox; Kodak; the University of Rochester, a medium-size research institution with excellent professional schools (including its engineering school, which has an institute of optics); and the Rochester Institute of Technology, one of the world's premier schools of print media. Less than an hour away is Alfred University, which has world-class programs in ceramics and glass sculpture and a division of expanded media, which seeks to promote collaboration among printmakers, designers, video artists, and computer programmers. Cornell, an outstanding research university, is in nearby Ithaca. In June 2006, the Arts and Cultural Council of Greater Rochester held a forum on culture and community renewal.

Indeed, the arts are far from neglected in the Finger Lakes region, which can claim 270 members of the American Institute of Architects, a professional certification body; famous craftsmen such as Wendell Castle and Albert Paley; and a cluster of design studios in Skaneateles, which sits on a lake as serene as Lake Orta, north of Milan, where Alessi is based. Rochester also boasts Eastman House, perhaps the world's preeminent museum of photography, and other fine-arts museums are nearby. So one shouldn't be surprised that Richard Florida, in his book *The Rise of the Creative Class*, rated Rochester the 21st most creative among large cities in the United States and second among large cities in its percentage of "super-creative" people. (According to a joint study by the Progressive Policy Institute and Case Western Reserve University, an average of 2.33 utility patents per 1,000 Rochester workers were issued in the years 1996, 1997, and 1998; the U.S. average was 0.40.)

Despite the region's concentration of optics, imaging, and offset printing, "information sharing has been partial, creating crosstown rivalries rather than a center of the global economy," according to one local manager. Creative collaboration among artists, designers, and manufacturers is almost nonexistent. This is true even within Corning,

The Experience for Designers

Money is not what makes talented designers and others

all over the world want to work with the Lombardy group of home-furnishings companies. Participants are paid nothing. Typically, the designers, who may never before have designed a consumer item, are given only a 3% royalty on any product they develop that is ultimately commercialized. (A designer with experience and a big reputation would surely demand a fee as well as a higher royalty rate.) What they get out of it is access to the most advanced thinking about design from not only visual artists but also scientists, critics, and executives. It is also flattering to be asked to try something for which one has no formal qualifications. The designers appreciate being able to learn from their colleagues and stretch their talents. Piero Gandini, the chairman of the lighting company Flos, explains, "When a designer makes his debut with Flos, we give him carte blanche so that he can express himself to the best of his ability."

What ensues is not the typical supplier-client relationship between designer and company but a true collaboration, characterized by give and take and an open door even to top management. Also, these Italian firms are not afraid of small production lots, which encourages the designers to take chances as they fashion their prototypes. And they can be confident that management will provide a rapid assessment of whatever results.

According to the Israeli designer Ron Arad, "Northern Italy is the center of the design world, above all because of its manufacturing culture. There is no other place in the world where you can find such a vast array of manufacturers who know the value of design." The American designer and architect Michael Graves says, "As a designer you and your people are brought in and treated as a member of a family – it's a very personal relationship between designer and manufacturer. It is what ties everything together." And the French designer Philippe Starck says, "When a project is presented to Claudio Luti of Kartell, to Enrico Astori of Driade, to Piero Gandini of Flos, to Umberto Cassina of Cassina...they love the project, they love it with a passion. When a prototype is taken to Alberto Alessi, he thinks it is Christmas. It is a splendid gift."

which in 1918 acquired Steuben, a maker of art glass that, thanks to Corning's innovations, soon became famous for its purity and clarity. Corning's leadership expected a fruitful exchange between the arts and industry to result. (In researching the Finger Lakes, I stumbled on the fact that Michael Graves himself, in 1989, had designed an item for Steuben.) But despite those hopes, the traffic between Corning and Steuben has been strictly one-way.

According to one Corning scientist, the company does regularly interact with Steuben, but the job of its


scientists is limited to keeping the quality of the glass and its other properties as consistent as possible. Situations sometimes arise in which Corning scientists alter the composition of the glass, but such changes typically meet with protest, because they interfere with the production of the standard goods. It was only a few months ago that Steuben approached Corning about departing from orthodoxy and developing colored glass.

Because it focuses exclusively on materials' functionality, Corning relies on its clients, such as Luxottica, an eyeglass manufacturer, and Samsung, which makes liquid crystal displays for cell phones and flat-screen monitors, to provide specifications for the glass substrates it makes. Those two companies are design-conscious, but their interaction with Corning doesn't reach the degree of collaboration that, for example, Kartell enjoys with Bayer, the German chemical company, which follows sociocultural developments so that it can propose new materials and uses to its clients before its competitors do. The clients, in turn, have come to rely on Bayer for its suggestions.

Yet the possibilities in the Finger Lakes region are evident, even to the people working there. Says one scientist

and manager at Xerox, "In the past, it was rare for local communities such as Kodak, Bausch & Lomb, Corning, Xerox, and a cluster of small firms to collaborate. But collaboration in design-driven innovation could allow each firm to create competitive advantages in its respective industry. Xerox could get inspired by Kodak's camera design and Corning's glass fiber. Who says Xerox could not use transparent glass as a copier's frame? It is artistic, modern, and trendy. It also could serve the functional purpose of providing a clear view of paper-jam locations."

...

There is no such thing as an undesigned object—only an object that is well or poorly designed. Thus every business that scants the design process does so at its peril. Conceived broadly enough, that process can be the source of a stream of products that consumers find delightful, meaningful, and worthy of their loyalty. And because of its openness, the process should also prove to be inexhaustible. 

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To order, see page 165.



"I caught Barclay lip-synching when everyone else was saying yes."



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Leadership Under Fire

by Dov Frohman

It may seem irresponsible to think about business in the middle of war. But your leadership is really tested only when you come under attack.

FOR ME, THE RECENT EVENTS in the Middle East have been a painful reminder of one of the most important lessons for any leader: You don't really know what it's like to run a business until you've had to do it amid the turmoil of war.

In 1991, I was the general manager of Intel's operation in Israel, which at the time was (and still today is) the company's largest unit outside the United States. During the First Gulf War, I faced what was the most difficult test of my entire career: whether to keep Intel Israel up and running during Iraq's Scud missile strikes against Israel or close the operations until the crisis passed.

Of course, many businesses keep functioning during wartime. But in the days before the First Gulf War, Israel confronted what appeared to be an unprecedented threat. The Israeli military

assumed that Iraqi missiles would be carrying chemical weapons. The government distributed gas masks and ordered every household to prepare a special sealed room in case of chemical attack. Most serious from a business point of view, in anticipation of the missile strikes, the Israeli civil defense authority directed all nonessential businesses to close and their employees to remain at home. The radical uncertainty of the situation – not knowing how many missiles would fall, where they would fall, what kind of destruction they would inflict – threatened to bring our business to a halt, even before a single missile had been launched.

It would have been easy to follow the civil defense directive and close down. Everyone was doing it, and we were not part of the war effort. Intel's senior executives in California would have un-

GARY SAWYER



derstood. Many of our employees would probably have appreciated the opportunity to focus on preparing their families for the attacks.

And yet I chose to ignore the government directive, keep our operations open, and ask our employees to continue to come to work. Some people thought I was being irresponsible. What right did I have to risk people's lives in time of war? Others thought I was crazy. What if any of our employees were killed? What if the government took legal action? What if disgruntled employees went to the press?

Despite these risks, I decided to move ahead, and Intel's employees responded. In the first days of the Scud attacks, when businesses throughout the nation were closed, roughly 80% of Intel's employees showed up, day in and day out, night shifts included. Thanks to their

performance, Intel Israel was one of the few businesses in Israel (and our Jerusalem semiconductor fabrication plant the only manufacturing operation) to remain open throughout the entire six weeks of the war. Not only did we keep our commitments to global Intel, we also established the reputation that, over time, would allow us to grow Intel Israel into an important center of excellence for the corporation, Israel's largest private employer, and a cornerstone of Israel's dynamic high-tech economy.

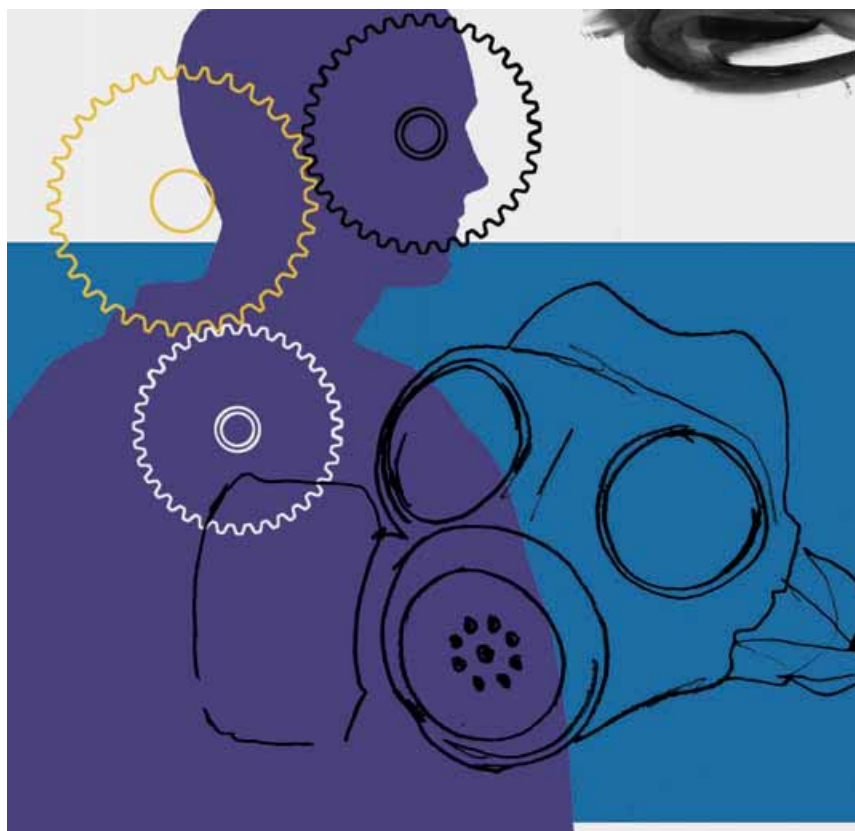
A Different Kind of War

I had left Israel in the early 1960s to get a PhD in electrical engineering at the University of California at Berkeley, but my dream had always been to bring back a new body of knowledge to Israel and help found a new field of innovation and industry. So in 1974, I returned

to set up Intel's first overseas unit, a small chip design center in Haifa. Few people know it, but we designed the microprocessor for the original IBM personal computer. And in 1984, we opened the company's first chip fabrication plant outside the United States, in Jerusalem.

By the early 1990s, Intel Israel was a key outpost of Intel's global production system. The Jerusalem fab was responsible for about three-quarters of the global output of the 386 microprocessor, at the time the company's best-selling product. Meanwhile, our development center in Haifa was hard at work on new products that would be critical to Intel's future, including key components of what would become the Pentium microprocessor.

When Iraq invaded Kuwait in August 1990, we knew there was a good chance



there would be a war. So I appointed a task force of senior managers to develop a contingency plan in case Israel was drawn into the conflict. At the time, we were assuming it would be a conventional war, and we were confident that we could handle it. That kind of war was not exactly new to Israel; we had had plenty of experience with what it would mean for our business during Israel's incursion into Lebanon in 1982. As a result, we made plans for replacing key personnel called up to the military and for operating the plant with a skeleton crew.

But almost from the moment we finalized our contingency plan, it became clear that this war would be very different. The politics of the U.S.-created anti-Iraq coalition made it imperative that Israel stay out of the war. For that very reason, it was in Saddam Hussein's interest to provoke Israel into intervening. By

September, U.S. satellites had detected the transport of ballistic missiles to western Iraq – a mere seven minutes' travel time from Tel Aviv. Israeli defense officials were saying that a chemical attack on the country's major population centers was likely – a belief that prompted them to lease two batteries of Patriot antiaircraft missiles, adapted for use against ballistic missiles, from the United States. Instead of being behind the lines of the war zone, which we were used to, we ran the risk of *being* the war zone.

In October, tensions mounted when the government issued every Israeli a personal protection kit, complete with gas mask and atropine injectors, to combat chemical poisoning. There was something about receiving those kits, being instructed to carry your gas mask with you wherever you went, and having to prepare a sealed room in your

house or apartment that brought the uncertainty and potential danger of the situation home in a palpable way.

By the turn of the year, as the U.S.'s January 15th deadline for Iraqi withdrawal from Kuwait drew near, my disquiet had grown. Many airlines suspended flights to Israel. The governments of the United States and Great Britain advised their nationals to consider leaving the country. Then on Tuesday the 15th itself, the Israeli government announced that all schools would be closed for the rest of the week. Slowly it was dawning on me that our contingency plan might be irrelevant to what was likely to be anything but an ordinary war.

And yet, despite all these warning signs, it still came as a surprise when I woke up on Wednesday, January 16th, to the news on the radio that, in anticipation of the start of hostilities and likely missile attacks, the Israeli civil defense authority was directing businesses to close and everyone but essential emergency personnel to remain home. It was only then that I fully understood: We were facing a completely different kind of problem than the one we had anticipated. This wasn't just a matter of calling up reserves. The government was telling us that *nobody* should come to work. I immediately called a meeting of the task force at the Jerusalem fab.

A Question of Survival

In the 20 minutes it took me to drive from my home in the historic village of Ein Karem, on the southwestern outskirts of Jerusalem, to the plant in the Har Hotzvim industrial district, I kept revisiting in my mind the logic of what I was about to do. It seemed almost irresponsible to be worrying about business in the midst of a potential chemical attack. And yet, if I didn't think about the possible consequences, who would?

One of my core beliefs is that the primary task of a leader is to ensure the survival of the organization. (See the sidebar "Lessons for Leaders in a Crisis.") It's a perspective that I'm sure is heavily influenced by my experience as a very young child during World War II. My

A former general manager of Intel Israel, now retired, and one of the pioneers of Israel's high-tech economy, Dov Frohman is also the inventor of the EPROM, the first reprogrammable computer chip. His book Leadership the Hard Way (written with Robert Howard) will be published by Jossey-Bass in 2008.

parents were Polish Jews who had emigrated before the war to Holland, where I was born in 1939. But after the German invasion of the Low Countries, they were taken and eventually killed by the Nazis. I survived only because the Dutch underground placed me with a devout Christian family in the Dutch countryside who hid me for the duration of the war. In retrospect, I can see how this experience inculcated in me a stubborn conviction that survival must never be taken for granted – and also that the actions of determined individuals can have a truly heroic impact on events.

My vision for Intel Israel had always emphasized survival in a highly volatile industry and region. As I used to put it, I wanted to create an organization that would be the last to close in a crisis. To be honest, many Intel Israel employees, including some of my direct reports, didn't much like this vision. They thought it was too negative. "Is that the best we can do," they would ask, "just

avoid being closed down?" So eventually, we came up with a simple slogan: "Survival through success."

I was convinced that a complete shut-down of our operations threatened both the success and the survival of Intel Israel. Managing a major unit in a global corporation is a continual fight for resources. When we first proposed setting up the Jerusalem fab in the early 1980s, we were put in competition with Ireland to see which country could develop the better proposal. We won that round and by the early '90s were already starting the process of negotiating and lobbying inside Intel to persuade senior management to expand the Jerusalem fab.

I knew Intel's leaders well and had good relations with them. I had worked with Andy Grove at Fairchild and been among the first generation of employees after he, Gordon Moore, and Bob Noyce founded Intel in 1968. I was confident that if we had to interrupt production due to the war, executives in Santa Clara

would understand. I wasn't worried that there would be a negative impact in the short term.

But as Intel grew larger, decision making became more decentralized. The key stumbling block to further investment in Israel was the lingering impression of geopolitical instability in the region. Indeed, we had already had a number of struggles inside the company over the transfer of strategic technologies and critical products to the Israeli operation. Therefore, I was convinced that if we had to interrupt production, even for a brief period of time, we would pay a serious price over the long term.

I had had a glimpse of the risks during a phone conversation with Intel's then-executive vice president, Craig Barrett, in September. Barrett was on a stopover in Amsterdam on his way to Israel for a routine annual operations review. But he called to tell me that he was considering canceling the trip. "Grove is worried about my coming to Israel," he told me, referring to the company's

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then CEO. “He thinks it’s too dangerous.” While I convinced him it was safe and he came, the call provoked a twinge in my gut. If Intel’s senior executives were seeing Israel as unsafe, what would that mean for our business? My concern wasn’t only for the survival of Intel Israel. It was also for the survival of Israel’s emerging high-tech sector. Intel Israel was a key anchor of Israel’s still small high-tech economy. If we couldn’t operate in an emergency situation, the trust of multinationals and venture capitalists in the stability of the Israeli business environment might crumble.

It’s another of my core leadership beliefs that “when in crisis, you go against the current.” When the going gets tough, genuine leadership means

The fact is, we had thought about applying for it in the past but just never got around to it. It had been pushed aside by more immediate and, at the time, more pressing concerns. And even if we applied for this essential-industry status right away, under the current circumstances who knew how long it would take to receive it? We decided we were going to act as if we already had it until we heard otherwise.

For three hours, we discussed the full range of risks that remaining open entailed. The main risk, obviously, was the potential injury to any of our employees on their way to and from work. People had sealed rooms at home, and we had created them in all our main facilities, including the Jerusalem fab. But what about the daily commute? This was

I made it extremely clear to my direct reports that there would be no coercion: No manager was to pressure employees to come to work who did not want to.

This prohibition was especially important to me – and not just for ethical reasons. The problem with coercion is that it often leads to backlash, creating the very resistance that it is meant to overcome. When you order people to do something, their first reaction is often, “Wait a minute, if they have to force me, there must be a problem with the whole thing.” I knew that I couldn’t control every single action of all my managers, but I could make it clear that there would be no direct pressure. “Let the culture do its work,” I advised.

We would also make it clear that keeping Intel Israel open for business was critical to the future success not only of the organization but also of Israel’s high-tech economy. I believed strongly that the only way I could expect Israelis to take a risk was if doing so was critical to the country, not just to the company.

We communicated our decision to the workforce on Wednesday afternoon. On the following day, with still no sign of missile attacks, turnout was relatively normal. But that Thursday, January 17th, was also the start of the allied bombardment of Iraq. What only one day earlier had seemed like a theoretical possibility would very quickly become reality.

The First Attack

At 2:00 in the morning of Friday, January 18th, I was awakened by the sound of an air-raid siren. I joined my wife and teenage children in the sealed room of our Jerusalem home and listened to the radio for the news. Eight missiles had landed in Tel Aviv and Haifa; as far as the authorities could tell, there were no chemical warheads. I got on the phone to the members of the task force and told them to meet me again at the plant. I grabbed my gas mask and headed out for the Jerusalem fab.

When I arrived at the fab at around 3:30, work in the clean room had al-

If it was safe enough for employees at the phone company to travel to work, there was no reason why we shouldn’t risk it as well.

making hard choices, doing the unexpected – and, sometimes, the seemingly impossible – even in the face of opposition. So as I drove to the task force meeting, I formulated what I saw then as an against-the-current decision to assure the company’s survival: We would ignore the civil defense directive. I was going to ask our people to come to work.

Back to the Drawing Board

“This is a completely different situation,” I said at the start of the task force meeting, “so let’s think differently.” The first thing we did was to throw out our contingency plan. The next was to ask how we could keep the operations going despite the civil defense directive.

In Israel, there is an official category of businesses that are designated essential parts of the nation’s economic infrastructure. In times of emergency, sectors such as utilities, defense contractors, and the national telecommunications network are allowed to continue to operate. But we didn’t have that legal status.

complicated by the fact that we had a contract with a private transportation company to bring our employees to work at the Jerusalem fab (a typical arrangement at most large Israeli companies), so if we were going to remain open, not only our own employees but also the transport company’s employees would be at risk. I weighed the physical risk to our workers and contractors heavily, but in the end concluded that if it was safe enough for employees at the utility company and the phone company to travel to work, there was absolutely no reason why we shouldn’t risk it as well.

At the Wednesday task force meeting, there were few objections to the idea of remaining open. To be honest, the whole prospect of missile attacks seemed so theoretical as to be literally impossible to imagine, almost unreal. In the end, we decided that we would issue a “call” for Intel employees to continue to come to work – a recommendation, not an order. No one would be punished if they decided to stay home.

ready resumed. At the sound of the alarm, the employees had evacuated to the sealed room, except for a few who had agreed to stay behind to man some etching machines that needed continuous tending to keep the flow of materials going. After the report that the missiles had landed, employees were given the opportunity to call home before returning to the clean room. Things were tense, but relatively normal.

When the task force convened half an hour later, we reaffirmed the decision to call people to work. Managers had to be contacted and instructed what to say to their staffs. Employees had to be called and told that the plant would indeed be open. The transportation company needed to devise alternate routes to get around police roadblocks. In the chaos of a crisis situation, clear communications are especially important. So we spent the bulk of our time planning exactly what to say to our workforce and coordinating our communications with our counterparts at Intel in the United States, who would be wondering what impact the missile attack was having on our operations.

Some 75% of the employees on the 7:00 AM shift made it to the plant. Although I hadn't told anyone, I had been expecting maybe 50%. The relatively high turnout was a major endorsement of our decision.

That night, after being at the plant for nearly 16 hours straight, I called Intel senior executives in Santa Clara. I stayed at the plant because I didn't want to call them from my home. I had no idea what their reaction was going to be, and I wanted them to see that Intel Israel was operating as normal—or as close to normal as possible under the circumstances. I explained that we had decided to remain open, but we weren't forcing any employees to come to work who didn't feel comfortable doing so, and that so far turnout was quite good. They asked a lot of questions; we discussed the potential risks. But in the end, they were 7,500 miles away. Under the circumstances, they simply had to trust us.

“Scud Business as Usual”

The second Scud attack came early on Saturday. No one was killed, but some people were injured. Intel's employees in Jerusalem kept coming to work. And when the design center in Haifa opened on Sunday (the first day of the normal Israeli workweek), turnout was up to 80%.

After the first few days, we entered a period that I took to calling “Scud business as usual.” Attacks continued to happen. On Tuesday night, for example, after two days with no Scuds, there was an attack outside Tel Aviv that led to the deaths of four people, wounded 96, and left hundreds homeless. But we carried on as if everything were normal, and no one tried to stop us. By the mid-

dle of the week, the civil defense authority was urging all Israelis to go back to work, so the fact that we were open for business was no longer so unusual. Still, because the schools stayed closed, absenteeism at most businesses remained high. The stress was enormous, and I and my team did all we could to boost employee morale. (See the sidebar “Intel's Wartime Kindergarten.”)

As our actions on the night of the first attack suggest, constant communication was essential. The task force met daily to assess the rapidly changing situation and plan our communications for the day. We used every means we could—phone, e-mail, on-site meetings, face-to-face conversations—to keep our

Lessons for Leaders in a Crisis

My experience in the Gulf War taught me a lot about responding to crisis situations. Many of the lessons were specific to our company and the kind of crisis we faced, but if I had to draw any general lessons, I guess I would say that in making decisions during a crisis you need to keep just three big rules in mind:

Focus on long-term survival. When you are under an attack of the kind we faced, the easy option is to close down, and in some cases that's the right thing to do. What you need to think about, though, are the long-term consequences. For Intel Israel, shutting down would have sent a signal that I agreed with those who thought Israel was a dangerous place to invest in. Over time, employees could have paid for the closure with their jobs, to the detriment of the organization and the country as a whole. I think that many of the employees who criticized my decision to stay open in the early days of the war would have regretted a closure far more.

Go against the current. Sometimes, the best way to survive a crisis is to do exactly the opposite of what people expect. Doing the unexpected has a galvanizing effect. It shakes people out of their passivity and helps mobilize them to action. At Intel Israel, our bias for going against the current made it natural to decide to remain open even though most businesses in Israel suspended operations. It was the perfect antidote to terror.

Trust your instincts. When it comes to leading in a crisis, good instincts are more important than good planning. The problem with chaotic situations like war is not so much that you can't anticipate everything. It's that you can't really anticipate *anything*. All you can do is trust your instincts, embrace the chaos, and then deal with the consequences as they emerge. For instance, we spent a lot of time and energy during the crisis trying to anticipate the legal ramifications of disobeying the government's instruction to close down. Imagine my surprise when I learned, weeks after the attacks began, that the civil defense directive to stay home from work only had the status of a recommendation, not a legally binding order. At the time, most people, ourselves included, had assumed exactly the opposite. So our decision to keep operations open was, from a legal point of view, not so risky after all.

employees informed of the latest developments. I was traveling continually between the three Intel sites in Israel—the fab in Jerusalem, the design center in Haifa, and our small sales and marketing operation in Tel Aviv—to meet with managers and employees in cafeterias and on production lines. I felt it was essential that I, as the organization’s leader, be present to employees “in the flesh.”

We also took great care in our communications to global Intel to keep senior executives informed of the developments on the ground in Israel. After the first few days of attacks, I sent a comprehensive e-mail to Intel senior management describing how we were meeting the “war challenge” and delivering on our commitments to the corporation. Andy Grove sent us an extremely supportive letter in response, which I had posted on bulletin boards throughout the organization. His strong public en-

dorsement had an enormous positive impact on employee morale.

Today, the decision to continue with business as usual doesn’t seem so radical. At the time, however, it was pretty controversial. In the white heat of the first few days of crisis, everybody operated on instinct. People were so busy that they barely had time to think. But once things settled down into “Scud business as usual,” some doubts and questions began to emerge.

Some saw the decision to remain open as an act of courageous leadership, but others viewed it as an unnecessary risk, literally playing with the lives of employees. Some wondered how we could justify risking people’s lives for a company that wasn’t even Israeli. Relatively few people actually refused to come to work, but many were bitter for quite a while. And one individual, who did refuse to come to work – and not only during the first week but also

in subsequent weeks, after the civil defense directive had been withdrawn – had to be let go.

But these complaints never really coalesced into full-fledged opposition to the decision. For one thing, whatever doubts some people had, there was the basic fact that the vast majority of employees did actually show up. Indeed, in the years since the war, I have often wondered why so many answered the call. Partly, I suspect, it was because coming to work was a welcome alternative to the psychological paralysis brought about first by the prospect, and then by the reality, of the missile strikes. Another part of it, I think, was that the call didn’t come in a vacuum. We had been talking for years about survival through success and the need to do whatever it takes to be the best. So while not everyone may have agreed with the decision to keep operations open, most understood why we were doing it and trusted that we had the best interests of the people and the organization at heart.

For me, one story in particular captures the way the organization rose to the occasion. A team from the Haifa development center was on a conference call with its U.S. counterpart when the alarm signaling a Scud attack began to sound. To the amazement of their U.S. colleagues, team members calmly asked for a brief interruption in the meeting so they could move to the site’s sealed room, located in the computer center, and then resumed the call a few minutes later as if nothing had happened.

After the War

The last Scud attack took place on February 25th, about six weeks after the bombardment of Iraq had begun and one day after the start of the ground war. On Thursday, February 28th, the Israeli state of emergency officially ended. All told, 39 Scuds in 18 separate attacks landed on Israeli territory, none carrying chemical warheads. Although only one person was killed directly by an attack, 74 people died of indirect causes—from heart attacks brought on by the missile strikes, for example, or by suffocation due to improper use of protective gear.

Intel’s Wartime Kindergarten

Keeping Intel Israel open during the crisis certainly presented some unanticipated challenges. One issue that I had seriously underestimated was the impact of my decision on our employees’ families.

To her credit, my head of human resources had raised this issue. The only woman on the task force and a mother, she was sensitive to the implications of our decision for our female workforce (about half of the employees in the Jerusalem fab were women). “Can we really ask mothers to be separated from their children during the threat of missile attacks?” I remember her asking at the task force meeting when we decided to remain open.

At the time, I didn’t exactly dismiss her question. But in the total scheme of things, dealing with the family fallout was not my highest priority. I felt that such separations were inevitable in an environment where the “front” was potentially everywhere.

Her concerns, however, turned out to be prescient. A few days into the attacks, a manager at the Jerusalem fab reported that the lobby was crawling with young children. Some of our employees, especially women, were bringing their kids to work. After all, the schools were still closed, and, just as my HR head had predicted, people didn’t want to be separated from their children in case of an attack.

The organization responded by temporarily entering the education business. Local managers in Jerusalem set up a kindergarten in a support building of the fab. It had never occurred to anybody on the task force (including my HR head) that establishing a kindergarten for employees’ children might be a good thing to do. But once faced with the fact that concerned parents were bringing their children to work, it was an obvious step to take. Throughout the Scud attacks, as many as 50 children were in the school on any given day.

More than 200 were wounded by blasts, flying glass, and shrapnel. Property damage to 4,000 buildings was in the millions of dollars. And 1,600 families had to be evacuated.¹

The war had indirect economic costs as well. According to the Israeli Ministry of Finance, industrial output during the war was at about 75% of its normal level. The costs to the Israeli economy in lost output totaled approximately \$3 billion.

At Intel Israel, we were extremely fortunate. None of the Scuds landed in the Jerusalem area, where most of our people worked. No Intel employee or family member was injured or rendered homeless by the attacks. And in terms of the economic impact, both the Jerusalem fab and the Haifa development center were able to meet all of their manufacturing and product development commitments.

Looking back, I realize that the decision to keep Intel Israel up and running during the First Gulf War was not as

dramatic as it seemed at the time. And yet, to this day, I remain convinced that meeting our commitments to Intel during the war was critical to the future evolution of Intel Israel – and, indeed, of the entire Israeli high-tech economy. A few years later, in 1995, Intel broke ground for a second semiconductor plant in Israel, at Qiryat Gat, on the outskirts of the Negev Desert. In 1999, the

Headquarters was 7,500 miles away. They simply had to trust us.

Haifa center won the assignment to develop the Centrino portable-computing technology, which was launched in 2003. And in subsequent years, whenever we got any push-back about doing major projects in Israel, it was always helpful to remind our colleagues that, as the experience during the war had dem-

onstrated, “Intel Israel delivers, no matter what.”

Today, Intel Israel is the headquarters for the company’s global R&D and product development in wireless technology, as well as a major center for chip fabrication. The organization is Israel’s largest private employer (and second largest employer overall), with a workforce of about 6,600, which is set to reach nearly 10,000 by 2008. In 2005, Intel Israel’s exports totaled \$1.2 billion and represented 14% of the total exports of Israel’s electronics and information industry. And in December 2005, Intel announced that it would invest an additional \$3.5 billion in a new fab in Israel, the largest single investment by a corporation in the history of the country. 

1. These figures were drawn from the *Israel Yearbook and Almanac 1991/92* (IBR Translation/Documentation Limited 1992).

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“Every now and then I run a background check on myself just to make sure I’m really ‘that good.’”



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Lift Outs How to Acquire a High-Functioning Team

by Boris Groysberg and Robin Abrahams



LUKE BEST

By hiring away whole teams from a competitor, companies can quickly gain capacity without all the headaches of a merger or acquisition. It's a high-risk, high-reward move.

COMPANIES LOOKING TO EXPAND quickly into a new geographic or functional area often choose to merge with or acquire other companies. But the risks of such moves are well-known, and the success rates are dismal. Of course, companies can also build capability by making strategic individual hires, but the process is much slower than a mass acquisition, and you never know whether an assortment of stars will work together effectively once they are separated from the conditions and resources that made them successful in previous environments. Star performers don't operate in a vacuum; they operate as part of a team, and their success stems at least in part from their team relationships.

There is an alternative, one that's gained attention in recent years: a *lift out*, which entails hiring a high-functioning group of people from the same company who have worked well together and can quickly come up to speed in a new environment. The first high-profile team move in corporate America occurred in 1946, when Air Force colonel Charles B. "Tex" Thornton brought nine

moved to the Lahey Clinic in June 1999, then was called on to perform an unprecedented joint liver-kidney transplant just a few months later. The surgery, involving three operating rooms and more than 20 medical professionals, required a level of skill and teamwork unlikely to be found in any newly assembled group. Acquire the right team in the right way, and you may get

tries, analyzed over 40 high-profile moves, and researched best practices as reported by headhunters who regularly facilitate these maneuvers. We also conducted two in-depth longitudinal case studies of this phenomenon. The first was of a series of involuntary team moves that followed the 1990 bankruptcy of investment bank Drexel Burnham Lambert in the wake of the Michael Milken scandal. The other was of Philadelphia law firm Duane Morris, which continues to successfully build new practices—both geographically and functionally—through lift outs.

For the purposes of this article, we have restricted the definition of lift outs to two or more people moving from one company to another at the same time. Hence, we disregard instances in which a new employee, over time, brings some former colleagues on board. Neither do we address the legal matters surrounding a lift out—questions of noncompetition, nonsolicitation, confidentiality, and intellectual property. These issues are highly contested, vary by country, and reside within the domain of labor lawyers.

Our research shows that, regardless of industry, nationality, or team size, a successful lift out unfolds over four consecutive, interdependent stages that must be meticulously managed. (See the exhibit "The Stages of a Successful Lift Out.") Here, we'll outline those four stages, drawing on triumphs as well as failures to illustrate the advantages and risks of a legitimate lift out.

STAGE ONE: Courtship

During the first stage, prior to the move, the interested company's representative and the leader of the targeted team meet to hash out their plans and determine if the proposed hire is, indeed, a good idea. The two parties can then move on to define their business goals and discuss strategies for achieving them. In addition, the hiring company should examine its assumptions about the team's relationships. Simultaneously, the team leader begins conversations about the potential move with the rest of his or her group and assesses their

other members of his elite statistical-control unit to the ailing Ford Motor Company. There, the team revolutionized, rationalized, and quantified the business much as it had done for the military. These "Whiz Kids" are considered by many scholars to be the founders of modern strategic management.

Today, lift outs are increasingly common in many professional-services industries—law, advertising, investment banking, consulting, general management, and even medicine. They enable a quick ramp-up in talent without the logistical and psychological stresses of an acquisition or the sociodynamic challenges of creating teams from scratch. The advantages of long-standing relationships and trust help an experienced team make an impact much faster than could a group of people brought together for the first time. There's no need for team members to get acquainted with one another or establish shared values, mutual accountability, or group norms. Instead, the team can hit the ground running and help the company as business opportunities arise. A liver transplant team from Beth Israel Deaconess Medical Center, for example,

not only cohesive, plug-and-play talent but also valuable external relationships, learning opportunities for existing staff—and the chance to embarrass a competitor.

A good lift out can even inflict financial or competitive damage on a rival. When Conseco Capital Management lost its chief equity investment officer and multiple members of his department to one competitor, and 16 or so associates in the fixed-income management group to another, the company also lost a significant number of clients. Another company, the investment bank HSBC, was left with only a graduate trainee to take charge of analyzing media equities after its entire team of media analysts decamped for ABN AMRO. As in that case, the sudden departure of a team can lead to premature internal promotions. Moreover, if the injured company is forced to poach from another institution, it may have to deal with a tricky integration and perhaps pay premiums to win over new recruits.

Lift outs, however, carry their own set of risks. Companies often take shortcuts in the giddy courtship stage, but the stakes are too high to be sloppy. A poorly handled lift out can lead to a loss of money, opportunity, credibility, and even native talent, if your lifted-out team later flees for still greener pastures with some of your original staff. To understand the risks and opportunities that lift outs present, we interviewed leaders of lifted-out teams and work groups in multiple industries and coun-

Boris Groysberg (bgroysberg@hbs.edu) is an assistant professor at Harvard Business School in Boston. His most recent HBR article, coauthored with Andrew N. McLean and Nitin Nohria, is "Are Leaders Portable?" (May 2006). Robin Abrahams (rabrahams@hbs.edu) is a research associate at Harvard Business School.

level of interest. The dialogue at this stage isn't about salaries and contracts but, instead, constitutes due diligence. If the courtship stage is slighted, both parties risk failure.

Make sure the market is really there.

The very first item on the agenda for both parties is to confirm that the market opportunity exists. The lift out will be ill-advised if the hiring firm's expectations are unrealistically high; if the firm does not have the status, reputation, and capabilities to succeed in the market it wishes to enter; or if it is unwilling or unable to provide the complementary resources that the new team will need in order to succeed.

A poorly planned venture can lead to profit losses and public humiliation and can damage the careers of the lifted-out team members. This was the case in at least two of the Drexel team hires during the early 1990s. While the Drexel name may be tarnished today, thanks to the actions of Milken and his junk-bond unit in California, the company—particularly the New York-based equities unit—used to enjoy an excellent reputation. When the firm went bankrupt, its competitors took advantage of the virtual bonanza of talent that became available. Barclays de Zoete Wedd (BZW), the UK Barclays investment banking unit based in New York, for instance, had been looking to break into the U.S. equities business, and it nabbed a team of high performers from Drexel.

At the time, even U.S. firms were finding it difficult to break into this market. Sure enough, BZW's U.S. securities branch was shut down little more than a year after it opened, leaving the Drexel alumni once again unemployed—and many at an even greater disadvantage than before, because their performance had dropped. After the unit folded, the *Economist* scolded the company for its rash hires: "BZW did not pause to carry out market research on the venture [of entering the U.S. market]. At the very least it might have asked itself how it intended to make money selling American shares to Americans at a time when Wall Street's native giants were incapable of doing so." Despite its great suc-



cess at Drexel, the team could not change the fact that a foreign bank simply did not have the credibility, reputation, capabilities, and clout to break into the competitive, tight-knit world of U.S. equities in the early 1990s.

In 2003, by contrast, Orrick, Herrington & Sutcliffe, a San Francisco-based law firm, recognized Italy as a market ripe for expansion because of the Italian government's strides toward deregulation and privatization. The firm hired a team of 23 Italian lawyers, including seven partners, from a Milan-based affiliate of Ernst & Young to open its first Italian branch. At that time, Ernst & Young operated as a multiservice professional firm, and the team, led by Alessandro De Nicola, embraced the move because it had felt hamstrung by the complex conflict-of-interest rules that accompanied the multiservice focus. Orrick's Milan office has nearly doubled in size over the past three and a half years. In February 2004, the company opened an office in Rome, and De Nicola was made the leader of all Italian operations.

Sometimes, the hiring company might not be the one to identify the market

opportunity; instances where a team leader opportunistically approached a hiring company have also proven to be successful. What is important is that the opportunity exists and that at least one side of the relationship has done the requisite due diligence.

Define your shared business goals and strategies. Next, the company and team leadership need to come to a shared understanding of their business goals and the strategy needed to achieve them. One lift out in which the two parties demonstrated this kind of insight was Lehman Brothers' hiring of Deutsche Bank's entire editorial and production department in March 2000.

That team's leader, Cheryl Tortoriello, had worked at Lehman back when Jack Rivkin was head of global equity research. Rivkin's tenure was widely regarded by the research department as a sort of golden age: He'd taken over the then-troubled team in 1987, rebuilt the culture, and raised the department from number 15 in the influential *Institutional Investor* rankings to number one in 1990, 1991, and 1992, the year he left. By 1994, the department had fallen to number nine.

Steve Hash, Lehman Brothers' current head of equities research, wanted to get the research department back to the top of the list. He believed that to do so the company needed a first-rate editorial and production team that could ensure that the firm offered clear, client-friendly financial information. The most prescient stock predictions in the world are of little use if they are not effectively communicated to clients, he reasoned.

Tortoriello agreed. Even more important, however, the two leaders shared a clear vision of the kind of culture they

wanted to create: one that would revive the best practices and style of the Rivkin era. The move has proved to be an unqualified success, both in terms of employee satisfaction and external metrics. Lehman's research department rose from number eight in the *Institutional Investor* poll in 1999 to number five in 2001, the year after Tortoriello's team arrived. Continuing to rise in the ranks, the department went on to achieve first place in 2003, with the largest margin of victory for any front-runner in 20 years, then maintained that status in 2004 and 2005.

Access to senior executives was most often cited as the factor responsible for the success of a lifted-out team.

wanted to create: one that would revive the best practices and style of the Rivkin era. The move has proved to be an unqualified success, both in terms of employee satisfaction and external metrics. Lehman's research department rose from number eight in the *Institutional Investor* poll in 1999 to number five in 2001, the year after Tortoriello's team arrived. Continuing to rise in the ranks, the department went on to achieve first place in 2003, with the largest margin of victory for any front-runner in 20 years, then maintained that status in 2004 and 2005.

A lift out of Drexel employees in March 1990 by Banque Indosuez, by contrast, was doomed by a lack of clarity. The company had hired a team led by Richard Sandor, a star futures expert, into its newly formed Indosuez International Capital Markets unit, which focused on swaps and derivatives. Unfortunately, the senior ranks could never agree about what, exactly, the Drexel team brought to the table—a full repertoire of capital market activities or a more narrow focus on swaps and derivatives. Just over a year after the move, Sandor left Indosuez, and the rudderless team drifted along, never gaining access to the firm's leadership or a clear sense of direction. The venture in swaps and derivatives may have reflected a genuine

opportunity, but the business goals were never clearly communicated to the team. As a result, the enterprise floundered.

Examine your assumptions about the team's external relationships. The hiring company should also look at what it hopes to get out of the team's external relationships. Is the new team expected to bring along high-profile, high-profit clients? Is it assumed to have relationships within a geographical area or a certain demographic? Because client loyalties are hard to predict, it's important both to ask directly about

these relationships during the courtship phase and to take the answers with a grain of salt. Even if the relationships do exist, the move could burn bridges, so it's dangerous to pin too much on what may be an elusive asset.

Bridges were burned in all directions, for example, when the advertising giant Interpublic Group brought in 17 creative and sales executives from Saatchi & Saatchi nearly two years ago in one of the largest lift outs in advertising history, hoping that the lucrative General Mills account would follow them. Sadly for Interpublic, the conservative General Mills remained with Saatchi & Saatchi—in a relationship that dated back to the 1920s—though the company did issue a series of terse press statements that, while not explicitly critical of Saatchi & Saatchi, suggested disappointment with the agency's people management. In the end, the move left Saatchi & Saatchi in a PR mess, General Mills feeling disgruntled, the team's leader out of a job because of a non-compete lawsuit filed by the agency, and the rest of the team members settled less productively as an independent group within Interpublic, with rumors swirling around them.

By contrast, when Smith Barney brought on a corporate-restructuring

team of about 15 people from Drexel Burnham Lambert in February 1990, the group's external relationships were so strong and fertile that many of their ventures were described in the press as "Drexel alumni bashes." Clearly, Smith Barney's move brought aboard more than just talent. The ability to exploit these relationships made Smith Barney a powerhouse in the restructuring business almost overnight, growing from two assignments in 1988 to 39 in 1991.

Start discussions within the team. Along with conversations between the team leader and the potential hiring firm, a series of discussions between the leader and his or her team members needs to take place. How should the group be structured in the new firm? Should the team be kept as intact as possible, or should some members stay behind? In Tortoriello's case, the move was comparatively simple because the group was a self-sufficient entity that elected to relocate en masse, but the issue is rarely so straightforward. It can be tempting to zoom in on the stars in an organization, but these forward-facing professionals' success may well depend on the backstage efforts of less visible players. (In their May 2004 *Harvard Business Review* article, "The Risky Business of Hiring Stars," Boris Groysberg, Ashish Nanda, and Nitin Nohria demonstrated that star equities analysts who moved in teams were more successful in their new companies than those who moved alone.) For that reason, a hiring company should make sure to interview all members of a team under consideration, while being careful not to jeopardize their relationships with their current employer.

Finally, once they know who they want on the team, leaders face the challenge of enticing those people to make the move. Leaders will probably need to be very persuasive with junior members, who perhaps hope for a promotion once the senior members have departed. In fact, team leaders would do well to go a step further and prepare employees for how to respond to any counteroffers the original company might make. Lehman's Tortoriello, after

ascertaining that all members of her team did indeed wish to move, coached and role-played various scenarios with them in case Deutsche Bank counter-offered. As it turned out, the bank made no effort to retain the group – which only affirmed the team’s decision to switch to a company where it would be more valued.

STAGE TWO: Leadership Integration

After a team has come on board, the first priority should be the integration of the team leader with the new company’s executive leadership. Integrating the rest of the group is important too – but without a good fit at the top, access to the company’s top leadership will be limited, and the overall effort will not succeed. In our interviews with lift-out leaders, access to senior executives was most often cited as the factor responsible for the success of the team. (In the rare cases where there is no team leader, the group itself must secure strong support from the organization’s leadership. This may have been one factor behind the failure of the BZW-Drexel lift out; it was one of the few we studied

that didn’t have a leader orchestrating the move.)

Cultural compatibility is critical with any new hire, but it is particularly important in lift outs. Because groups change companies without changing bosses, they can often be more loyal to their leaders than to the companies they work for. This was especially true of many of the Drexel moves: Strong leaders were often responsible for their staff’s reemployment after the firm’s bankruptcy, thus creating formidable ties between the team members and the boss who got them back in the game.

Leadership integration goes more smoothly when the hiring company has a clear culture that is communicated through its operations. Of course, culture and values should be discussed during the courtship phase, but even the most comprehensive dialogue can’t convey all the nuances until the team is on board. Integration is not the time for self-delusion or “big happy family” talk. Statements like “We here at X company value Y characteristic” should be backed up by specific practices that illustrate the value placed on Y. For example, law firm Duane Morris, founded by Quak-

ers, has a strong and explicit culture that is embodied in its compensation policies, strategic planning, and consensus-based style of decision making. It’s even represented in the company’s office decor, which is uniform across the firm’s many locations. This is not to suggest that Duane Morris’s cultural ethos is the only correct one. Rather, it is to say that Duane Morris knows what its culture is, backs up its values and preferences with specific behavioral practices, and is able to explain its culture clearly to potential new teams – which it has done repeatedly, and with success, through the years. This approach makes it easy for team leaders to fully understand the environment they will be entering. Given the firm’s emphasis on growth through team acquisition, the company certainly benefits from communicating its values right from the start.

Hiring firms should be wary of the temptation to bring on a new team in order to reinvigorate the existing culture or facilitate change. In business, as in romance, opposites may attract, but they may also have difficulty living together once the thrill has passed and temperamental differences come to the fore.

The Stages of a Successful Lift Out

A lift out – the hiring of an existing high-performing team from another company – unfolds over four interdependent stages. The way these are managed can make or break the move.

STAGE ONE	STAGE TWO	STAGE THREE	STAGE FOUR
Courtship (prior to lift out)	Leadership integration (post-lift out)	Operational integration	Full cultural integration
Team leader and leadership of acquiring company hold conversations to achieve clarity on market opportunity, business goals, strategy, and viability of external relationships. Team leader begins conversations with team members to determine interest in migrating and to forestall possible counteroffers.	Team leader works to ensure cultural fit with leadership of hiring firm and continued access to resources and top leadership.	Team leader secures vital operational resources for the team so its members can do their day-to-day work and succeed in their new environment.	Having established credibility through operational success, the new team can achieve full cultural integration, working seamlessly with new colleagues. Team members build relationships with other groups and become culturally socialized in the new firm.

STAGE THREE: Operational Integration

The third stage is about making sure the team can get the job done. The success of this phase depends directly on the success of stage two: A team leader well integrated with the leadership of the new company will be able to ease transitions. As J. Richard Hackman observed in his influential book *Leading Teams*, effective team leadership consists less of posturing and rallying the troops than it does of setting clear directions and securing necessary resources.

Moises Curiel, a Mexican tax attorney, led approximately 60 lawyers from Mancera Ernst & Young to law firm Baker & McKenzie's tax practice in 2004. Curiel had gone through a long courtship phase and had worked closely with Baker & McKenzie's leaders to reach an understanding of how the entities would work together. As a result, he was able to ensure that all his team members would start on their first day with the resources they needed to do their jobs. In Curiel's words, "All the desks, all the offices, all the laptops, all the cars: Everything will be ready for these new guys, to say 'Hello, welcome, this is a great place, and this is a great position.'...They cannot arrive and feel like nobody's waiting for them and feel like a dog alone off the street, because of course they will be not motivated, they will be so sad and frustrated [at] the start of the situation."

Continuity is another key condition for operational integration. Ideally, the lifted-out team will at least start by working with the same or similar clients, vendors, and industry standards. In one successful move we studied, the majority of staff (approximately 50 people) from a law office based in Prague, Czech Republic, led by partners Jason Mogg and Michael Schilling, signed on in 2000 with the international law firm Linklaters to help its Central and Eastern European expansion. In Mogg's words, "We didn't lose anybody; right down to the cleaning lady and the receptionist, every single person came with. They were all very enthusiastic about it."

Employees experienced so little disruption in their day-to-day work that, as Mogg put it, "We changed the nameplate on the door, changed everyone's business cards, and were in business the next day." Linklaters' interest in Mogg and Schilling's teams was rooted in their regional expertise, so the lawyers merely continued with the work they had been doing all along with the same clients, but for a different employer. Schilling told us, "It may be, over the years, that [the team] will then be asked to do many different things and grow beyond what you initially recruited them for. But certainly in that initial phase, if they can do...what they are good at already, you allow them to prove themselves and to make themselves feel that they have earned a place in the firm." In 2004, Mogg was promoted to managing partner of the Bratislava, Slovakia, office, responsible for all Central and Eastern European operations.

These examples are all the more noteworthy because they involve teams lifted out by companies based in other countries. A lift out that crosses national as well as corporate boundaries is almost certain to bear a higher level of operational and cultural dissonance, and entail a steeper learning curve, than a domestic move. The most successful transnational lift outs are those in which the teams are hired for their regional expertise and allowed to continue in the same business practices, as with Mogg and Schilling's groups as well as Curiel's. In cases where they are hired for functional expertise and expected to grow a new business or open doors to a new market – as at BZW and Banque Indosuez – the risks seem to be greater.

One thing that history makes clear is that, though teams should not isolate themselves from the rest of the new organization, they paradoxically need a degree of autonomy. Most teams move, after all, in order to stay together. Tortoriello appreciated Lehman's confidence in her abilities because it allowed her to manage the integration process as she saw fit and run her own shop. Mogg and De Nicola likewise identified a "light management style" from the top as a

key to their teams' success. Teams should be given clear goals but wide latitude in the means by which they achieve their ends. Failure to grant some autonomy is counterproductive and demoralizing. Such a management style may well have played a role when Richard Sandor's team unsuccessfully moved to Banque Indosuez. His group felt micromanaged yet did not fully understand what it was they were supposed to accomplish.

STAGE FOUR: Full Cultural Integration

In the final stage, the new team must be willing to re-earn credibility. Once the team members hit their new environment – regardless of their prior accomplishments and no matter how strenuously the hiring company wooed them – they must prove their value and gain their new colleagues' trust. Due diligence during the courtship stage can ease this challenge a bit, but even the most rigorous interview process is no substitute for working side by side. Indeed, while feel-good team-building exercises have their place (Curiel credits a company soccer team that mixed newcomers and existing Baker & McKenzie staff for some of his group's achievement of cultural integration), real operational successes are paramount. As Mogg put it, "Delivering successful results and making contributions to the business – every time you do that, you gain credibility, and that's absolutely crucial....You don't always start, when you move to a new firm, with huge credibility. You have to earn it." Operational successes help new as well as established employees avoid developing what social psychologists call "in-group" and "out-group" relationships.

Perhaps the most famous investigation of in- and out-group relations was the Robbers Cave experiment, conducted in 1949 and 1953 by social psychologist Muzafer Sherif and colleagues. The researchers gathered nearly two dozen preadolescent boys in a summer camp setting, then separated them into two groups (the "Rattlers" and the "Eagles") that were initially kept apart.

When the campers were brought together, prejudices and tensions quickly formed, and the conflict escalated to the point where the rival teams were ransacking each other's cabins and burning each other's flags. Attempts to pacify the groups through a positive-propaganda campaign were useless. So,

Ideally, the lifted-out team will start by working with the same or similar clients, vendors, and industry standards.

too, was a series of communicative and noncompetitive activities that were not unlike the team-building exercises of today's corporate retreats. The only way the two groups could reconcile their differences (though, interestingly, they maintained a sense of separate group identity), was when they were forced to rely on each other to complete difficult joint projects, such as fixing a leak in the water supply. These activities allowed each group to perceive the other's true abilities and realize that the success of one would benefit both.

One might expect lawyers, investment bankers, advertising executives, and software engineers to be more sophisticated in their social interactions than young boys, and generally they are. But the events of Robbers Cave have been replicated in many situations, with adults as well as children. What's more, subsequent research has shown that groups are most likely to develop mutual respect by working not only cooperatively but also complementarily – that is, when each group has specific skills to bring to the table that the other does not. In these situations, respect can quickly flourish.

Another aspect to developing credibility involves managing the expectations of existing employees. When the Deutsche Bank team joined Lehman, Tortoriello made clear to the 90 analysts her group would be supporting that the system would work well if they adhered to certain practices and standards. As she put it, "If somebody drops

150 pages on me and says it has to go out today, that's just not going to happen." This is a process that needs to be handled tactfully, however, because existing employees may already resent or be suspicious of the high-profile newcomers. As De Nicola described, "The risk...is either that the people of the

firm joined by the group feel themselves alienated because maybe they are less [important] than the group that joined the firm, or they are less profitable, or they think that now they don't count for anything. So don't alienate the people who already are in your firm." Banque Indosuez made this mistake when it closed an unprecedentedly fast deal to acquire Drexel talent for its In-

ternational Capital Markets unit. The transaction was so great a departure from the firm's usual mode of business that, according to a 1993 analysis in *Investment Dealers' Digest*, it "flabbergasted Indosuez executives," who were accustomed to a much more deliberate pace. According to an ex-employee quoted in the article, "They were used to sending memos back and forth, and dragging things out." The uproar ensured that the ex-Drexelites would remain in the spotlight and that resentful existing employees would look for every opportunity to downplay and undermine the newcomers' contributions.

No two companies are identical, of course, and some degree of cultural mismatch may be inevitable. When significant differences exist, however, a strong team leader can help his or her team members integrate with and become socialized to their new environment.

Roberto Casati, a partner in the Milan office of an international law firm, has gone through both mergers and team

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Joseph L. Rotman School of Management
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moves. He spoke of his own experience as a team leader with some nuance: “The best thing you can do to make sure you smoothly merge or integrate with the new organization is to step back a little bit, make sure that you do not position yourself as the point of difference or defender of the team, and manage in a way that makes the team recognize that

related functions. All of these factors allowed for smoother cultural integration.

The move of the Saatchi 17, however, lies at the other end of the spectrum: All of the players—the team, its leader, the hiring company, the losing company, and the team’s most significant client—were worse off after the lift out than before. A columnist for *Adweek* described

founding with an artistic collage of clips from the advertising industry media detailing the “rebellion” of the Saatchi 17.

This case is remarkable for the harm it inflicted on all the players. Saatchi & Saatchi lost a talented team and alienated and demoralized remaining staff. It also angered a major client, General Mills, which was dragged into a maelstrom of negative publicity. Mike Burns was denied the job he’d pinned his hopes on at Interpublic and separated from his team; his credibility took a hit as well. The Saatchi 17 lost the General Mills account and their leader. Interpublic found itself in sudden possession not of a well-tended \$550 million account, but rather of a highly cohesive and rebellious team. After the move, the team’s identity was centered on its contentious history, and, at least for some time after the move, the group was unable to attract significant clients. (Things have brightened all around since then.)

The Saatchi 17 move may be unique in the breadth and depth of its lose-lose results, but it does illustrate the dangers of an unsuccessful lift out. For the hiring company, the most common risk is defection. If a team leaves after only a brief tenure, the company loses the investment it has made in the team’s integration. Losing a lifted-out team, especially one whose acquisition had been hailed as a strategic triumph, can also be humiliating. Such a loss of face can have tangible consequences in the professional-services industries, where a company’s reputation for wise counsel is in large part its stock-in-trade.

For team members, an unsuccessful lift out can mean isolation or unemployment. The move may destroy relationships—with former colleagues, clients, and vendors—and impair the employees’ effectiveness for years to come. For both teams and hiring companies, lift outs represent a gamble on credibility, portability of performance, and human capital—but if managed well, the maneuver can be both economical and effective in the war for talent. ▢

The members of a new team must be willing to re-earn credibility. They must prove their value and gain their new colleagues’ trust.

there are other leaders in that organization that they can turn to and look at as being as good and as reliable as you are.”

High Stakes

The move by Cheryl Tortoriello and her team to Lehman Brothers embodies the ideal lift out in many respects. She and Steve Hash had worked together in her first stint at Lehman, and their existing relationship facilitated the courtship phase, but she also went to great lengths to prepare her team for the move and to make sure it was the right decision. The leadership integration phase, too, went smoothly, because Tortoriello and Hash shared a vision of the future and how to get there. The operational stage benefited from a high level of autonomy and creative freedom along with Hash’s executive sponsorship and logistical support, even allowing the team to continue production with almost no interruption after September 11, 2001. The events of that day, wrenching as they were, drew together Tortoriello’s original group and existing Lehman staff, setting the stage for full cultural integration. Tortoriello’s realistic view of the challenges of merging with the Lehman research department also supported this final phase. She realized that some of Lehman’s people would feel out of place and eventually leave and that a new team dynamic would form. She also strongly encouraged her team to build relationships with other departments and looked for feedback on their performance from

the move as a “fiasco from the get-go” and suggested that “everyone involved should have to teach a class on ‘How Not to Steal a Piece of Business.’” Mike Burns, a 25-year veteran at Saatchi & Saatchi, was joint chief executive of the New York office and vice chairman and worldwide account director for the estimated \$550 million General Mills account until September 2004. That’s when worldwide CEO Kevin Roberts replaced him with Mary Baglivo, an advertising superstar from outside the company, as chief executive officer of the New York office and worldwide marketing director. A furious Burns resigned the following February, and 17 of his loyal staff—a mix of senior creative and account executives who had worked on the General Mills account—submitted their resignations within a week.

Almost immediately, the 17 executives were reportedly engaged in conversations with Interpublic Group, which presumably hoped that the General Mills account would follow Burns’s team to its new home. The 17 were hired en masse at Interpublic to form an independent unit, the General Mills account stayed with Saatchi & Saatchi, and the latter slapped Burns with a lawsuit (since resolved) to prevent him from joining another agency and leaving his former team without their leader. The Saatchi 17 remained at Interpublic, but, at least for the first several months, the unit’s Web site listed no current projects. Instead, it played on the group’s notorious

Reprint R0612J

To order, see page 165.

some CEOs we interviewed wished to remain anonymous.
read our report and you'll understand why.

Let's start with what we can tell you. We conducted interviews with a broad cross section of CEOs – 765 to be exact. They are working in 20 different industries and 11 regions around the world.

And they spoke with an honesty usually reserved for the protected privacy of a boardroom. They revealed their plans, their motivations, and in some cases, even their weaknesses.

Said one CEO, "Since 70 percent of our business is based on a service that will no longer exist as we know it, we need to adapt our enterprise to survive."

Given that level of candor, some chose not to reveal their names.

While you don't need to know who they are, you do need to know what they said.

They talked quite openly about a two-year window, in which 65% of them expect to make fundamental changes to their businesses.

They spoke about devoting much of their innovation effort, a full 30%, to revamping the sacrosanct business model.

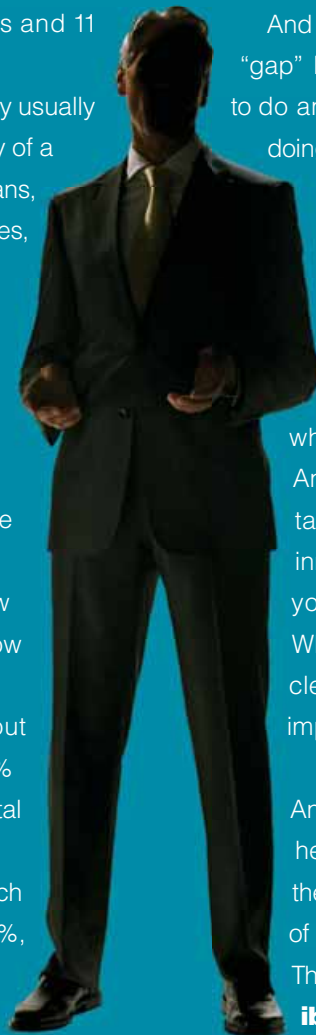
"We are at the critical point," admitted one CEO, "where we should transform our business model itself."

And some confessed, quite honestly, to a "gap" between the collaboration they'd like to do and the collaboration they're actually doing. Said one respondent, "It has been like Relationship 101 – we're terrible and we need to improve."

Other findings were equally surprising. On page 21, for example, you'll discover which department was conspicuously low on the list when it comes to idea generation. And you'll learn that most CEOs have tasked one person with bringing their innovation agenda to life. On page 29, you'll find out who that person is. Whichever page you turn to, one thing's clear. CEOs are placing an enormous importance on innovation.

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Embrace the Dark Side
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Fischhoff, Baruch

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Fiss, Mary S.

*The Ultimately Accountable Job:
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Fontaine, Mary H.

*Leadership Run Amok: The
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June
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*Breaking the Trade-Off Between
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Give Me That Old-Time Motivation
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*Meeting the Challenge of
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Gerson, Ben

*HBR Case Study: The Reign of
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November
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Ghemawat, Pankaj

Apocalypse Now?
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Gibson, Lib

Mapping Your Innovation Strategy
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Godes, David

Better Sales Networks
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Golden, Brian R.

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Goldstein, Daniel G.

Profiting from the Long Tail
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Goldstein, Dominique C.

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Reprint F0606G

Gopal, Ashok

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Gourville, John T.

*Eager Sellers and Stony Buyers:
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Groysberg, Boris

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Gunther, Robert E.

The Wisdom of Deliberate Mistakes
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Haley, Thea S.

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Hamel, Gary

*The Why, What, and How of
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Defeating Feature Fatigue
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All Your Products Are Profitable,
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*The Five Messages Leaders Must
Manage*
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Reprint R0605G ♦ OnPoint 432X

Hammond, John S.

*The Hidden Traps in Decision
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Originally published in 1998
Reprint R0601K

Hasker, Steve

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Hassan, Fred

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Heath, Dan

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Tapping a Risky Labor Pool
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Hemp, Paul

Are You Ready for E-tailing 2.0?
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Herzlinger, Regina E.

Why Innovation in Health Care Is So Hard
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Hewlett, Sylvia Ann

Extreme Jobs: The Dangerous Allure of the 70-Hour Workweek
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Hiltabiddle, Tim

HBR Case Study: The Nice Guy
February
Reprint R0602A, Reprint Case only R0602X, Reprint Commentary only R0602Z

Holloway, Charles A.

The Sales Learning Curve
July–August
Reprint R0607J ♦ OnPoint 1003;
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The Seasoned Executive's Decision-Making Style
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Huang, Ming-Hui

HBR Case Study: Eliminate the Middleman?
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Humphreys, John

HBR Case Study: How Low Will You Go?
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Hurley, Robert F.

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Huston, Larry

Connect and Develop: Inside Procter & Gamble's New Model for Innovation
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Immelt, Jeffrey R.

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Inderrieden, Edward

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The Rise of Corporate Nationality
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K**Kacmar, K. Michele**

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Kanter, Rosabeth Moss

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How to Implement a New Strategy Without Disrupting Your Organization
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Kaufman, Gary

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The Hidden Traps in Decision Making
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Managing Multicultural Teams
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Khanna, Tarun

Emerging Giants: Building World-Class Companies in Developing Countries
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HBR Case Study: Just Trying to Help
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Kramer, Mark R.

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Kramer, Roderick M.

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Kramer, Vicki W.

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Kwak, Mary

With Friends Like These: The Art of Managing Complementors
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Laurie, Donald L.

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Leslie, Mark

The Sales Learning Curve
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Lewin, Arie Y.

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Lo, Andrew W.

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Lorimer, Sally E.

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McEwen, William

Inside the Mind of the Chinese Consumer
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McLean, Andrew N.

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Meer, David

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Meyerson, Debra E.

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A conversation with Mario Almondo
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Nunes, Joseph C.

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O**O’Byrne, Stephen F.**

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Living Agreements for a Risky World
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Making M&A Fly in China
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"The troops are rallying behind you but only to eventually give you a push out the door."



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Curveball: Strategies to Fool the Competition

George Stalk, Jr., makes a valid case in "Curveball: Strategies to Fool the Competition" (September 2006) that low-cost airlines such as Southwest often leave competitors in the dust when it comes to operating efficiency. However, based on my experiences as a former senior analyst in strategy and long-range planning for America West Airlines

is the often vilified but utterly necessary hub-and-spoke system, which, as the article correctly points out, regularly contributes to aircraft delays and downtime. Point-to-point routes are great for city pairs like New York and Los Angeles, a market with sufficient demand to justify frequent nonstop flights. The passenger trying to get from Des Moines, Iowa, to Shanghai, China, however, would be thoroughly out of luck were it not for legacy-airline commitments to hub-and-spoke operations.

Low fares from the likes of Southwest and Ryanair are one form of customer service. The ability to fly between secondary and far-off cities is an equally important (and often lucrative) customer service. For the foreseeable future, legacy carriers will continue to do a far better job of providing it than low-cost entrants. Managers of legacy carriers do not deserve to be portrayed as fainthearted for accepting that as one of their companies' duties to shareholders and to the traveling public.

Ron Levin

*MBA Class of 2008
Harvard Business School
Boston*



(now US Airways), I would argue that lower asset utilization among legacy carriers has nothing to do with his thesis that rivals are misinterpreting Southwest's success. The significance of high asset utilization is far from a new concept to traditional airlines. In fact, to boost utilization, all of the legacy U.S. carriers operate red-eye patterns wherever possible and economical, while Southwest keeps every one of its 468 Boeing 737s at a gate overnight.

A more reasonable explanation for lower utilization among legacy airlines

Stalk responds: Reading Ron Levin's letter, I gather he regards low-cost airlines like Southwest and Ryanair as rude competitors. They skim the best point-to-point air markets while legacy carriers steadfastly fulfill a customer service, flying to and from hubs and secondary cities and accepting losses in the billions of dollars. Therefore, to call the management of the legacy carriers

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fainthearted is unfair. Actually, if I were a shareholder, calling their management fainthearted would probably seem too polite.

Levin does raise some interesting points that I did not have room to discuss in the article. For example, why do legacy carriers such as his former employer squeeze incremental revenue miles by scheduling red-eye flights that disperse their fleets, while Southwest planes are parked, mostly at home base? Despite these efforts – or because of them – they still have aircraft asset utilizations that are 20% to 25% below those of Southwest and JetBlue and costs per seat-mile that are 20% to 25% higher. How can such an obvious difference in operational philosophies be ignored?

Also, the hub-and-spoke network is a remnant of the era when heavy government regulation of U.S. domestic airlines mandated service to secondary cities. In the 1970s, hub and spoke was an industry best practice – a ripe situa-

tion for a competitor to throw a curve, which is what Southwest did. Today, some 20 years after the budget airline showed that, economically speaking, certain point-to-point routes were superior to hub and spoke, the viability of hub-and-spoke networks is openly being questioned within the industry. The production of the Airbus A380 is a bet on its bright future. With more than 500 seats in three classes, it has roughly twice the capacity of the Boeing 787, which was developed in response to the rise of point-to-point networks. Someone is wrong. (Hint: When is the last time you flew a Boeing 747 from Philadelphia to Paris?)

With deregulation, the poor passenger traveling from Des Moines pays a fare that at least reflects the real economics of getting to Shanghai, rather than an artificial rate set by the government. I haven't checked, but such fares in total are likely to be lower than they would have been in the days of heavy regulation.

Ten Ways to Create Shareholder Value

Before we adopt a policy of steadfast reliance on the principles set forth in Alfred Rappaport's article "Ten Ways to Create Shareholder Value" (September 2006), we need to qualify principles 2 and 3. The article claims that strategic decisions concerning core businesses, new business ventures, acquisitions, share repurchases, and cash-dividend issuance should be made according to "the expected incremental value of future cash flows" instead of "the estimated impact on reported earnings." This holds true only under the presumption of risk neutrality: that a decision maker cares only about the expected return on an investment, not about the risk (variance of outcomes or the potential gains or losses) embedded in such an investment.

A company strictly adhering to the principles as stated in the article should never voluntarily elect to insure its as-



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sets unless the probability of a claim for their impairment during a given period multiplied by its payout exceeds the period premium. Risk management and the (often logical and necessary) inherent posture of risk aversion as incorporated into decision making through mean-variance (risk-return) formulations, and as amended and expanded to reflect advances in economic and financial theory and practice, are important considerations in the evaluation of a corporation by managers, investors, and board members.

Michael Koro

*Real Estate Investor
Charlottesville, Virginia*

Rappaport responds: Expected-value analysis is a tool used to improve the quality of decision making. It compels executives to think probabilistically in the face of uncertainty. Uncritical acceptance of the expected-value number as the single criterion for decision making will lull executives into a false sense of security and cause them to ignore the uncertainties embedded in the scenario and the probability estimates used to calculate the number. Indeed, management needs to be concerned not only about the variability of outcomes for articulated scenarios but also about the likelihood that an unarticulated scenario will materialize. Decision-making frameworks, including expected value, are, of necessity, more nuanced than a single bottom line.

When making strategic investment decisions using expected-value analysis, executives can usefully ask the following questions: How much of the company's value is at risk should the worst-case scenario materialize? Is this a tolerable risk? Is management too risk averse for those shareholders with diversified portfolios who focus on systematic rather than unsystematic or company-specific risk? Should the very substantial shareholder value added and strong strategic positioning of the upside scenario tilt the decision in favor of investing despite the relatively modest probability attached to it? Does the expected value of the strategic investment provide an

adequate margin of safety? Are there alternative ways of investing in a strategy that allow the company greater flexibility and less value-at-risk? For example, is a trial research-and-development investment with an option to abandon the project if results are unsatisfactory preferable to a large and irreversible acquisition?

Contrary to Michael Koro's contention, properly conducted analysis of expected value does not presume risk neutrality. Proper implementation of the expected-value model goes well beyond looking at just the expected-value number. It requires a careful assessment of the organizational consequences of the spectrum of uncertain outcomes.

Special Issue on Sales

This was an excellent issue on a long overdue topic (July–August 2006). HBR editor Thomas Stewart says it all in his opening letter when he decries the puzzling absence of a formal sales curriculum in business schools.

Most organizations fail to acknowledge sales mastery as a strenuous pursuit requiring significant individual and corporate investment. Companies continue to cling tenaciously to the misguided notion that a Rolodex and chutzpah are the only elements necessary to drive top-line growth. In reality, buyers today are more sophisticated, while few sales professionals understand the concept of patient, professional persistence.

More challenging from a long-term standpoint, the corporations that once composed the backbone of professional sales development, such as IBM, AT&T, and Xerox, have abandoned the farm-team approach. Without such a system in place, what's left behind is a landscape devoid of the infrastructure necessary to develop the next generation of sales leaders.

Townsend Wardlaw

*Founder/Chief Executive Officer
Three Value Logic
Boulder, Colorado*

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EXECUTIVE SUMMARIES

December 2006



“ Good performance on one objective does not automatically result in good performance on others. If anything, the odds are in the other direction. ”

—page 62

COVER STORY

62 | Managing the Right Tension

Dominic Dodd and Ken Favaro

Of all the competing objectives every company faces, three pairs stand out: profitability versus growth, the short term versus the long term, and the whole organization versus the units. In each case, progress on one front usually comes at the expense of progress on the other.

The authors researched the performance of more than 1,000 companies worldwide over the past two decades and found that most struggle to succeed across the three tensions. From 1983 to 2003, for example, only 32% of these companies more often than not achieved positive profitability and revenue growth at the same time.

The problem, the authors discovered, is not so much that managers don't recognize the tensions—those are all too familiar to anyone who has ever run a business. Rather, it is that managers frequently don't focus on the tension that matters most to their company. Even when they do identify the right tension, they usually make the mistake of prioritizing a “lead” objective within it—for example, profitability over growth. As a result, companies often end up moving first in this direction, then in that, and then back again, never quite resolving the tension.

The companies that performed best adopted a very different approach. Instead of setting a lead objective, they looked at how best to strengthen what the two sides of each tension have in common: For profitability and growth, the common bond is customer benefit; for the short term and the long, it is sustainable earnings; and for the whole and its parts, it is particular organizational resources and capabilities. The authors describe how companies can select the right tension, what traps they may fall into when they focus on one side over the other, and how to escape these traps by managing to the bonds between objectives.

Reprint R0612C

FORETHOUGHT

20 | The Curse of Knowledge

Impenetrable strategy statements can't unite employees behind an organization's goals, but concrete language and stories can. **Reprint F0612A**

Interest Doesn't Always Compound

A study of executive life in one of history's great multinational enterprises—the British Empire—reveals that the leading workaday reality in foreign offices was boredom. **Reprint F0612B**

How Many Women Do Boards

Need? To reap the value of women's contributions, a board needs at least three female directors. **Reprint F0612C**

The High Cost of Low Wages

As a comparison of Costco and Sam's Club shows, stingy pay and benefits translate into higher costs in the long run. **Reprint F0612D**

Reverse Product Placement in

Virtual Worlds Retailers are starting to place real products in virtual worlds. It's just a matter of time before virtual products make the leap into the real world. **Reprint F0612E**

Shut Up and Stop Whining

Larry Winget, "The Pitbull of Personal Development," uses irritation rather than motivation to get managers on the road to improvement. **Reprint F0612F**

What's Your Return on Knowledge?

Measuring the value of your knowledge-management program probably depends less on hard numbers than on soft indicators like anecdotes and employee surveys. **Reprint F0612G**

Tapping a Risky Labor Pool

Cincinnati Works, a nonprofit employment agency in Ohio, provides an innovative business model for placing—and sustaining—unskilled entry-level workers. **Reprint F0612H**

Book Reviews Featuring *The Marketing Code*, by Stephen Brown.

HBR CASE STUDY

35 | The CEO Who Couldn't Keep His Foot out of His Mouth

Lisa Burrell

In the four years since Rob Miranda became CEO of Growing Places, a provider of on-site child care for companies in the midwestern United States, he has been a font of ideas. For instance, he set up rooms where moms can breastfeed their babies during breaks in the workday and put Webcams in classrooms so that parents can "visit" their children from their desks. As a result of Rob's entrepreneurial vision and operational savvy, the company has achieved profitable growth.

The problem is that Rob tends to stick his foot in his mouth. Evan Breyer, the company's founder and chairman, hopes that Rob will learn to avoid making verbal gaffes; he even gets Rob to see a coach. But while Evan is wrapping up a facility tour for a potential corporate sponsor of a scholarship program, Rob makes an insensitive remark about breastfeeding in front of the visitors—among them, a reporter. Not surprisingly, the local paper runs a scathing editorial the next day. Several days later, during a conference presentation on preschool curricula, he does it again with a comment implying that teachers are lazy and unprepared. The result is more bad press and a meaningful dip in stock price. It's beginning to look as though Rob is not going to change, and many board members are talking ouster.

Should Evan try to persuade the board to hang on to Rob?

Commenting on this fictional case study are Ronald A. Heifetz, a professor at Harvard's Kennedy School of Government; John H. Biggs, the former CEO of TIAA-CREF; Torie Clarke, a CNN analyst; and Roger Brown, a cofounder of Bright Horizons.

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ORGANIZATION & CULTURE

49 | Extreme Jobs: The Dangerous Allure of the 70-Hour Workweek

Sylvia Ann Hewlett and
Carolyn Buck Luce

Today's overachieving professionals labor longer, take on more responsibility, and earn more than the workaholics of yore. They hold what Hewlett and Luce call "extreme jobs," which entail workweeks of 60 or more hours and have at least five of ten characteristics—such as tight deadlines and lots of travel—culled from the authors' research on this work model.

A project of the Hidden Brain Drain Task Force, a private-sector initiative, this research consists of two large surveys (one of high earners across various professions in the United States and the other of high-earning managers in large multinational corporations) that map the shape and scope of such jobs, as well as focus groups and in-depth interviews that get at extreme workers' attitudes and motivations. In this article, Hewlett and Luce consider their data in relation to increasing competitive pressures, vastly improved communication technology, cultural shifts, and other sweeping changes that have made high-stakes employment more prominent. What emerges is a complex picture of the all-consuming career—rewarding in many ways, but not without danger to individuals and to society.

By and large, extreme professionals don't feel exploited; they feel exalted. A strong majority of them in the United States—66%—say they love their jobs, and in the global companies survey, this figure rises to 76%. The authors' research suggests, however, that women are at a disadvantage. Although they don't shirk the pressure or responsibility of extreme work, they are not matching the hours logged by their male colleagues. This constitutes a barrier for ambitious women, but it also means that employers face a real opportunity: They can find better ways to tap the talents of women who will commit to hard work and responsibility but cannot put in overlong days.

Reprint R0612B; HBR OnPoint 1685

78 | Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility

Michael E. Porter and Mark R. Kramer

Governments, activists, and the media have become adept at holding companies to account for the social consequences of their actions. In response, corporate social responsibility has emerged as an inescapable priority for business leaders in every country.

Frequently, though, CSR efforts are counterproductive, for two reasons. First, they pit business against society, when in reality the two are interdependent. Second, they pressure companies to think of corporate social responsibility in generic ways instead of in the way most appropriate to their individual strategies.

The fact is, the prevailing approaches to CSR are so disconnected from strategy as to obscure many great opportunities for companies to benefit society. What a terrible waste. If corporations were to analyze their opportunities for social responsibility using the same frameworks that guide their core business choices, they would discover, as Whole Foods Market, Toyota, and Volvo have done, that CSR can be much more than a cost, a constraint, or a charitable deed—it can be a potent source of innovation and competitive advantage.

In this article, Michael Porter and Mark Kramer propose a fundamentally new way to look at the relationship between business and society that does not treat corporate growth and social welfare as a zero-sum game. They introduce a framework that individual companies can use to identify the social consequences of their actions; to discover opportunities to benefit society and themselves by strengthening the competitive context in which they operate; to determine which CSR initiatives they should address; and to find the most effective ways of doing so. Perceiving social responsibility as an opportunity rather than as damage control or a PR campaign requires dramatically different thinking—a mind-set, the authors warn, that will become increasingly important to competitive success.

Reprint R0612D

94 | Disruptive Innovation for Social Change

*Clayton M. Christensen, Heiner Baumann,
Rudy Ruggles, and Thomas M. Sadtler*

Countries, organizations, and individuals around the globe spend aggressively to solve social problems, but these efforts often fail to deliver. Misdirected investment is the primary reason for that failure. Most of the money earmarked for social initiatives goes to organizations that are structured to support specific groups of recipients, often with sophisticated solutions. Such organizations rarely reach the broader populations that could be served by simpler alternatives.

There is, however, an effective way to get to those underserved populations. The authors call it “catalytic innovation.” Based on Clayton Christensen’s disruptive innovation model, catalytic innovations challenge organizational incumbents by offering simpler, good-enough solutions aimed at underserved groups. Unlike disruptive innovations, though, catalytic innovations are focused on creating social change.

Catalytic innovators are defined by five distinct qualities. First, they create social change through scaling and replication. Second, they meet a need that is either overserved (that is, the existing solution is more complex than necessary for many people) or not served at all. Third, the products and services they offer are simpler and cheaper than alternatives, but recipients view them as good enough. Fourth, they bring in resources in ways that initially seem unattractive to incumbents. And fifth, they are often ignored, put down, or even encouraged by existing organizations, which don’t see the catalytic innovators’ solutions as viable.

As the authors show through examples in health care, education, and economic development, both nonprofit and for-profit groups are finding ways to create catalytic innovation that drives social change.

Reprint R0612E; HBR OnPoint 1683

104 | Strategies to Fight Low-Cost Rivals

Nirmalya Kumar

Companies find it challenging and yet strangely reassuring to take on opponents whose strategies, strengths, and weaknesses resemble their own. Their obsession with familiar rivals, however, has blinded them to threats from disruptive, low-cost competitors.

Successful price warriors, such as the German retailer Aldi, are changing the nature of competition by employing several tactics: focusing on just one or a few consumer segments, delivering the basic product or providing one benefit better than rivals do, and backing low prices with superefficient operations. Ignoring cut-price rivals is a mistake because they eventually force companies to vacate entire market segments. Price wars are not the answer, either: Slashing prices usually lowers profits for incumbents without driving the low-cost entrants out of business.

Companies take various approaches to competing against cut-price players. Some differentiate their products—a strategy that works only in certain circumstances. Others launch low-cost businesses of their own, as many airlines did in the 1990s—a so-called dual strategy that succeeds only if companies can generate synergies between the existing businesses and the new ventures, as the financial service providers HSBC and ING did. Without synergies, corporations are better off trying to transform themselves into low-cost players, a difficult feat that Ryanair accomplished in the 1990s, or into solution providers.

There will always be room for both low-cost and value-added players. How much room each will have depends not only on the industry and customers’ preferences, but also on the strategies traditional businesses deploy.

Reprint R0612F; HBR OnPoint 1684

114 | Innovating Through Design

Roberto Verganti

In 1985 the architect Michael Graves designed his first consumer product—a now famous teakettle—for Alessi, the northern Italian home-furnishings manufacturer. Although Graves later designed a knockoff for Target that goes for one-fifth the price, Alessi has sold more than 1.5 million of the original version, which grew out of a process that Roberto Verganti calls “design-driven innovation.”

Alessi, the lighting manufacturers Flos and Artemide, the furniture maker Kartell, and a handful of other firms based in the Lombardy region ignore the design industry’s two norms: “tech push,” whereby an improvement in performance and functionality dictates a modification in design, and “market pull,” whereby the design accommodates consumers’ demand for new features. Instead, they favor an R&D operation in which a community of architects, suppliers, critics, publishers, artists, designers, and others immerse themselves in a discourse about the role, identity, and meaning of a product well before they address its form. The products that result often represent a dramatic break from their predecessors—giving them longer commercial lives and creating high consumer expectations for the brand’s future offerings. A familiar example of how a change in a product’s meaning can lead to a change in its design and identity is the iMac, whose friendly colors and ovoid form declared it to be, in contrast to the typical desktop computer, an appliance for the home.

The author’s eight years of research into seven European design communities revealed the Lombardy cluster’s special strengths: the number and quality of the links between components of the design system, such as schools, studios, and manufacturers. In addition, Lombardy is strong on imagination and motivation—qualities within reach of any group of businesses. Verganti uses the Finger Lakes region of New York State to demonstrate that the potential for a design discourse exists almost everywhere.

Reprint R0612G

124 | Leadership Under Fire

Dov Frohman

Dov Frohman was the head of Intel Israel at the start of the First Gulf War, and it fell to him to determine how the company would respond. In this first-person account, he describes what it’s like to hold not just the future of a company but the future of an entire industry and the lives of many employees in his hands.

Israeli businesses were used to preparing for war, or so Frohman thought when he assigned a task force to draw up plans in the fall of 1990 to replace enough called-up reservists to operate the Jerusalem fabrication plant, the Haifa design center, and the Tel Aviv sales and marketing office on skeleton crews.

But that was before Saddam Hussein stationed ballistic missiles just seven minutes away from Tel Aviv. Concerned about chemical attacks, the Israeli civil defense agency called for all nonessential Israeli businesses to shut down when the allied attacks against Iraq began on January 17, 1991. The first missiles hit Jerusalem in the small hours of the next day. Instead of being behind the war zone, Intel Israel was going to be right in it.

Frohman called in his task force and drove the 20 minutes to work that morning. It would have been easy to follow the civil defense directive and close down. Everyone was doing it; Intel’s senior executives in California would have understood. But Frohman chose to ignore the directive and asked his employees to continue coming to work to keep operations running.

This is the story of how and why the Intel senior executive made that decision, how he carried it out, and what the consequences were. It is a lesson about decision making when the stakes couldn’t be higher.

Reprint R0612H

133 | Lift Outs: How to Acquire a High-Functioning Team

Boris Groysberg and Robin Abrahams

More and more, expanding companies are hiring high-functioning groups of people who have been working together effectively within one company and can rapidly come up to speed in a new environment. These lifted-out teams don’t need to get acquainted with one another or to establish shared values, mutual accountability, or group norms; their long-standing relationships and trust help them make an impact very quickly. Of course, the process is not without risks: A failed lift out can lead to loss of money, opportunity, credibility, and even native talent.

Boris Groysberg and Robin Abrahams studied more than 40 high-profile moves and interviewed team leaders in multiple industries and countries to examine the risks and opportunities that lift outs present. They concluded that, regardless of industry, nationality, or size of the team, a successful lift out unfolds over four consecutive, interdependent stages that must be meticulously managed.

In the courtship stage, the hiring company and the leader of the targeted team determine whether the proposed move is, in fact, a good idea, and then define their business goals and discuss strategies. At the same time, the team leader discusses the potential move with the other members of his or her group to assess their level of interest and prepare them for the change.

The second stage involves the integration of the team leader with the new company’s top leadership. This part of the process ensures the team’s access to senior executives—the most important factor in a lift out’s success.

Operational integration is the focus of the third stage. Ideally, teams will start out working with the same or similar clients, vendors, and industry standards.

The fourth stage entails full cultural integration. To succeed, the lifted-out team members must be willing to re-earn credibility by proving their value and winning their new colleagues’ trust.

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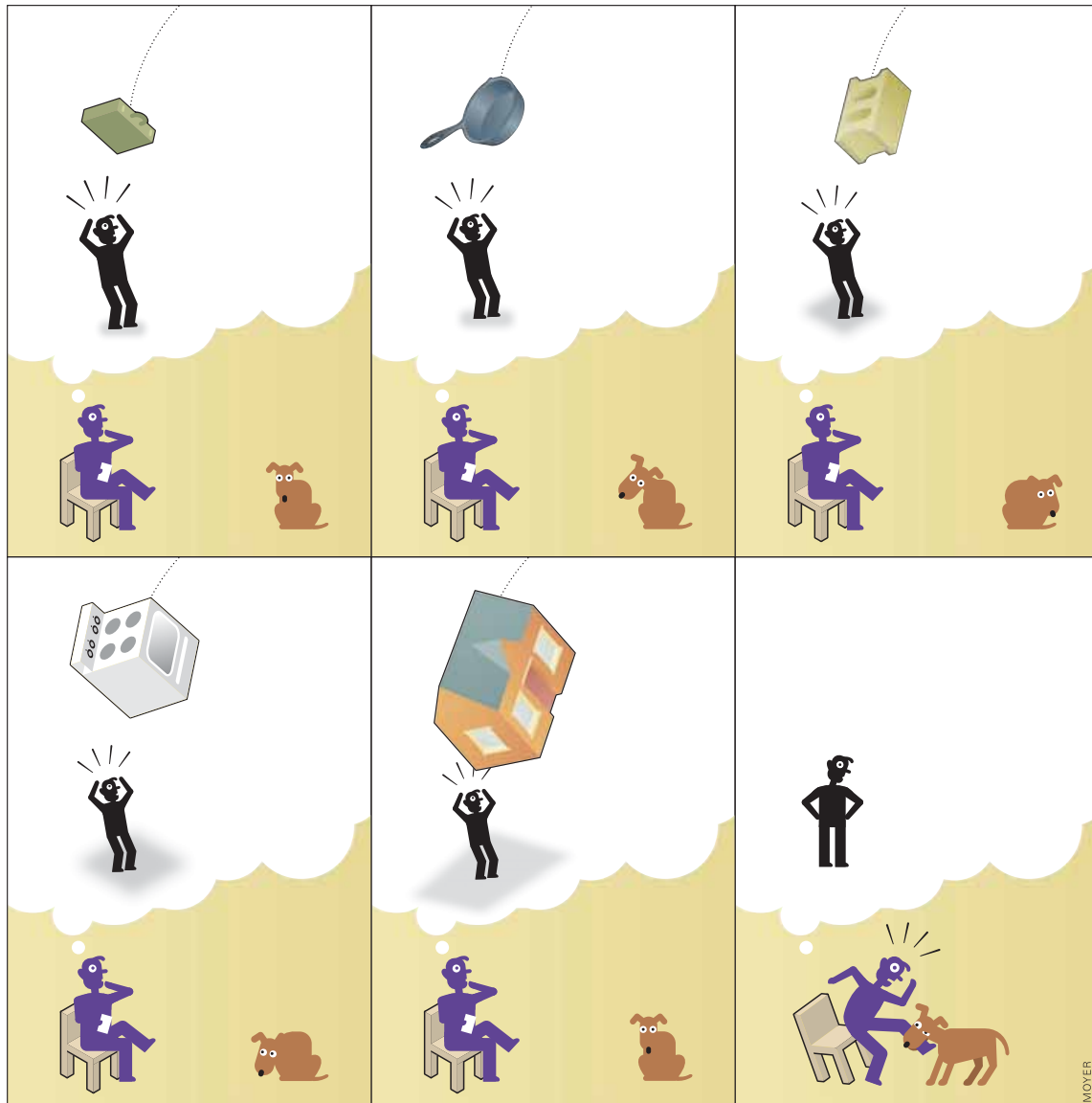
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Blindsided

The risks businesses face range from currency fluctuations to chemical spills to computer system failures. Leaders try to mitigate these risks with tools like hedging, insurance, and backup systems. Some firms take this a step further and adopt an “enterprise risk management” program—a comprehensive set of techniques designed to work in concert to protect the organization.

Unfortunately, as David McNamee points out in “Risk Reflections,” an interview published in the October 2004 issue of *Internal Auditor*, such programs often suffer from a lack of imagination. “Most of us are too specialized or focused and so accustomed to our environment that we cannot break out of our current thinking patterns to think broadly about our risks,” he writes. “It is usually the risk that ‘no one ever thought of’ that causes the most harm.”

In fact, Adrian J. Slywotzky and John Drzik argue in “Countering the Biggest Risk of All” (HBR April 2005), there is an entire category of risk—“strategic risk”—that is generally ignored by managers and poses the greatest danger to companies’ long-term growth plans and shareholder value. Only by taking a broad view, the authors say, can you anticipate the threats that are bound to bite you in the end.

Don Moyer can be reached at dmoyer@thoughtformdesign.com.

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