The Authentic Leader…page 86 Where Marketing Fails…page 74

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62 **Strategy and Your Stronger Hand**
Geoffrey A. Moore

74 **Marketing Malpractice: The Cause and the Cure**
Clayton M. Christensen, Scott Cook, and Taddy Hall

86 **Managing Authenticity: The Paradox of Great Leadership**
Rob Goffee and Gareth Jones

98 **Regional Strategies for Global Leadership**
Pankaj Ghemawat

110 **"A Players" or "A Positions"? The Strategic Logic of Workforce Management**
Mark A. Huselid, Richard W. Beatty, and Brian E. Becker

18 FORETHOUGHT

39 HBR CASE STUDY
Just in Time for the Holidays
Eric McNulty

53 MANAGING YOURSELF
How to Build Your Network
Brian Uzzi and Shannon Dunlap

122 BEST PRACTICE
Up to Code: Does Your Company's Conduct Meet World-Class Standards?
Lynn Paine et al.

135 TOOL KIT
Getting Offshoring Right
Ravi Aron and Jitendra V. Singh

150 EXECUTIVE SUMMARIES

156 PANEL DISCUSSION

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FEATURES

December 2005

62 **Strategy and Your Stronger Hand**
Geoffrey A. Moore

There are two dominant business models in the world. Knowing what they are – and which one your company follows – will guide you toward the right strategic moves.

74 **Marketing Malpractice: The Cause and the Cure**
Clayton M. Christensen, Scott Cook, and Taddy Hall

Markets are simple when you look at them from the point of view of your customers. They have a job to do. You have a product or service. Does it do the job they need to get done?

86 **Managing Authenticity: The Paradox of Great Leadership**
Rob Goffee and Gareth Jones

No senior executive can become authentic by looking into a mirror and saying, "I am authentic." Authenticity is largely defined by what other people see in you and, as such, can to a great extent be controlled by you. Here's how to manage it and make yourself more effective as a leader.

98 **Regional Strategies for Global Leadership**
Pankaj Ghemawat

Successful border-crossing companies often apply a regionally oriented strategy in addition to – or even instead of – a global one. Five approaches can help global companies create value in a highly regionalized world.

110 **"A Players" or "A Positions"? The Strategic Logic of Workforce Management**
Mark A. Huselid, Richard W. Beatty, and Brian E. Becker

What good is an "A player" in a bit part? Rather than focus on the players, you should identify the critical jobs, then invest heavily in those positions and make sure the right people star in the most important roles.

continued on page 8

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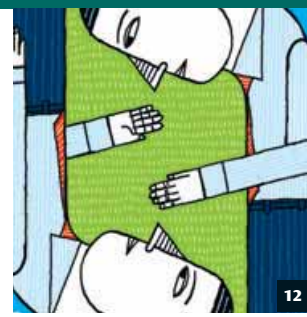

12 **FROM THE EDITOR**

On the One Hand

The awkwardness a person feels when trying to use his weaker hand has found its way into our language: The words "adroit" and "gauche" come from the French for "right" and "left." It's similar with companies and the way they do business.

18 **FORETHOUGHT**

Do monopolies *really* stifle innovation?… The damage incompetent managers can do…Be selective when extending premium brands to other product categories…An ounce of prevention is worth tons of savings in health care costs…Is there a shortage of emotional intelligence in the C-suite?…Good writers can improve product development processes…Video games' influence on and in the workplace…The four cultural tensions facing Chinese executives… Porsche insources student expertise… Even stable, low-turnover businesses are vulnerable to social-capital leaks.

39 **HBR CASE STUDY**

Just in Time for the Holidays

Eric McNulty

It's the busiest time of year for North Pole Workshops, and production is in high gear. But an unexpected surge in demand for one toy may leave children around the world disappointed on Christmas morning, whether they've been naughty or nice.

53 **MANAGING YOURSELF**

How to Build Your Network

Brian Uzzi and Shannon Dunlap

Is your network as strong as you think? Maybe not, if you cultivated most of the connections yourself. Learn how to diversify your contacts and really expand your reach.

96 **STRATEGIC HUMOR**

122 **BEST PRACTICE**

Up to Code: Does Your Company's Conduct Meet World-Class Standards?

Lynn Paine, Rohit Deshpandé, Joshua D. Margolis, and Kim Eric Bettcher

Codes of conduct have long been a feature of corporate life – but what should they say? New research sheds light on a growing global consensus.

135 **TOOL KIT**

Getting Offshoring Right

Ravi Aron and Jitendra V. Singh

Only half the organizations that shift processes offshore generate the expected financial benefits. It's not that offshoring can't work; it's that companies aren't systematic enough in their efforts. A methodology for choosing which processes to send out – and where – can help.

145 **LETTERS TO THE EDITOR**

In the global era, companies can expand within one line of business across borders more easily than across lines of business within one country.

156 **PANEL DISCUSSION**

Don't Fence It In

Don Moyer

Shielding your cherished products and business ideas from your competitors may thwart your attempts to innovate.

10 **COMPANY INDEX**

HBR now includes an index of authors' affiliations and organizations mentioned in articles.

150 **EXECUTIVE SUMMARIES**

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Organizations in this issue are indexed to the first page of each article in which they are mentioned. Subsidiaries are listed under their own names.

ABB . . . 98
Abbott Laboratories . . . 18
Accenture . . . 62
Adobe . . . 62
Agere Systems . . . 18
Airbus . . . 62
Allsec Technologies . . . 135
Amazon . . . 62
America Online . . . 62
Apache . . . 62
Apple Computer . . . 62, 74
ASK Computer Systems . . . 62
AT&T . . . 18
Bank of America . . . 135
Bayer . . . 98
BBC . . . 86
Bechtel . . . 62
Bell Labs . . . 18
Best Buy . . . 62
Black & Decker . . . 74
BMW . . . 18
Boeing . . . 62
Bose . . . 18
The Boston Consulting Group . . . 135
Bulgari . . . 18
Burlington Northern Santa Fe Railway . . . 62
Canon . . . 62
Cartier . . . 18
Cemex . . . 98
Charles Schwab . . . 62
Cheyenne Symphony Orchestra . . . 53
Christie's . . . 62
Church & Dwight . . . 74
Cisco . . . 62, 98
Colgate-Palmolive . . . 74
Columbia University . . . 53
Compaq . . . 62
Cornell University . . . 18
Costco . . . 110
Cullinet Software . . . 62
De Beers . . . 18
Dell . . . 62, 98
Digital Equipment . . . 62
Disney . . . 62, 86
Dr. John's Products . . . 74
Dun & Bradstreet . . . 53
eBay . . . 62, 74
Electronic Arts . . . 62
Electronic Software Association . . . 18
EMC . . . 62
Ernst & Young . . . 62
European Union . . . 98
Fairchild Semiconductor International . . . 18
FedEx . . . 62, 74
Ford . . . 74, 98, 135
Gap . . . 62
Gartner . . . 135
Gecis Global (now Genpact) . . . 135
GE Europe . . . 98
General Electric . . . 18, 62, 98, 110, 135
General Motors . . . 18, 74, 98
GlaxoSmithKline . . . 110
Goldman Sachs . . . 62
Google . . . 62, 74
Great Plains Software . . . 62
Halliburton . . . 62
Harvard Business School . . . 74
Hertz . . . 62
Hewlett-Packard . . . 62
Hilton . . . 62
Honeywell . . . 62, 98
IBM . . . 18, 53, 62, 110
IDEO . . . 62
Intel . . . 62
Intuit . . . 74
Johnson & Johnson . . . 62, 74
Kodak . . . 62, 74
Lehman Brothers . . . 135
Linux . . . 62
Lockheed Martin . . . 62
Louis Vuitton . . . 18
Lucent Technologies . . . 18
Macy's . . . 74
Makita . . . 74
Management Science America . . . 62
Marks & Spencer . . . 86
Marriott International . . . 18, 74
Mattel . . . 39
McCormack & Dodge . . . 62
McDonald's . . . 62
Mercedes-Benz . . . 18
Microsoft . . . 53, 62, 110
Milwaukee Electric Tool . . . 74
Motorola . . . 62
Nestlé . . . 62, 86
Nike . . . 62
Nissan . . . 74
Nokia . . . 62
Nordstrom . . . 110
Office Tiger . . . 135
Oracle . . . 62
Palm . . . 62
Peachtree Software . . . 62
Pierre Cardin . . . 18
Playmobil . . . 39
Porsche . . . 18
Procter & Gamble . . . 62, 74
Robert Bosch Tool . . . 74
Roche Pharmaceuticals . . . 86, 110
Rolex . . . 18
Royal Philips Electronics . . . 98
Samsung . . . 98
SAP . . . 62
SBC Communications . . . 18
Siebel . . . 62
Sony . . . 62, 74
Stern School of Business, New York University . . . 18
Sun Microsystems . . . 62
Swiss Re . . . 62
Symbol Technologies . . . 62
Tata Group . . . 122
Tektronix . . . 62
Texas Instruments . . . 18
Time Warner . . . 62
Toyota . . . 98
Unilever . . . 74, 86
United Airlines . . . 62
United States Postal Service . . . 74
United Way of America . . . 53
University of Kentucky . . . 18
UPS . . . 74
U.S. Trust . . . 62
Verizon . . . 62
Wal-Mart . . . 98, 110
Western Electric . . . 18
Whirlpool . . . 98
The World Bank . . . 62
Wyeth Consumer Healthcare . . . 110
Xerox . . . 62
Zara . . . 39, 98

AUTHOR AFFILIATIONS

Abbott Laboratories . . . 18
Advertising Research Foundation . . . 74
Annals of Improbable Research . . . 18
Capgemini . . . 18
Creative Management Associates . . . 86
The Education Arcade . . . 18
Geobra Brandstätter . . . 39
Harvard Business School . . . 74, 98, 122
Harvard Business School Publishing . . . 39
Henley Management College . . . 86
IMD International . . . 18
Insead . . . 86
Intuit . . . 74
John Galt Solutions . . . 39
Kellogg School of Management, Northwestern University . . . 53
London Business School . . . 86
Massachusetts Institute of Technology . . . 18
Mohr Davidow Ventures . . . 62
Pharmaceutical Research and Manufacturers of America . . . 18
Rutgers . . . 110
Sony Computer Entertainment America . . . 18
Stanford University . . . 18, 39
SUNY Buffalo . . . 110
TalentSmart . . . 18
TCG Advisors . . . 62
Thunderbird, The Garvin School of International Management . . . 18
Tuck School of Business, Dartmouth College . . . 39
University of California, Santa Cruz . . . 18
University of Kalmar's Baltic Business School . . . 18
University of Stellenbosch . . . 18
Wharton, University of Pennsylvania . . . 135

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On the One Hand

A FEW YEARS AGO, a group from IBM Global Services met to try to understand the organization's selling process. Global Services is the part of IBM that tries to make megadeals with megacorporations, supplying hardware, software, service and support, outsourcing services, and more. Deals can take years to negotiate and can be worth billions.

Needless to say, there aren't many potential customers of this sort, so if one deal slips through the company's fingers it can't just reach into the pool, guddling another one. The sales teams don't have a lot of data, either. People who sell personal computers or Game Boys, who have millions of customers, have oodles of statistics to guide them. They can test and tweak everything from prices and packaging to the text of their direct-mail letters. The group from IBM Global Services, by contrast, had only their colleagues' impressions to go on – stories about success and failure, along with hypotheses about why one approach worked and another fell through. They were informed, professional impressions, to be sure, but they represent an entirely different *kind* of knowledge from the data possessed by people who compete in mass markets. Indeed, the purpose of the meeting, which was run by David Snowden, who has since left IBM to run an organization called the Cynefin Centre, was to listen for patterns, hunches, and archetypes in sales teams' stories – stuff that would drive a quant bonkers.

The differences between businesses of the kind represented by IBM Global Services and those represented by, say, Apple Computer, run far beyond sales and marketing. What I've just described is a fundamental difference between two kinds of companies. That's the thesis of Geoffrey Moore's brilliant article, "Strategy and Your Stronger Hand," which leads off this issue. Every company has a preferred way of doing business, just as every person has a dominant hand. The awkwardness that a person feels trying to use the weaker hand has found its way into our language: The words "adroit" and "gauche" come from the French for "right" and "left." It's similar with businesses, Moore shows.

On one side of the line are volume-operations businesses – companies that, for the most part, mass-produce for mass markets. They might be manufacturers (appliance makers, for example) or service companies (retail banking comes to mind). On the other side are complex-systems businesses. These are outfits that bring a suite of products or services to a small number of customers. Boeing and Airbus are complex-systems manufacturers; in services, investment banking is an example. Ambidexterity is rare.

The practical implications of this distinction are enormous. Because the two kinds of businesses have such different economics, virtually every indicator on their CEOs' dashboards would (or should) be different. Each kind of organization has its own characteristic management screwups. For instance, volume-operations companies struggle to align the interests of functions that depend on each other and handle work sequentially; classically, they suffer when work is "thrown over the wall" in a production process that goes from procurement to manufacturing, distribution, and sales. In complex-systems businesses, the intracompany coordination problem is quite different. Typically, it involves getting semi-independent businesses to work together for the common good, subordinating their individual P&Ls to that of the enterprise.

These differences – cultural, economic, and organizational – are so deep that companies run great risks when they move into a business that doesn't suit their dominant hand. Consider the siren song of "solutions" – the wish of many an industrial company, struggling to avoid the commoditization of its products, to "move up the value chain" and "provide end-to-end solutions to customers" by offering consulting or maintenance services, for example. That often means bolting a complex-systems business on to a volume-operations base. It rarely works. In Moore's view, such a company would be better advised to look for a way out of its problem that doesn't involve trying to change its dominant style of doing business. It's easier to convert a shortstop into an outfielder than it is to change a southpaw into a righty.

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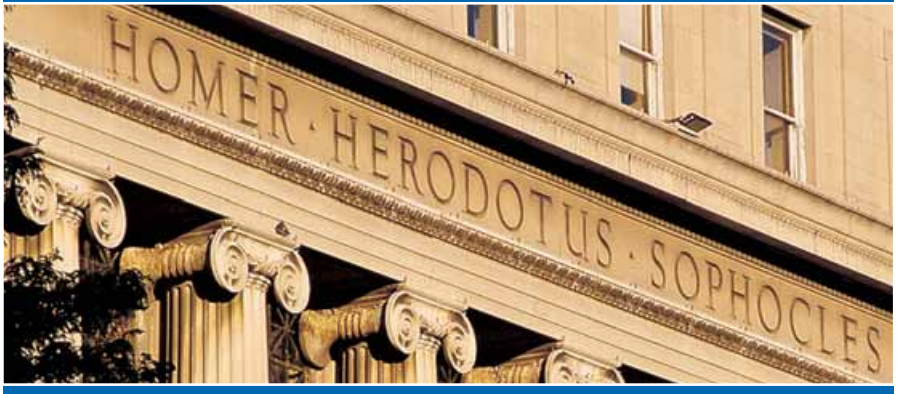

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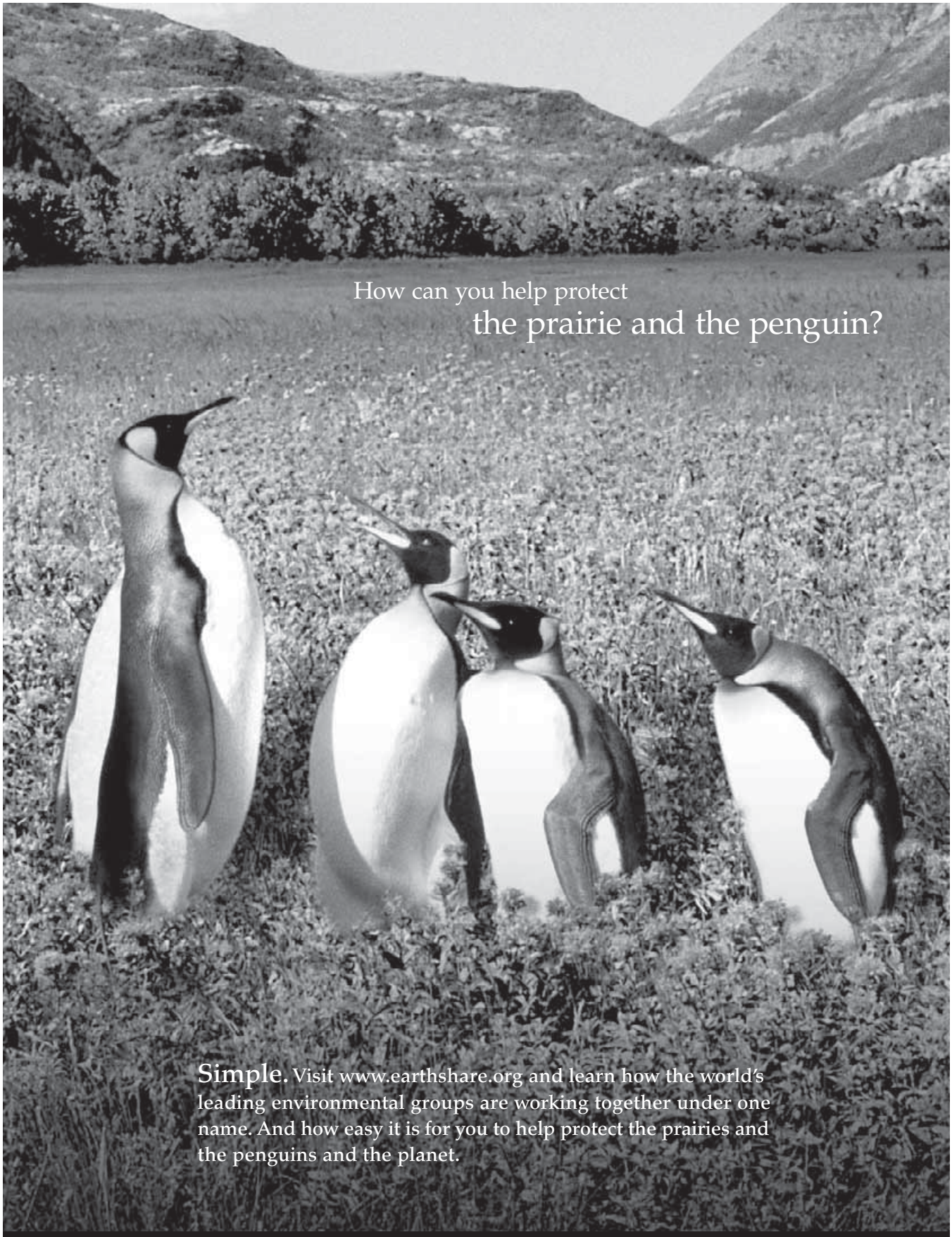

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forethought

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

STEPHEN SAVAGE

GRIST

No Monopoly on Innovation

by MICHAEL RIORDAN

Fifty years ago, when the American Telephone and Telegraph Company still held a monopoly on U.S. phone service, the first minute of a toll call could easily cost a dollar – the equivalent of about $5 today. But a few pennies of that 1950s dollar supported research and development efforts at Bell Telephone Laboratories and at AT&T's manufacturing arm, Western Electric.

This corporate combination was probably the most potent innovation engine the world has ever known, spawning such midcentury marvels as the transistor, the laser, the solar cell, cellular telephony, and satellite communications. And it developed almost all of the silicon technology that others used to invent the microchip. Without a doubt, Bell Labs and Western Electric laid the foundations of the information age and today's global society.

But these institutions have been declining since the 1984 breakup of AT&T. Soon that corporate colossus – once the largest company in America – will no longer exist, having been acquired by SBC Communications for only $16 billion. Bell Labs, whose physicists have garnered six Nobel Prizes for their scientific breakthroughs, is but a shadow of its former self under Lucent Technologies. And in 2002, Lucent spun off most of the remains of Western Electric as Agere Systems. A long-distance call may now cost pennies, but the nation has lost one of its leading institutions of science and technology.

Many economists argue that monopolies stifle innovation. The lack of competition induces corporate somnolence, and new technologies are patented mainly to consolidate and protect a company's

dominant market position rather than to encourage the creation of revolutionary products and services. But innovation was a much different affair at AT&T, which espoused a corporate ethos of universal service – and especially at Bell Labs, which adhered to a management philosophy calculated to attract some of the world's best scientists and engineers to work in an industrial lab. A healthy percentage of the costs of R&D were built right into the calling-rate base. Thus assured of steady financing, lab managers could afford to take the long view and pursue breakthrough technologies that might not pay off for a dozen years or more but might ultimately be of enormous value to society. AT&T's patient capital and secure cash flows allowed the company to take the substantial risks involved in attempting *sustained* innovation across a broad technology front.

The transistor is perhaps the best example of that process. AT&T's managers recognized the long-range need for a solid-state amplifier and switch during the 1930s, but it wasn't until 1947 that John Bardeen, Walter Brattain, and William Shockley invented the device. And it took another 15 years or so of technology development before transistors began to assume their modern form. Bell Labs and Western Electric fostered almost all the subsequent innovations this transformation required: purifying silicon, growing large crystals of this semiconductor material, diffusing layers of impurities into the crystals, patterning the layers using a protective oxide surface layer, and so on.

During the 1960s, Fairchild Semiconductor and Texas Instruments adapted many of these technologies to develop the microchip, whose manufacture now adds more than a trillion dollars per decade to the global economy. These smaller, less-robust companies could never have pursued the many different innovations that made their core product possible. But they were exquisitely poised to drink from the rich technology stream flowing from Bell Labs and Western Electric.

Only a large corporation such as AT&T – or others like General Electric and IBM – could ever afford to support the sustained, multidisciplinary, mission-oriented R&D efforts needed for these innovations without worrying too much about the short-term impact on the bottom line. And it was crucial that this work be accomplished in a pragmatic industrial setting, with a long-range goal of delivering better goods and services – an ethos that hardly exists in government or university laboratories.

Such farsighted institutions, performing basic research and development

STUDIES SHOW

Those Who Can't, Don't Know It

by MARC ABRAHAMS

The ancient phrase "A fish rots from the head down" describes the pernicious effects that incompetent managers have on those below them. But such managers are hard to correct or criticize because they don't recognize there's a problem.

Psychologists David Dunning of Cornell University and Justin Kruger, now at New York University's Stern School of Business, supplied scientific evidence that incompetence is bliss – bliss, that is, for the incompetent person. Their study, "Unskilled and Unaware of It: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments," appeared in 1999 in the *Journal of Personality and Social Psychology.*

To explore the breadth and depth of human incompetence, Dunning and Kruger staged a series of experiments. In one, they asked 65 test subjects to rate the funniness of certain jokes. They then compared each test subject's ratings with those of eight professional comedians. Some of the participants repeatedly couldn't predict what others would find funny – yet described themselves as excellent judges of humor (rather like the character David Brent in the British version of the TV series *The Office*). Although less colorful, Dunning and Kruger's other experiments – involving grammar and logic – yielded similar results.

Incompetence, the study demonstrated, represents a dismaying troika of cluelessness: Incompetent people don't perform up to speed, don't recognize their lack of competence, and don't recognize the competence of others. "The skills that engender competence in a particular domain are often the very same skills necessary to evaluate competence in that domain," the researchers conclude. In other words, if incompetents have people reporting to them, their poor judgment may damage careers besides their own. "Unskilled and Unaware of It" is online at www.apa.org/journals/features/psp7761121.pdf.

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

Reprint F0512B

within industry, are necessary if society is to realize fundamental breakthroughs, like the transistor, that have the potential to transform it. AT&T's seemingly excessive charges on toll calls served as a kind of R&D tax: The company provided a reliable mechanism for diverting a tiny fraction of our everyday expenses – coming from all corners of the U.S. economy – to long-term R&D projects that eventually made tremendous improvements in our lives.

Surveying today's science and technology landscape, I can find nothing comparable to the AT&T–Bell Labs–Western Electric innovation machine. But at least we can now call anywhere in the country and gab for hours, never worrying about the costs.

MICHAEL RIORDAN *(riordan@stanford.edu) teaches the history of physics and technology at Stanford University in California and at the University of California, Santa Cruz. He is a coauthor of* Crystal Fire: The Birth of the Information Age *(W.W. Norton, 1997).*

Reprint F0512A

MARKETING

How Not to Extend Your Luxury Brand

by MERGEN REDDY AND NIC TERBLANCHE

In 1972, Diane von Furstenberg created the multifunctional wrap dress, which captured the imagination – and the pocketbooks – of a generation. By 1976, she had sold more than five million of her designs and was hailed by *Newsweek* as "the most marketable woman in fashion since Coco Chanel." Von Furstenberg didn't stop there: She developed a line of beauty products and fragrances and

stamped her name on everything from luggage to eyewear to jeans to books.

The strategy worked at first. Von Furstenberg's premium name generated high margins for every product it adorned, regardless of the category. But a few years into this heady growth, the brand lost momentum. Revenues and profits plummeted, and, ultimately, von Furstenberg had to sell her design and cosmetics houses to pay off debts.

What happened? Generally, luxury brands increase in profitability when consumers perceive that these goods offer more value (or *premium degree*) than other comparable products. Brands like Bose, De Beers, Louis Vuitton, and Rolex all became more profitable as their premium degree grew. Von Furstenberg products showed this same effect, for a time.

But our study of 150 luxury brands, involving interviews with more than 300 executives worldwide and analyses of approximately ten years' worth of financial data for each brand, shows that this rule doesn't always hold. Specifically, our research found that a luxury brand's profitability will usually increase as the premium degree increases – but only if the brand is extended into product categories adjacent to the core brand. Von Furstenberg's problem, it appears, was not that the name had lost its cachet or that the quality of the goods carrying it was poor; it was that a brand people associated with high-end dresses just didn't translate well to nonadjacent products such as luggage and books.

Consider Louis Vuitton and Cartier, each of which has gross margins above 79%. These brands have profitably extended their names into categories adjacent to their core products. Cartier expanded its brand from jewelry to watches, perfumes, and accessories. Louis Vuitton transferred its name from handbags to clothing, jewelry, perfumes, and accessories. However, remember Pierre Cardin? The brand's early extensions into perfumes and cosmetics in the 1960s succeeded so well that the company began to sell licenses indiscriminately. By 1988, it had granted more than 800

licenses in 94 countries, generating a $1 billion annual revenue stream – and profits plummeted. It wasn't until the Pierre Cardin name started appearing on wildly nonadjacent products such as baseball caps and cigarettes that margins collapsed. Initially, the brand extensions into the perfumes and cosmetics categories were successful because the premium degree of the Pierre Cardin brand transferred undiminished into the new, adjacent categories. The owners of Pierre Cardin, unfortunately, attributed this to the strength of the brand rather than to the brand's fit with the new product categories.

Of course, some brands leap successfully among categories. Such success often depends on whether the core brand's value, in the eyes of consumers, is primarily symbolic or functional. Some luxury brands are valued for their functional aspects; people buy Porsches, for instance, in part because of the vehicles' world-class performance and engineering. Other luxury brands, like Louis Vuitton, are valued more for the lifestyle they project than for the particular expertise or functionality they embody. We've found that symbolic brands can be more easily exported into nonadjacent categories than functional brands and can succeed in these categories when they consistently promote their core symbolic attributes. (For more on this concept, see "Marketing Malpractice: The Cause and the Cure" also in this issue.) For example, when Bulgari licensed its name to Marriott to create a chain of luxury hotels, customers bought into the concept because of the symbolic value of the Bulgari

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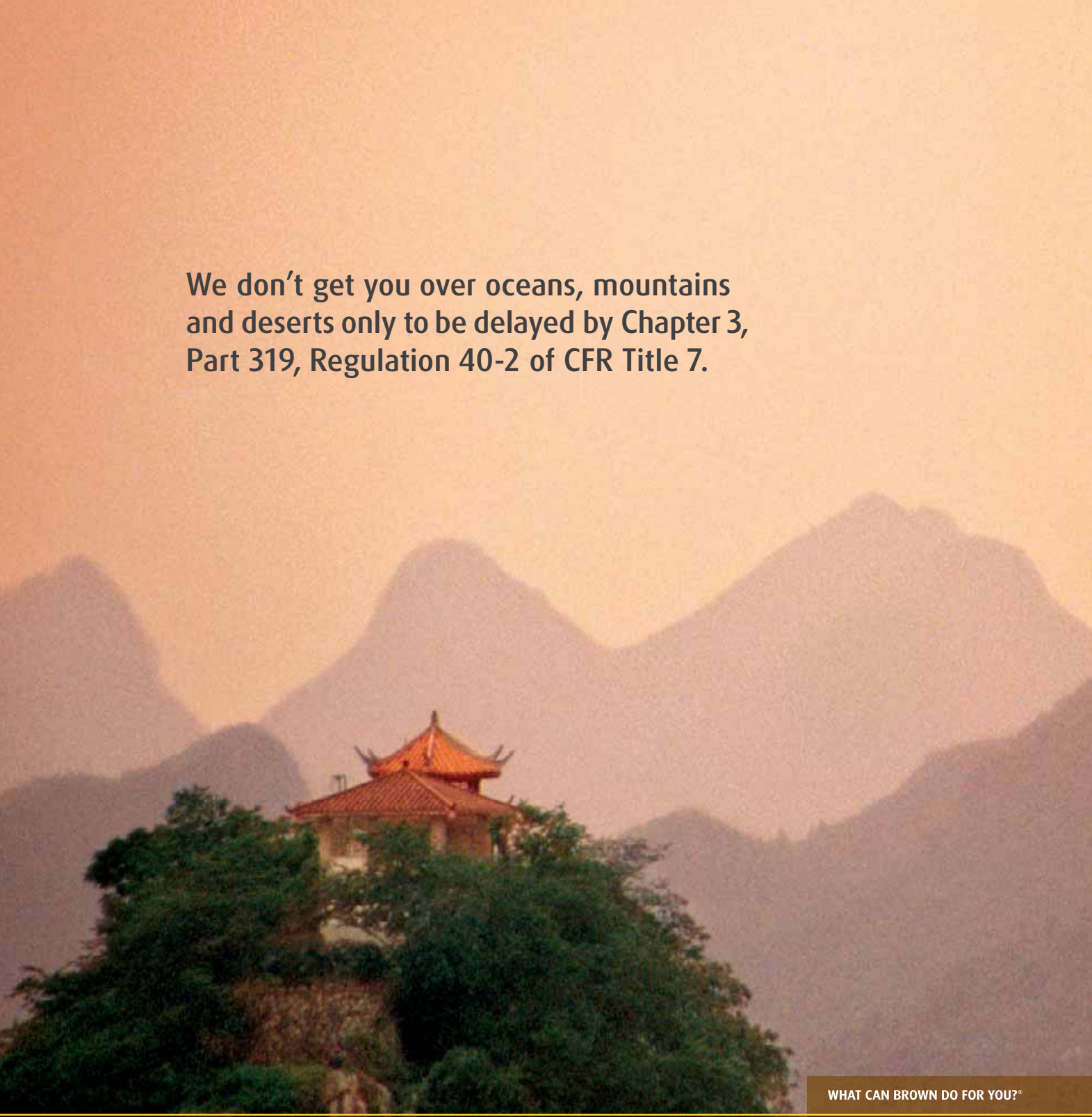

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Opinion

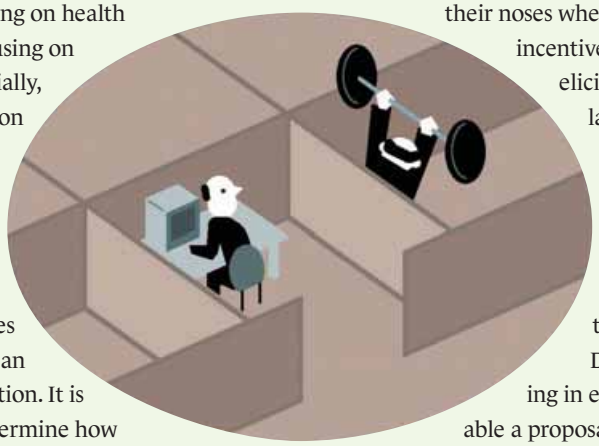
by MILES WHITE

The Cost-Benefit of Well Employees

When companies buy computers for their employees, they also provide training to make sure the investment pays off. So why do those same companies invest millions of dollars in health care without making any particular effort to ensure that their employees stay healthy?

As major purchasers of health care, corporations have almost as much of a stake in preserving or improving employees' health as the employees themselves do. My company invests hundreds of millions of dollars in health care; a company like General Motors – which in June placed much of the blame for its massive layoffs on health care costs – invests considerably more. We need to protect these investments and capitalize on them as we would on any other.

Companies can do that by recognizing that they achieve larger gains when they address the causes, rather than the treatments, of ill health. Focusing on health care is inherently reactive; focusing on health is proactive and, potentially, a game changer. The chief reason companies fail to invest in health, I think, is that it is often difficult to quantify the return. Executives know how to measure savings from disease-management techniques that reduce the cost of care for an employee with a chronic condition. It is much trickier to accurately determine how much they could save by keeping that employee from getting sick in the first place. For that reason, significant investments in prevention require some faith.



Given that employees spend about a quarter of their time at the office, companies can do quite a bit to help them stay healthy and to cut their own costs in the process. For example, companies can:

1. Provide plenty of nutritious options in cafeterias and vending machines. And because healthy foods often cost more, employers can subsidize the purchase of them.

2. Make workplaces smoke free and help employees kick the habit outside of work.

3. Encourage exercise by offering employees free use of a fitness center or subsidizing employees' memberships to local gyms. When possible, leaders should set the example themselves, even if that just means taking a brisk ten-minute walk at lunch.

4. Offer on-site health education and screening for conditions like high blood pressure and high cholesterol.

5. Share with employees who do take care of themselves some of the savings they generate.

6. Design health care programs with a component that reaches out to employees' immediate families. At Abbott, we cover an average of 1.6 dependents for every employee. Keeping those families healthy produces even greater savings for the company.

Very few companies do all of these things (that includes ours – we do four out of six). And admittedly there are barriers to thoroughly embedding health consciousness in the corporate culture. Such actions can raise charges of paternalism, manipulation, or senior executives inserting their noses where they don't belong. Creating incentives for healthy behavior may elicit cries of unfairness, particularly from superior performers with poor health habits. Companies must also be vigilant that their preferences for healthy living don't influence hiring and promotion decisions.

Despite those concerns, investing in employee health is as unassailable a proposal as you are likely to find in business. Employees live healthier lives; companies do the right thing and decrease their health care costs. In the process, organizations also reduce costs resulting from lost productivity and absenteeism and become more attractive to many employees and job seekers. Nothing could be more straightforward.

Yes, health care does impose a heavy burden on employers. But while government, industries, and interest groups concentrate on the long-haul task of reforming this monster, individual employers should meaningfully influence their own small piece of it.

MILES WHITE *is the chairman and CEO of Abbott Laboratories, based in Abbott Park, Illinois, and immediate past chairman of the Pharmaceutical Research and Manufacturers of America.*

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name, not because Bulgari has engineering skills that it brought to bear on the design and installation of Marriott's bath towel holders. Von Furstenberg made the mistake of emphasizing the technical aspects of the nonadjacent products the company branded (such as the shapes and finishes of its eyeglass frames), when it should have played up the symbolic value of the brand name.

When managers want to extend their luxury brands into nonadjacent categories, they should first consider whether the brands have appropriate symbolic power to cross categories. They should also consider whether the symbolism can be consistently promoted in the new categories. Rolex perfume? Maybe. Lamborghini wine? We don't think so.

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Reprint F0512C

SELF-MANAGEMENT

Heartless Bosses?

by **TRAVIS BRADBERRY AND JEAN GREAVES**

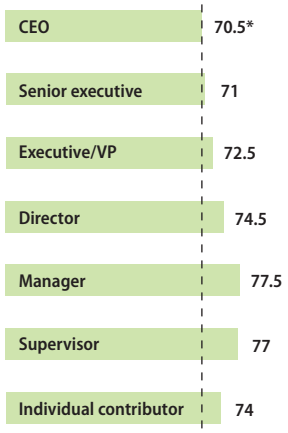
Considering the mountains of literature about emotional intelligence, you'd think corporate executives would be pretty smart about it. But our research shows that the message still isn't getting through. During the past five years, we have measured emotional intelligence in more than 100,000 senior executives (including 1,000 CEOs), managers, and line employees across industries on six continents. For each respondent, we measured self-awareness, social-awareness, self-management, and relationship-management skills to yield a cumulative EQ (or "emotional intelligence quotient") score on a 100-point scale.

As the exhibit at right shows, EQ scores rise as executives climb the ladder, peaking at the manager level, falling off thereafter, and bottoming out, alarmingly, at the CEO level. (Though the absolute difference between the highest and lowest scores is only seven points, this is a highly significant statistical difference.)

How could it be that the very people who need emotional intelligence the most seem to have it the least? It appears that companies are still promoting executives principally on the basis of what they know or on how long they've served the company rather than on their ability to lead. Yet, for every job we've studied, emotional intelligence is a better predictor of performance than technical skill, experience, or intellect – confirming what psychologist Dan Goleman and others in the field of emotional intelligence have been saying for years.

If you're in the rarefied ranks of C-suite executives, your subordinates are

Emotional Intelligence Scores and Job Title



* Score reflects a cumulative emotional intelligence quotient based on a 100-point scale

probably more emotionally intelligent than you are. That's not advantageous for you or your company. A decade of research shows that emotional intelligence can be honed – that's the good news – but first you have to recognize the need.

TRAVIS BRADBERRY *(tbradberry@talentsmart.com) and* **JEAN GREAVES** *(jgreaves@talentsmart.com) are the cofounders of TalentSmart, based in San Diego, California. They are the coauthors of* The Emotional Intelligence Quick Book *(Fireside, 2005).*

Reprint F0512E

PRODUCT DEVELOPMENT

Revaluing Writing

by **JACK SHULMAN**

Companies spend whatever it takes to develop intellectual assets. At the same time, they routinely seek to minimize their investment in the technical and procedural documents that tell people how to use those assets. Such meta-information as instruction manuals, process descriptions, and procedure guides script the experience of customers and the performance of suppliers and employees. Yet companies view the creation of this information as, at best, a cost of doing business and, at worst, something they can safely ignore.

Good writers can change all that. What's more, good writers who are consulted early enough can improve the product development process and, potentially, products themselves.

Unfortunately, writers in many companies don't get that chance. Brought in at the end of the development cycle, they are expected only to take what the project team says is important and turn it into English. When this happens, the writers may become caught in a squeeze play between the engineering and marketing groups: The engineers are unavailable, having built little or no time into their schedules for tedious meetings with people whom they believe think only in adjectives and verbs, not specs and functions. And the marketing folks are losing patience, having been slowly going mad for months, waiting to find out what they are expected to sell and unable to understand why it takes so long to get facts on a product that is nearly complete. In a multinational, multilingual corporation, the burden of translation and localization compounds this problem.

In addition, the writer's act of mastering a product's or a process's complexities and then distilling those into simple, clear language for a lay (or expert) reader sometimes reveals flaws, contradictions, or unfulfilled product promises that developers are too close to the project to see. Questions from smart and skillful writers can cause engineers to reconsider a product design element after it has

continued on page 28

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Conversation

HENRY JENKINS ON VIDEO GAMES AND THE WORKPLACE

Play to Win

Fifty percent of Americans play video games, spending approximately seven hours a week glued to some type of screen, according to the Electronic Software Association. While that level of play gets blamed for everything from violence to obesity to illiteracy, gamers can bring some desirable qualities to the workforce if companies know how to exploit them, says Henry Jenkins, director of comparative media studies at MIT (and cofounder of the gaming and learning research initiative, The Education Arcade).

How do gamers approach work differently?
For one thing, they become very good at making rapid decisions based on limited information. Online games make constant demands on your attention; there are multiple problems emerging at the same time, and players get very good at making reasonable predictions and charting actions based on information as it comes in. They can then quickly reroute themselves and change their priorities as new problems arise, which is the style of decision making emerging in the contemporary workplace.

Does constant gaming hurt players' social skills?
Actually, it does the opposite. Collaborative play is quickly becoming dominant in this medium. Most people who play alone are just rehearsing the skills they need to participate in group activities. Users of multiplayer or alternative-reality games learn to work with other people over distance, to share knowledge, to resolve disputes quickly, and to stay on task. Any large company needs collaboration and coordination among people in multiple locations who bring different skills and knowledge to bear on a problem.

How might a game teach that?
There's a problem in the game *I Love Bees* that presents players with a bunch of numbers. The group has to figure out that they're GPS location numbers and that those numbers attach to pay phones in all 50 states. The players then have to figure out how to get someone in every state to the right pay phone at the right time to pick up the phone to hear a question. After that, they have one or two minutes to find the answers, which appear on 50 Web pages. People who have never met have been pulled together ad hoc just to solve this problem. They have to network their contacts to figure out who in Idaho might be able to get to this pay phone in time. Those are the kinds of skills you need in a collaborative environment.

Should firms develop and deploy games internally?
Some corporations are already developing games specific to their industries or businesses for training and orientation. Games can also be a very powerful part of knowledge management. Corporations often give employees manuals but no real sense of how that information can be used. The challenge is to take knowledge that is lying inert in a book or a manual and make it compelling by turning it into a role, or an activity, or a goal that a player can achieve.

How about for recruitment and hiring?
You could certainly use games to identify people with the skills you need: problem solving, information research, resource management, team building. But games could have an even more radical impact on the hiring process. We think of hiring in individual terms – finding the best person for the job. But if collaborative games are used in hiring, you can start thinking: "How do I hire the best team? How do I hire a group of people who already play well together and have experience combining their skills in ways that are useful for my company?"

If gaming skills become important in the workplace, does that disenfranchise women?
The current market for games is something like 40% female, but women don't play games for nearly as many hours as men, don't play the range of games, and don't play games for extended periods of their lives. The flip side is that gaming is a space where women can compete aggressively with men without regard to physical differences. As the gaming gap closes, there may be benefits for women in terms of preparing them for competition in the workplace, and there may be advantages for men in learning to collaborate with diverse groups. The challenge is to design games that appeal equally to both sexes.

– LEIGH BUCHANAN

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been finalized. When writers are brought in late, the result can be slipped manufacturing and shipping dates, cost overruns, and delayed or lost revenue.

Companies that want to reverse this dynamic and use their writers as a strategic asset can take the following steps:

Involve writers early. It takes time to understand a product, process, or technology well enough to effectively explain it. Early involvement gives writers a realistic chance of delivering complete and accurate information at launch. The marketing department and your customers will be pleased.

Make use of writer "audits." Ensure that writers have sufficient time to question the development team as the product evolves. Ideally, and perhaps uniquely, writers can perform continuous reality testing on the product or process, comparing what the team tells them about it and their own experiences with it. Products and processes are often modified and even redesigned based on discoveries by writers in their quest for the facts.

Use writers to compound the value of your intellectual capital. The best writers aren't just adept at technical or business language; they are also expert communicators. Much of a company's intellectual capital resides in the brains of people who have difficulty making their ideas accessible outside their narrow disciplines or who simply don't recognize that something they know may be useful or important. Writers can elicit that information, provide it in exactly the language and structure required by each audience, and, in the process, preserve and enhance the value of your intellectual capital to your customers, suppliers, and employees.

The written word and the writing process itself are powerful tools that can have a real, strategic impact on your business. Give your writers the opportunity not just to document but also to help create.

JACK SHULMAN *(jack_shulman@playstation.sony.com) is the director of information design and development at Sony Computer Entertainment America, based in Foster City, California.* Reprint F0512F

GLOBALIZATION

The Changing Face of the Chinese Executive

by MANSOUR JAVIDAN AND NANDANI LYNTON

As China's economy surges toward $6 trillion in 2020, Chinese executives are assuming prominent roles on the global stage. But despite all the talk about China's influence on the world, the world is also shaping China's business leaders as they reach out through foreign acquisitions and international partnerships. As a result, Chinese executives today are in flux.

To understand the pressures these nascent leaders face, and the effect those pressures may have, researchers asked 158 middle managers in mainland China about their cultural practices (how things are done in their businesses) and about their values (how the managers believe things should be done). The survey was part of a ten-year study of 62 cultures called Global Leadership and Organizational Behavior Effectiveness, or GLOBE. Based on respondents' answers and on our understanding of globalization, we identified four tensions that will influence how these leaders develop over the next 15 years.

Empowerment Versus Autocracy. Having established themselves as high-quality subcontractors and mass producers, Chinese companies dream of saturating the world with their own brands – homegrown equivalents of, say, Sony and Cisco. Such ambitions require an emphasis on innovation. Organizations must reward creativity, encourage entrepreneurship, and facilitate knowledge sharing. However, today's Chinese leaders are autocratic; employees defer to them. Although executives recognize that they must give employees real decision-making power and push responsibility further down in the organization, they will struggle against a long history of benevolent paternalism.

Diversity Versus Insularity. Chinese businesses typically encourage "in-group" cultures. That is, employees work only with those they know and are intolerant of diversity. In-group cultures tend to resist new or different ideas and impede cross-unit collaboration and coordination. Chinese executives recognize that they must work closely with many groups (including non-Chinese ones) to sustain global expansion. Their challenge is to abandon their strong emphasis on personal trust and instead develop mechanisms for formal trust – for instance, clear-cut, objective performance metrics and specific rules and regulations that are less susceptible to individual interpretation.

Self-Sufficiency Versus Reliance on Government. Chinese executives are already adopting a more businesslike mien as they wean themselves from political and social support. The country's financial system is reducing the number of loans it makes to keep companies running, and many Chinese businesses no longer support employees by ensuring lifelong jobs and providing apartments, hospital care, or even movie tickets. Still,

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the transition is not easy. Executives' attempts to downsize for efficiency, demand high performance from employees, and cut employees' benefits conflict with Chinese society's ingrained values of caring for the group.

Global Perspective Versus National Pride. Chinese managers told us they consider "worldliness" to be a negative trait that inhibits outstanding leadership. Great leaders, they believe, are faithful to Chinese traditions. A global perspective that reflects emerging cultural and societal norms may compromise those traditions. That attitude is the consequence of history. In the eighteenth century, China was the dominant world power until its prestige declined as a result of foreign invasions and pressures. The wound to national pride remains open, and its influence should not be underestimated. Even as Chinese executives learn to cooperate with non-Chinese colleagues and partners, they will remain true to their values and will make a point of demonstrating national pride. In terms of aggressiveness and strategy, it may be that these executives will sometimes *act* like their non-Chinese competitors, but they will not *be* more like them.

The future of Chinese business depends in large part on its leaders' ability to resolve these four tensions. If they do not succeed, Chinese companies will continue to act chiefly as subcontractors for the world's global corporations. If they do succeed, however, they will prove themselves masters at managing complexity, equal to the most difficult challenges this increasingly complex world presents.

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Reprint F0512H

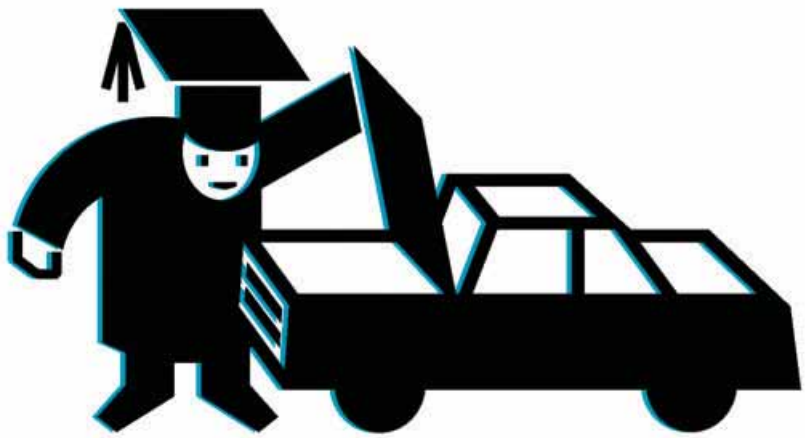
ALLIANCES

Bringing the College Inside

by SIGVALD HARRYSON AND PETER LORANGE

Academic–industry alliances have been around long enough to sprout their own ivy, yet these staples of technology innovation have undergone little innovation themselves. Now a few companies are pioneering ways to get more out of university research. One particularly successful model comes from Porsche, which has brought academic brainpower inside.

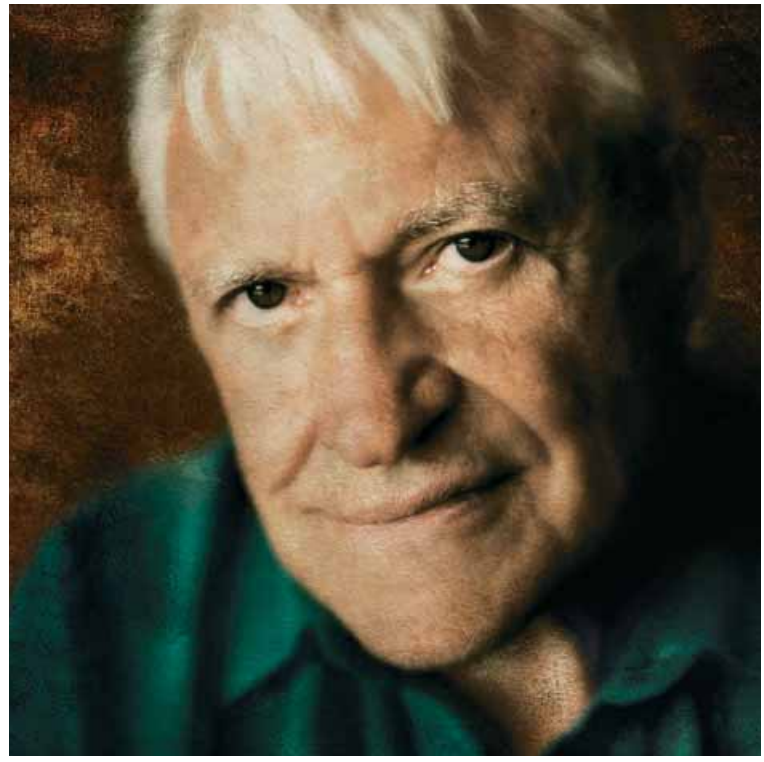
A few years ago, Porsche, which produces 10% as many cars as BMW or Mercedes-Benz, beat both in developing and launching a revolutionary ceramic brake system. The company succeeded even though it got a comparably late start on the project, employed about one-tenth as many engineers as its competitors, and had few internal experts in lightweight and composite materials. Our analysis of Porsche's innovation model attributes that achievement, and other R&D advances, to the company's habit of open collaboration – particularly to its distinctive academic alliances.



Porsche routinely collaborates with universities on projects for which it lacks the requisite expertise. Every year, the carmaker brings nearly 600 students who are working on their master's degrees into its R&D facility in Weissach, Germany, where they labor alongside 2,000 staff engineers for four to six months. An annual budget of up to $30 million finances paid internships for the students and also supports external university research or research-institute-based studies conducted exclusively for Porsche. This arrangement allows the manufacturer to employ just ten staff specialists in basic research, compared with about 200 each at BMW and Mercedes-Benz. A student costs the company 15% of what a full-time employee costs, so the savings are substantial.

Although the students focus on basic R&D, they participate in every stage of product development. (Safety and quality remain largely the province of Porsche's employees and strategic suppliers.) Interns are also involved in commercializing their work, which is not the case in conventional industry–university alliances. Toward that end, students help Porsche identify new suppliers for the technologies they develop, and they collaborate on production techniques that combine the latest research from their universities with suppliers' real-world experiences.

Porsche's internships are open to students worldwide, but most interns hail from local universities because the company requires that they labor on its premises. The work is intense – sometimes as much as 60 hours per week –



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Jess S Jackson

kj.com/truth

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and integration with staff engineers is complete. Porsche takes great care selecting its interns from the 2,000 students who apply each year, emphasizing passion, creativity, and the strategic relevance of their thesis topics to the company's practical R&D problems. The first screening is conducted by the corporate human-resource organization; the second, by the units that will employ the students.

Porsche's insourcing program also keeps its talent pipeline primed: The company offers its top interns – fewer than 10% – full-time jobs. The possibility of landing one of those prize positions motivates students. Those not asked to stay become part of an alumni network that provides advice on research and technology. Alumni may meet several times a year, sometimes for a weekend at a castle in southern Germany or Austria, where they enjoy elegant meals and early test-drives of the company's latest models.

Porsche's university alliance offers six lessons:

Value creativity and passion over high grades. Students who love the product or the industry generally perform best. For example, Porsche recruited one intern with below-average grades who had financed his education working part-time at a garage that specialized in the company's cars. He was intimately familiar with every part of every model and ultimately became a full-time employee.

Use the Web. Porsche keeps costs low by managing the application and selection process online.

Treat interns like employees. To ensure effective collaboration between staff and students and to provide the best intern experience, Porsche fully integrates students into development projects, invites them to after-work events, and provides detailed performance assessments, even for those students who are not considered for full-time employment.

Focus on communication and presentation. To ensure that research results are rapidly absorbed and diffused, Porsche encourages students to make regular presentations to other parts of the company, emphasizing strong visuals rather than detailed written reports.

Deploy students in any activities that add value. Porsche gives interns challenging, sometimes sensitive tasks, such as identifying new suppliers and supporting commercialization, so they will experience the full cycle of innovation and help transform the research efforts into business value for Porsche.

Build loyalty. The company ensures that students will continue to support the brand by providing stimulating and rewarding work during their internships and maintaining active alumni networks.

By insourcing student expertise, Porsche can explore more promising ideas and move them to production faster than its competitors. Companies pursuing innovation should consider following its example, so they, too, can absorb all that the academic world has to offer.

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Reprint F0512J

SOCIAL CAPITAL

When Stability Breeds Instability

by GARDINER MORSE

It seems to be a natural law that strength creates vulnerability. When an asteroid smacked the earth 65 million years ago, it was little rodents, not T. rex, that survived; and certainly the notion is woven through the events of September 11. Today, everyone knows that social capital – the relationships that bind communities – makes organizations strong. Well, you can guess where this is going.

In an article published in the August 2005 *Academy of Management Journal,* management professor Jason Shaw of the University of Kentucky and his colleagues described the effects of social capital and turnover on productivity in 38 restaurants belonging to an upscale chain. They surveyed more than 2,000 employees, from kitchen staff to managers, to evaluate employee performance and social capital (as measured by the nature of the employees' networks). They also assessed restaurant performance and staff turnover rates. Most important, the researchers measured the social capital of individual employees, depending on the workers' roles in organizational networks, and so could gauge the social-capital loss when individuals left.

As you'd expect, the researchers found that losing social capital is bad for productivity. More surprising, however, were the differences the researchers found between the restaurants with high staff turnover and those with low staff turnover. Low turnover – typically a sign of organizational health – seemed to increase a restaurant's vulnerability to the effects of losing social capital. That is, as these sites lost employees (and, so, leaked social capital) productivity fell faster than it did in the high-turnover restaurants experiencing their own leaks. Because the low-turnover sites were relatively high-performing to begin with, they continued to outperform the restaurants with lots of staff churn. But when the social-capital loss began to climb above the average for all the stores, the performance of the low-turnover stores actually fell below that of the high-churn stores.

The takeaway, of course, isn't that high turnover is good because it buffers against the hazards of social-capital drain. (Perversely, high turnover may actually help when a company is hemorrhaging social capital, but, at that point, preserving employees' social networks should be the least of the organization's concerns.) Rather, this research emphasizes the importance and fragility of social capital in firms with stable staffing. In these businesses, where long-term employees build complex, gap-bridging networks, a few departures can have a disproportionate impact on the top line.

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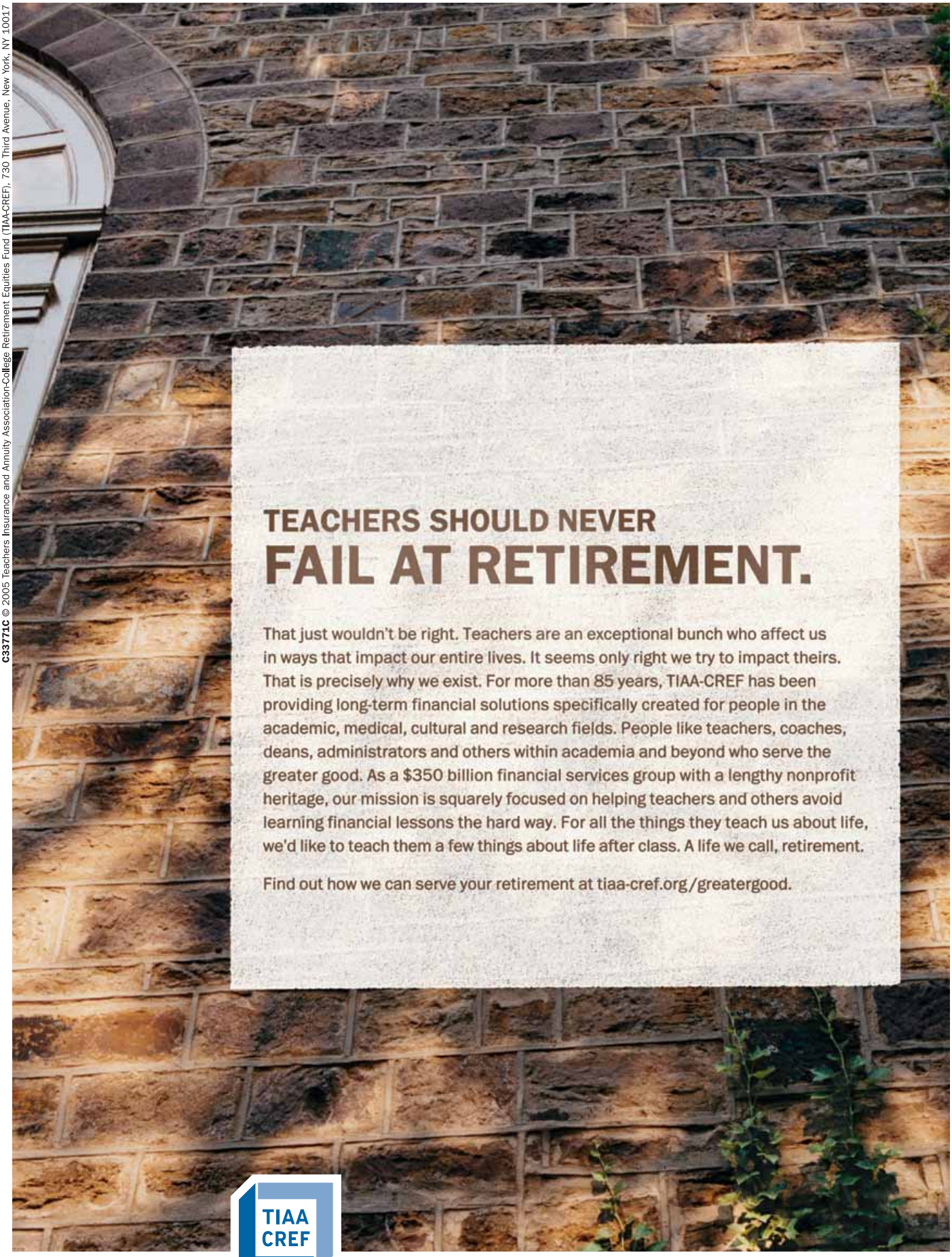
Reprint F0512K



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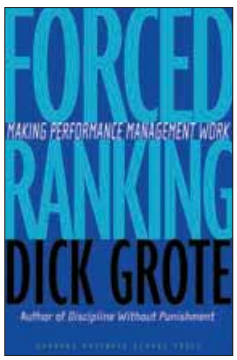
Reviews

Forced Ranking
Making Performance Management Work
Dick Grote
(Harvard Business School Press, 2005)

Managers today are as likely to inflate grades as college professors were during the Vietnam War. By bestowing universally glowing performance reviews on their employees, bosses look good to their superiors and avoid conflict with underlings. And when a critical mass of managers at a company delivers such rosy reports, the rest of their brethren must follow suit or risk drawing scrutiny to their seemingly inferior units. Weak performers become complacent, and strong performers grow resentful. What's a meritocratic leader to do?



Get tough, says consultant Dick Grote. The only way to stop the rot in "socialistic" companies, he argues, is to introduce forced ranking. Managers will never become truly accountable for personnel decisions until they recognize degrees of talent among their subordinates. You have A employees. You have B employees. And, yes, you have C employees.

But Grote's strong stand buckles under the many qualifying statements he later injects into this book. Unlike such forced-ranking evangelists as Jack Welch, Grote believes most companies should use the technique as a kind of shock treatment, a temporary supplement to traditional performance evaluations. Otherwise, after two or three years, the company may start to lose even some adequate employees. On the one hand, the author sympathizes with GE's rank-and-yank philosophy; on the other, he advises companies to merely tell C players to shape up rather than show them the door. (He does applaud managers who develop A players while leaving Cs to lift themselves up by their bootstraps.)

Grote acknowledges the common criticisms of forced ranking: that it promotes a ruthlessly individualistic environment and pushes people into unethical behavior. He says companies can avoid those problems by including teamwork among the ranking criteria. But brilliant performers often aren't great team players, which leaves managers in a bind. If your stars and your strong collaborators are different people, which are As and which are Bs?

More tellingly, Grote suggests that forced ranking may not work well in socialistic companies – the type that would seem to benefit most from it. For forced ranking to work optimally, Grote writes, "it's important that the company's performance appraisal process be world-class." The last chapter presents Grote's suggestions for overhauling the appraisal process – distinct from introducing forced ranking. Is there a chicken-and-egg problem here?

The author has clearly wrestled with this subject for decades, and the book offers concrete, sensible advice, including scripts managers can use to inform their employees about their ranks. Grote also takes criticisms of his thesis more seriously than do most business writers. Yet by stepping back from absolutist positions like GE's and wavering on how much ailing companies will benefit, this seemingly confrontational book ends up pulling its punches.

– JOHN T. LANDRY

One Billion Customers: Lessons from the Front Lines of Doing Business in China
James McGregor
(Free Press/Wall Street Journal, 2005)

The growing clamor for goods by China's huge domestic market is like a bell to salivating Western companies. But McGregor, a longtime journalist who helped negotiate Dow Jones's forays into the Chinese media market, takes a skeptical tone in this collection of colorful case studies. He says Chinese bureaucrats and business negotiators harbor lingering resentment over the country's colonial past and follow authoritarian traditions that assume one party must be on top. As a result, they relentlessly press for concessions and reinterpret laws to their advantage.

Multisourcing: Moving Beyond Outsourcing to Achieve Growth and Agility
Linda Cohen and Allie Young
(Harvard Business School Press, 2005)

These consultants want to help "compulsive, ad hoc outsourcers" regain control by better analyzing which business functions to hand off. The confusing term "multisourcing" refers to a coordinated approach to sourcing that integrates the internal and external provision of services. Readers can generate their own criteria for their outsourcing decisions – based on a function's importance to their companies' strategies – using the classification schemes that are at the heart of this workmanlike book.

Why Great Leaders Don't Take Yes for an Answer: Managing for Conflict and Consensus
Michael A. Roberto
(Wharton School Publishing, 2005)

Leaders know dissent is valuable, but that doesn't mean they have to like it. Many executives lay down the welcome mat for naysayers but leave the door locked. At NASA, for instance, a manager invited her engineers to voice any criticisms they had, even as she was subtly silencing their concerns about the Challenger's safe return to Earth. In this intelligent book, the author uses the space shuttle case and other high-stakes situations to demonstrate how leaders can create catalysts for eliciting contrary perspectives while still building consensus around a final decision. – JOHN T. LANDRY

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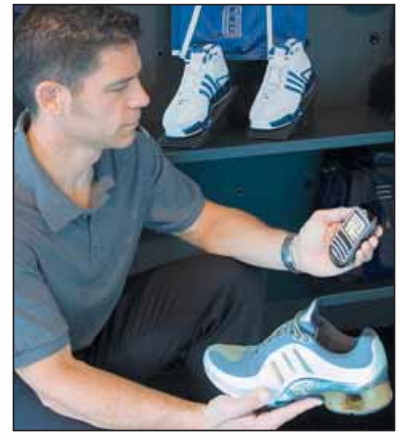

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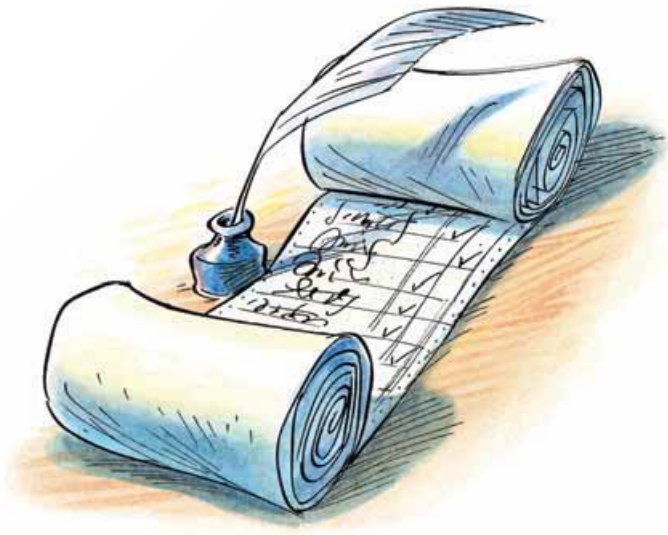

North Pole Workshops is skating on thin ice when demand for one toy suddenly surges and another goes from "in" to "over" in a blink. How can the team avoid disappointing customers – without a crippling increase in costs?

Just in Time for the Holidays

by Eric McNulty

A BITING WIND WHIPS AROUND THE sprawling manufacturing campus at North Pole Workshops. The streets between the solid brick buildings are covered in fluffy white snow. Flurries swirl against the steely gray sky of a late November morning. But the soft glow of light from the windows and steady hum of machinery hint at the productivity inside.

Buildings 1 and 2 house the company's massive mail facility, where children's letters to Santa are sorted and matched against a database that tracks the writers' behavior over the course of the year. Inside Building 3, gleaming steel equipment moves board games and Erector sets toward pallets where they are shrink-wrapped and readied for distribution on Christmas Eve. Red garland is draped across the windows that line the outer walls, though none of the busy elves seems to notice the festive touch.

A large man in a red suit walks among the workers. His smiles and waves are returned by the elves bustling on the shop floor. It is just five weeks until Christmas, and the plant is in high gear. The man is startled by the short, sharp blast of a horn and turns to find a forklift stacked high with boxes pulling up alongside him.

"Sorry for the horn, Santa. Not a minute to waste," says the elf at the wheel.

"How's everything going, Smitty?" Santa Claus asks.

"It seems that all the children want Timmy!" The elf pauses to wipe a handkerchief across his forehead. "We got the news late last night – put the pedal to the metal on Timmy the Tinsel Town Train. I've been on this floor for almost

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

DANIEL VASCONCELLOS

75 years, and I've never seen it busier. Gotta run!" The elf toots and waves as the forklift scoots around Santa and heads toward the far end of the building.

All I Want for Christmas

A few moments later, Santa sits high above the whirring conveyor belts in a glass-walled office that provides a sweeping view of the activity below. Two elves have joined Santa at his bright-green conference table, grinning as Santa pores over a hefty computer printout.

"Well, this is unexpected," says Santa. "Look at the spike in demand for the anniversary edition of Timmy the Tinsel Town Train. It's good to see an old favorite doing well," he says with a surprised chuckle.

"Uh, that's the CD-ROM for Timmy's interactive adventure series, Santa," says Isobel Lee, Director of Wish List Fulfillment and Delight. "The train set is just, well, chugging along."

"Oh," he laughs, adjusting his spectacles. "Well, regardless, it's nice to see that kids still love Timmy."

"Maybe too much," says Dexter Pepperflepper, Chief Shoprunner. "I don't know that we can keep up with that demand. We weren't expecting it, and our duplication facilities are maxed."

Santa strokes his thick white beard. This is the third time in three years that his elves have been caught off guard by a toy's sudden surge in popularity. Earlier in the season, even a month ago, it would have been possible to find capacity, but now every line is running full tilt. The elves are on overtime in the sprint toward Christmas.

"How does this keep happening?" Santa asks. "I thought we had all kinds of fancy new planning software."

"We do," says Lee. "But it's not perfect." She explains how the list-checking team looks at samples of incoming letters and e-mail traffic and extrapolates demand. Those figures are then matched against the naughty and nice database. "But the percentage of children rated 'very good' is running 20% ahead of our assumptions. And technology penetration in Eastern Europe and the interior of mainland China is greater than projected."

"We can't disappoint the children," says Santa. "And we don't have much time left before Christmas." He lifts his bulk out of the chair. "I'll see you two at the operating committee meeting this afternoon. We can't solve this on an empty stomach." With that, he heads out of the office into the blustery, cold afternoon toward his house for a much-needed bowl of porridge.

Dashing Through the Snow

On his way home, Santa detours to the stables for his daily visit with the reindeer. A few minutes watching the young reindeer calves playing their rambunctious games and feeding them carrots is enough to remind him how much he loves the holidays and making children happy on Christmas morning.

He looks up at the sky and watches the vapor trail of a passenger jet slowly dissolve. Not so many decades ago, he had the airways to himself. So far, he's been able to avoid a collision, but last year there were three near misses, and air traffic seems to get heavier all the time. The GPS navigation system installed last year saved him more than 50,000 miles and almost 14 minutes on the run – but the number of deliveries continues to grow. Maybe he should ask Cindy Counterwaite to look into an upgrade that would allow him to adjust the flight plan based on live weather reports. Or perhaps he should invest in nimbler reindeer – or maybe even motorize the sleigh. But as his eyes return to the exercise field, Santa knows that he wouldn't have the heart to say goodbye to Rudolph and the gang.

Santa walks toward his house, a simple peak-roofed structure adorned with gingerbread detail. It looks almost like a toy itself among the solid manufacturing buildings. Inside, Santa plays with the steaming porridge in his bowl. Behind him, a fire roars in the oversize fieldstone hearth.

Mrs. Claus comes up behind her husband and lovingly pats his shoulders. "It's always hectic about now," she says. "And every year, you and the elves make it in the end."

"But it gets harder every year," Santa says. "More kids. More toys. Lists that arrive later and later. Oh, it used to be so simple – wooden blocks, a train set, a doll. We made the same toys year after year, and the kids were thrilled to get them. I was able to trust my own intuition. Now we have more than a million SKUs. It's getting so I have trouble keeping them all straight. Trends jump across the oceans in an instant. I've asked the elves in the field to go beyond reporting on kids' behavior and start trend spotting. I've invested in software. But still I can't help thinking that one of these days we're not going to be able to do it."

"You're worrying too much about this," she replies. "You still have good intuition. You know the kids; you know what they like – in fact, you know better than they do. They're always changing their lists based on the latest television ads. You know what they'll truly love. That's the magic of getting a gift from Santa Claus."

Santa puts his jacket back on and fastens the thick black belt. He knows that Mrs. Claus is right, but he also knows that even elfin magic can't always save the day.

Naughty or Nice?

Santa pauses outside the boardroom and nods appreciatively at the activity below. He is startled from his reverie when his executive helper, Stanley Wibersham, rushes up behind him out of breath.

"You have to see this, Santa." The elf hands him a copy of *Teen Scene* magazine with the headline "Teen Queen Spat: Juicy Details Inside."

"Page 36," wheezes Wibersham.

Santa flips open the magazine and reads in disbelief.

In an exclusive *Teen Scene* interview, Rebecca June hinted that Leslie Line-

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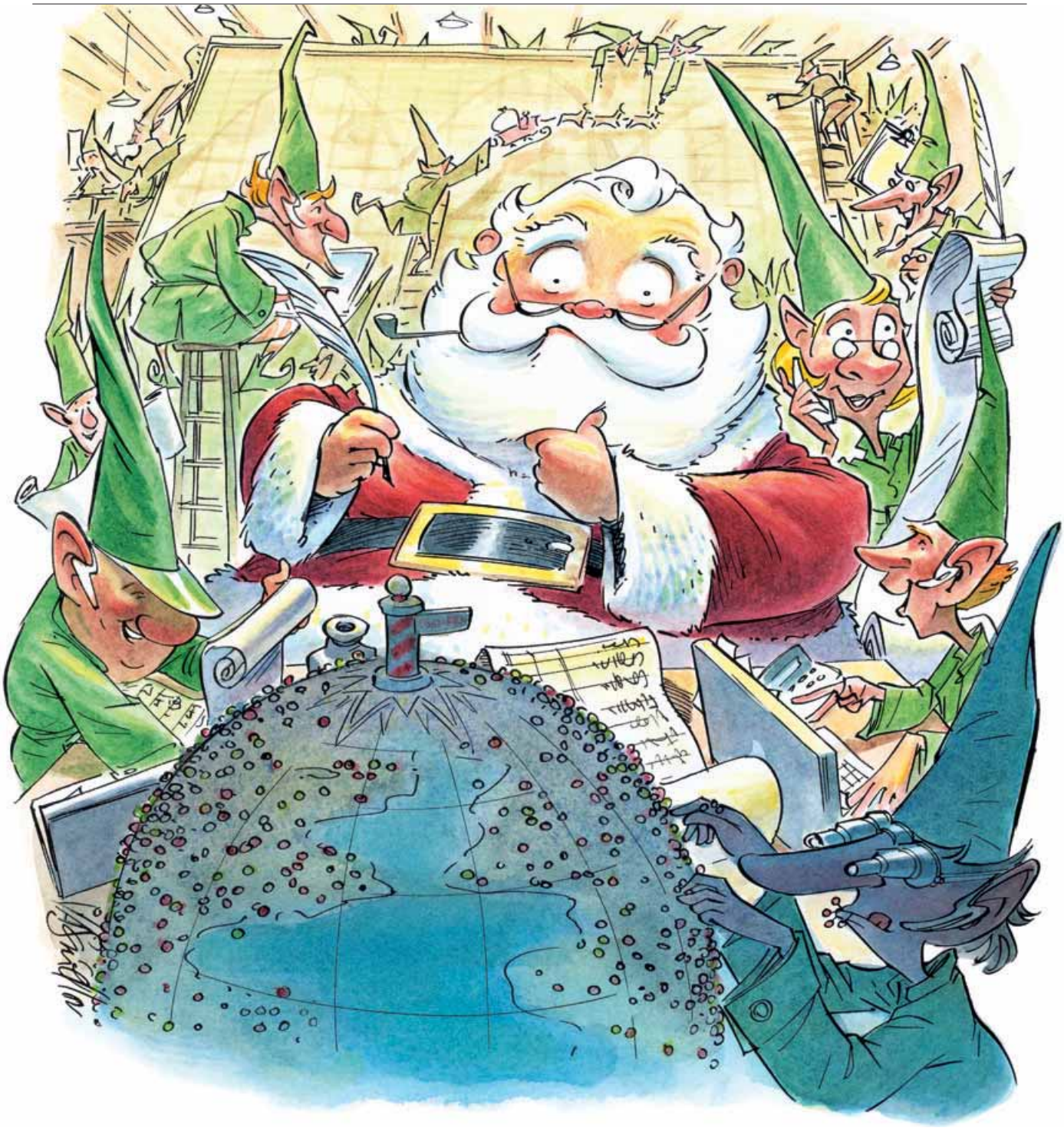

han missed the Teen Scene Awards because she had put on a few pounds (not that we could see them when she was clubbing late into the night in LA). When we caught up with Leslie, she shot back, "Rebecca June is juvenile. How can you take her seriously when she walks around with a stupid kitty cat on her wrist? That's so yesterday."

Santa points at the grainy shots in the magazine. "A few extra pounds? Either one of them could be blown away by a stiff breeze." He glances down at his own few extra pounds and closes the magazine quickly, resisting the urge to put both girls onto the Naughty list. Rebecca June's "stupid kitty cat" is the new Meowrrr, a big-eyed, plush kitten cell-phone carrier with eyes that light up when the phone rings and purrs when stroked, thanks to special sensors embedded in the fur. It's also the product North Pole has planned to be the top choice among girls eight to 15 years old.

When Santa arrives in the boardroom, the senior elves on the management team are merrily watching Holly – the model for the Meowrrr – chase a candy-cane wrapper across the

floor. Cindy Counterwaite, Chief List Twice Checker, and Dexter Pepperflepper are standing on their chairs, dangling brightly colored ribbons in an attempt to attract the kitten's attention.

"OK," says Santa, as he makes his way to the head of the large rectangular table. He holds up the magazine. "In case your copy of the latest *Teen Scene* hasn't arrived yet, the Meowrrr has been called 'so yesterday' by the young lady with the number one pop album in the U.S." He picks up a sample Meowrrr from the table and strokes it gently as it mews at him. "How can you be so yesterday when you haven't even had a chance to be so today?"

"We are the original just-in-time business.... We have one delivery date: December 25."

The room grows quiet as the team realizes that along with the challenge of a spike in demand for Timmy CDs, they are also looking at a likely sharp dip in interest in the Meowrrr. Pepperflepper winces when he checks his units-on-hand report and sees that there are ten million Meowrrrs ready to go. He considers the possibility of turning the toy into something else, but very few of the components are reusable.

"I think I may have at least a partial solution," says Barry Fiddledip, Chief Bedazzler. He flashes the *Teen Scene* ad sales numbers on the projection screen. Fiddledip explains that *Teen Scene*'s circulation is mostly in the U.S. and Canada, so distribution plans for Asia and Europe can go ahead as scheduled.

"Cell phone penetration in Africa is up significantly, so we can shift some units there," he adds. Fiddledip's bright blue eyes are alive with the eternal optimism of a marketer and the undying mischief of an elf. "And I haven't given up totally on North America. Rebecca's fans may want the Meowrrr to show their support."

"That's a nice bit of elf marketing magic if it works." Santa turns to Counterwaite. "I know we can pull our lists based on naughty and nice. Can we segment Rebecca June fans versus Leslie Linehan fans?"

"No, sir," says Counterwaite. "Celebrity preferences among preteen girls change too frequently. I can pull Barbie lovers."

Santa turns back to Fiddledip. "So net net?" He scoops a handful of red and green butter mints from one of the bowls in the center of the table.

Fiddledip clears his throat and squares his shoulders. "I think we can still move seven to seven and a half million units." An uncharacteristically somber mood descends as the elves contemplate three million Meowrrrs sitting in the warehouse, unloved, on December 26. And, worse, millions of disappointed children who might not find a Timmy CD under the tree.

Making a List– And Checking It Twice

Santa stands and paces the room. "Let's talk about the bigger issue. We are the original just-in-time business. We have one market: the world's children. We have one deliverable: the right toys to the right kids. We have one delivery date: December 25. We can't move extra merchandise through after-Christmas sales. We don't have outlet stores. We have to get these things right. Cindy, how can we improve our planning?"

Counterwaite shuffles the papers in front of her. "Our ERP system is certainly adequate, Santa. But it isn't state of the art by any means." She explains that there is no direct link between the letters received from children, which have to be hand keyed into the system, and the procurement and manufacturing systems. Indeed, Jeffrey Peartree, North Pole's Chief of Children's Correspondence, had repeatedly commented on the fact that incoming mail was sorted so efficiently and yet the data didn't feed into the planning process. Sitting back in his chair now, Peartree simply raises his pointy eyebrows in resignation.

Counterwaite flashes a new slide onto the screen. "If we invest in upgrades to the system, we can make our processes leaner and be more responsive with our manufacturing." She goes on to advocate investing in a system that would allow them to get a better sense of real demand, rather than extrapolating from early data. She describes for her colleagues multilingual scanning capabilities, which would get the kids' requests into the system more quickly, and a true CRM module that would let them tag gift requests with all the available data points about each child's behavior over the course of the year–data that comes in from a variety of sources such as mall Santas and report cards.

"What Cindy says is all true, I'm sure," interjects Pepperflepper. "But none of that would help us cope with this situation. All the planning in the world can't help when there are sudden shifts in demand like we've just seen. We need to be able to turn our manufacturing on a dime." He puts up a slide that shows the cycle times for the manufacture of various sample product lines. It highlights the improvements that have come with outsourcing, starting with block cutting ten years earlier, electronic components five years earlier, and software development for the past two years.

Suddenly, Fiddledip leaps onto his chair. "I defy you to find anyone who can match an elf's artistry and craft in toy making!" The room is quiet for a moment until Holly pounces into the bowl of butter mints, sending them flying in all directions. The group bursts into laughter, and the debate continues with urgency but good humor. Santa watches the interaction, weighing the alternatives. Would better software give him an accurate picture of demand? Would more market research eliminate some guesswork? Or should he give up on accurate predictions altogether and make manufacturing more flexible? All the elves in the room, he knew, wanted to make the kids happy. They just didn't agree on how to do it.

How can North Pole Workshops better respond to shifts in demand?

• Four commentators offer expert advice beginning on page 44.

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Santa should stop thinking of himself as a victim of demand uncertainty. He needs to stop reacting to fads and start creating them. That's just the way it works in the toy business. Yes, toy makers do market research, but focus groups for kids produce notoriously inaccurate results. A child might honestly like a toy when he's alone in a room, and he might even ask for it in his letter to Santa, but his wishes will morph instantly when he sees what other kids think is cool. Even the best technologies for capturing early demand indicators don't always work for toys.

Instead, Santa needs to invest more in helping the children understand what's cool, making his products cool, and creating an agile supply chain that can deliver what's cool. Old-fashioned advertising works well. Even better are tie-ins to other fads. The elves should visit playgrounds to see what kids are talking about and research potential hit movies scheduled for release during the holiday season. All the better if they can make the toy tradable and collectible, like Yu-Gi-Oh! cards. Linking a toy with a pop culture icon is a good strategy, too – though it can be risky, as North Pole Workshops learned. Movie tie-ins aren't risk-free either. *A Bug's Life* sold some toys; *Antz*, not so many.

Santa should stop thinking of himself as a victim of demand uncertainty. He needs to stop reacting to fads and start creating them.

Another tool that toy companies use all the time to build demand is controlled scarcity. In other industries, a shortage is a bad thing. In the toy industry, you might find executives giving each other high fives over a shortage. It creates buzz. The trick is to start a fad and allow some shortage, while avoiding so much scarcity that you disappoint a lot of people. One way to do that is to ship a limited quantity of the product to stores in the fall, making it tough to find, and quickly catch up around Thanksgiving.

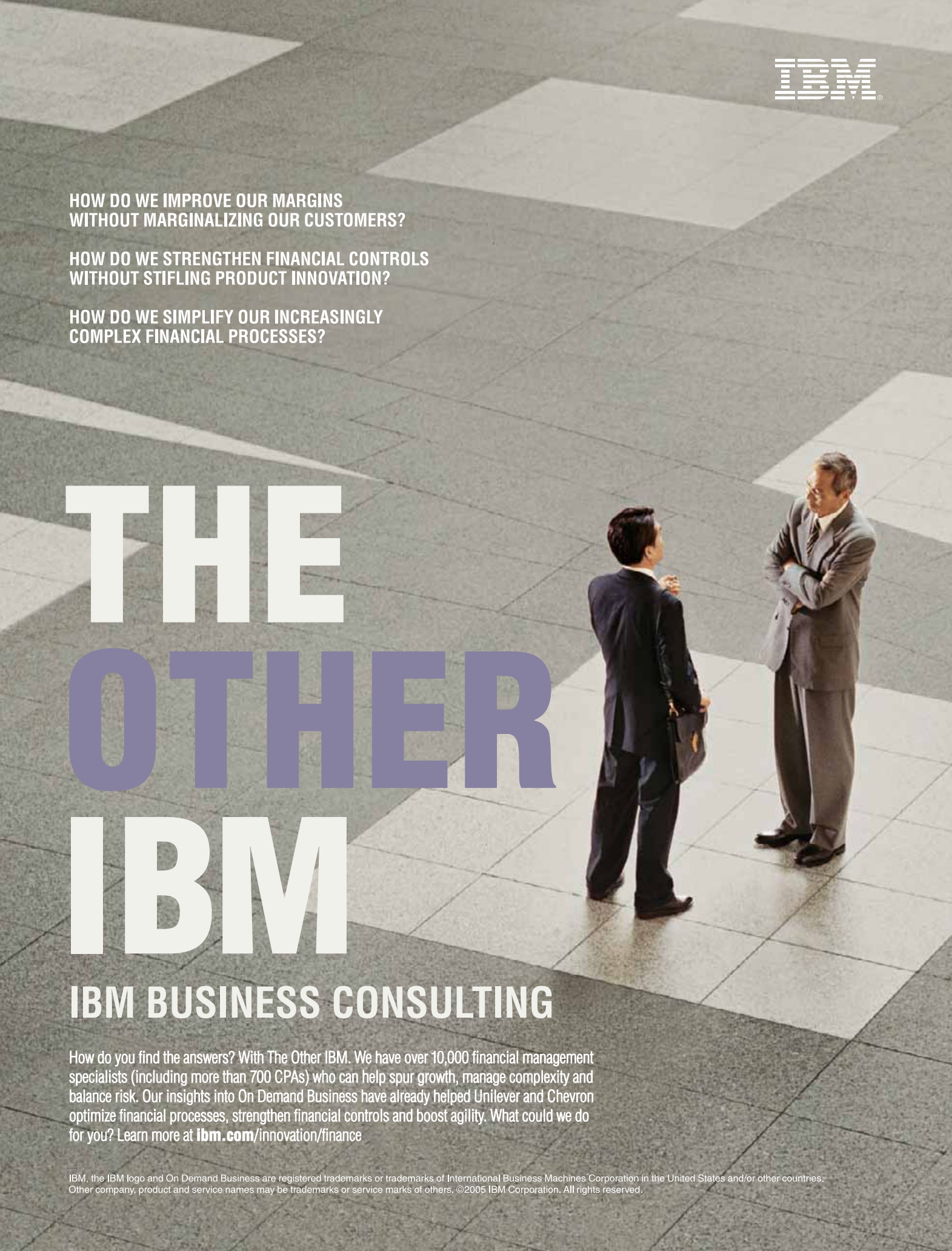
Better yet, combine scarcity with variety. Look at Beanie Babies. You can get a Beanie Baby anytime, but you can't necessarily get, say, the white cat. Many of the really hot toys like Pokémon cards and Furbys have benefited from this approach. Every year, the media feed the impression of an overall shortage for a product, when in fact only one version is hard to get. Part of this trick, of course, is to get parents and children to substitute within the category and still be happy.

Mattel has pursued a variety strategy – a form also called a rolling mix – for its Hot Wheels line for some time. This month you might have the green Ferrari. It stays in the collection for a short time and then disappears. You don't promise retailers any particular version. Instead, you ship a "basic assortment," a box of cars or action figures, and you change the mix every week. Kids love rooting through the boxes to see what they can find. The strategy drives traffic and awareness, and it creates collectors. Variety strategies require a supply chain that thrives on change, but surprisingly, such strategies don't force retailers to manage an endless number of SKUs. A car, any version, can be a unit.

Some high-tech companies have begun to use a kind of rolling mix strategy, and Zara, the Spanish retailer, does it all the time. It makes a small weekly shipment to each store, and when the clothes are gone, they're gone. Zara has trained consumers to come back every week to see what's new – and created urgency to buy while the item is available.

One more thing: The elves are understandably resistant to Elf Pepperflepper's idea of outsourcing, but it is the norm in the toy industry. Toy makers have outsourced production nearly completely. Well before China was cool, Mattel was sourcing from China. The industry is on the leading edge of low-cost sourcing. And toy companies source from many different countries to protect against currency risk and political risk.

WENDY WRAY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Horst Brandstätter *is the owner of Geobra Brandstätter, a toy manufacturer and maker of Playmobil products, located in Zirndorf, Germany.*

Santa Claus doesn't seem to be thinking very clearly about the future. He's been in the business much longer than I, but I can still claim 50 years. I would advise him to keep three things in mind: first, the hazards that short-term strategies conceal; second, the responsibility he has to his customers; and third, the limits of an automated customer-management system.

Children drive the demand in our industry. Of course, large companies manipulate children's desires with clever marketing and gigantic budgets. For example, the Star Wars films introduced a whole army of Darth Vaders and Luke Skywalkers to the toy box. The demand these campaigns create is usually short-term, and in no place on earth is short-term demand created better than the United States. There is a major trade fair in the U.S. each February where retailers decide what to buy for the next Christmas season. But one cannot help going wrong if one chases the trends.

Our philosophy here at Playmobil might help Santa Claus. We believe that as a toy manufacturer, we have a pedagogical responsibility to our customers that transcends our profit goals but that also yields lasting success. We offer products that help children develop motor skills, refine a sense of taste, and understand the world. We make it more fun for them to play than to sit in front of the television, and we try to guide their aggressions into healthy channels. Of course, we pay attention to trends. But we try to ignore them as much as we possibly can, even if it hurts our short-term revenues. For example, we do not purchase licenses for brand names such as Disney, Star Wars, or the Olympic Games. This is connected with a rule that Hans Beck, the inventor of the Playmobil figures, set for us 30 years ago: Never disappoint the customer. If we were to rely on licensing, disappointment would be inevitable. There is the danger that the children might not get what they want because we made a bad choice. Or parents might have to spend extra money because they are supporting the originator's licensing costs.

If Santa really wants to fulfill children's wishes, there should not be any talk about outsourcing his production.

I also do not believe that Santa Claus can solve his problems by collecting more data on his customers or by evaluating them better. Market research is very difficult in the toy industry. One cannot simply interview children and then transfer these data directly into product development. One must consider more clever methods to understand children's desires and fantasies. Just like Santa Claus, we receive many letters – about 150 per month. If we were to merely transfer information from these letters into CRM software, everything between the lines would be lost. That is why we look at these letters not as raw data but rather as feedback from loyal customers who wish to share their experiences with our products. They provide us with precious ideas. For example, we introduced a line of firefighter figures and vehicles to the Playmobil set. Children wrote to us saying that they wanted a fire station for the figures. Good idea. We developed a very nice fire station. We also try out our toys before we market them by observing children at play with new Playmobil products. But a human being must interpret these samplings.

If Santa really wants to fulfill children's wishes, there should not be any talk about outsourcing his production. We at Playmobil are in the process of retrieving outsourced production back to our main facility. This way, we can closely monitor production to our strict quality-control standards, and we can react to market signals during the Christmas season.

We also believe that outsourcing is the wrong strategy for us from an organizational standpoint. As an enterprise, we bear responsibility not just for the children but also for our employees. Just think how hard it might be for an unemployed elf to find another job!

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So-called planning methodology is built on the premise that a good point forecast for demand is available and all we need to do is get it and then use it.

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Talk about fourth quarter pressure! Santa deals with volatile and unpredictable demand in a very short selling season. While focus groups (or a review of children's correspondence to Santa) and analysis of early-season demand are beneficial, there is no foolproof way of obtaining error-free forecasts in this environment. Unfortunately, a great deal of so-called planning methodology is built on the premise that a good point forecast for demand is available and all we need to do is get it and then use it. Virtually all MRP systems work that way, and many managers have apparently been trained to think deterministically rather than in terms of probabilities.

Once we agree that demand for a specific toy in December is inherently difficult to forecast, what can Santa do? The standard academic solution is to apply the Newsvendor model, which involves four steps: Plot a bell-shaped curve representing demand uncertainty; assess the cost of underage (being short); assess the cost of overage (excess inventory); and conduct economic balancing to minimize expected costs.

Santa might argue that he must satisfy 100% of demand, but since the bell curve goes on indefinitely to the right, that's mathematically impossible. The Newsvendor model forces Santa either to make an economic determination of the shortage cost or fall back to a "service level" or fill rate approach and decide that, say, he wants to fulfill 98% of demand without stockouts. Presumably the other 2% can be explained, and buffered, by the Naughty List to achieve Santa's mission – the right toys to the right kids.

After applying the Newsvendor model, there will still be costs of overage and underage; even if they have been minimized, they will not be zero. Now Santa and the elves can start thinking creatively about other ways of coping with product shortages: substitution; risk sharing or hedging; and postponement.

Product substitution is a tried-and-true device for coping with stockouts in many markets. If a grocer runs out of ketchup in 10-ounce bottles, he may substitute 12-ounce bottles. Of course, as all of Santa's helpers know, with trendier items like toys this strategy will carry you only so far.

Risk sharing, typically applied between a supplier and an OEM, replaces a price-only contract for components with a contract that states, for example, the OEM's willingness to pay a small price premium per unit; in return, it would gain volume flexibility from the supplier. Instead of purchasing 10,000 components for $1 each, say, the OEM might offer to purchase a minimum of 9,000 components for $1.04 each, as long as the supplier agreed to provide up to an additional 3,000 units on short notice.

Yet another strategy might be risk hedging combined with a standard supply chain concept called postponement; that is, shifting risks to material and capacity management instead of finished goods, redesigning products so that many SKUs share a common base. Consider the case of the HP Deskjet printer, which was redesigned so that country and language localization took place at a relatively late point in the supply chain. In Santa's case, the Meowrrr's underlying technology could have been developed early on, with the color split and volume postponed until closer to reindeer liftoff. A combination of postponement and hedging can help Santa balance production planning with demand forecasting.

If managers think that 100% service is attainable, they will be disappointed when it doesn't occur, whereas if Santa's elves think probabilistically, they will sleep better at night when the inevitable glitches do occur. But probably not until December 26.

It may sound obvious, but the first thing to do is to stop production on the Meowrrr immediately and try to reschedule the duplication lines to run Timmy CDs. And since the Timmy train is very stable, North Pole Workshops should produce the remaining units as quickly as possible and then shift capacity dedicated to the train to the CD. The shortfall should then be outsourced.

These steps may avert a total meltdown this year, but Santa needs to make sure this doesn't happen again. And the most effective solutions lie in better planning, not real-time technology. When it comes to planning, Santa's mistake is that he's treating all items the same way. A key component to planning and, as time progresses, execution, is classifying items according to how much value they bring to the business and the degree to which you can forecast demand for them. Business value can be assessed with something as simple as unit sales or as complicated as a blended measure that takes into account order frequency, inventory costs, and profit margin. Forecastability depends on factors such as how new a product is and how connected it is to trends in the marketplace. Santa should set up a matrix that classifies toys according to these two dimensions and plot every toy on the matrix. Then his production strategy should vary by quadrant.

Timmy the Tinsel Town Train, for instance, falls in the low-value, high-forecastability quadrant. It's low value, relatively speaking, because while sales chug along, the toy is unlikely to command a premium. Santa should run the trains through the duplication facilities very early in the season to free capacity for more volatile items closer to Christmas. He'll be able to reduce capacity requirements in his busiest season without a significant increase in working capital and without taking a large inventory risk. Then the elves can watch for any external events that could cause a spike in demand and add extra production if necessary. The key assumption in this strategy is that the organization has to be ready to write off or dispose of extra inventory. But using a cost/benefit analysis, it will be easy to determine the breakeven point between production and inventory.

The Timmy CD might be an example of a low-value, low-forecastability item. The elves should develop a base level of inventory and reserve outsourced duplicating capacity for scenarios such as this, where demand unexpectedly takes off. This allows Santa to avoid the cost of full investment in greater capacity, trading off inventory risk for flexibility with a defined cost.

The Meowrrr falls in the high-value, low-forecastability quadrant. Santa could follow one of several strategies, depending on the toy's cost structure. One would be to build to a high level of demand and take the risk of having to destroy significant amounts of excess product. Another would be to hold open internal capacity to maintain flexibility and postpone production until actual demand was known. This would be feasible because North Pole Workshops has already made the low-value Timmy trains earlier in the season. Santa would be able to shield his organization from the inventory risk associated with high-fashion items and still meet demand. Once again, his elves would have to conduct a cost/benefit analysis of the strategy.

The most effective solutions lie in better planning, not real-time technology.

Each of these strategies has both a demand and a supply component. By planning in advance how to address demand variability, North Pole can monitor its assumptions and approach to supply and fine-tune its position up until the pre-Christmas crunch. Another important implication: Because this is a process framework, it won't require any significant investment in new technology that may or may not make a real difference in the elves' ability to meet demand. Next Christmas should be much merrier in the North Pole.

Reprint R0512A
To order, see page 155.

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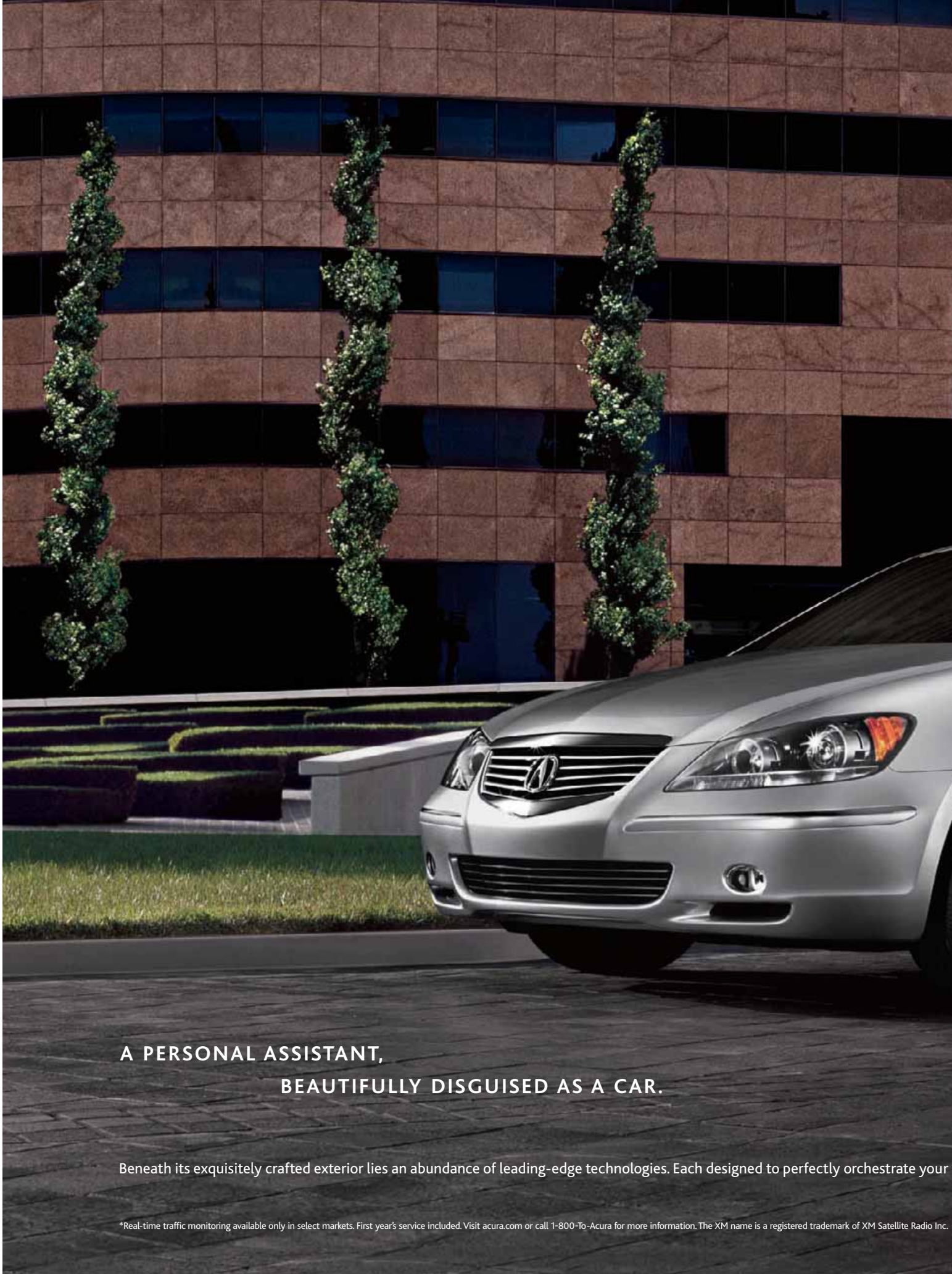

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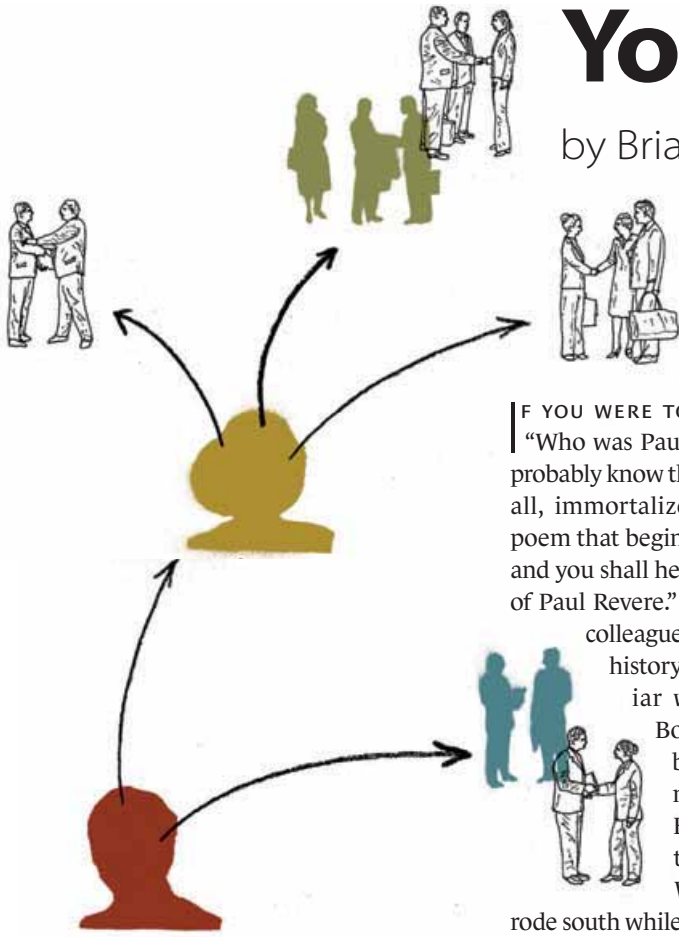
Strong personal networks don't just happen at the watercooler. They have to be carefully constructed. Here's how to strengthen your connections.

How to Build Your Network

by Brian Uzzi and Shannon Dunlap

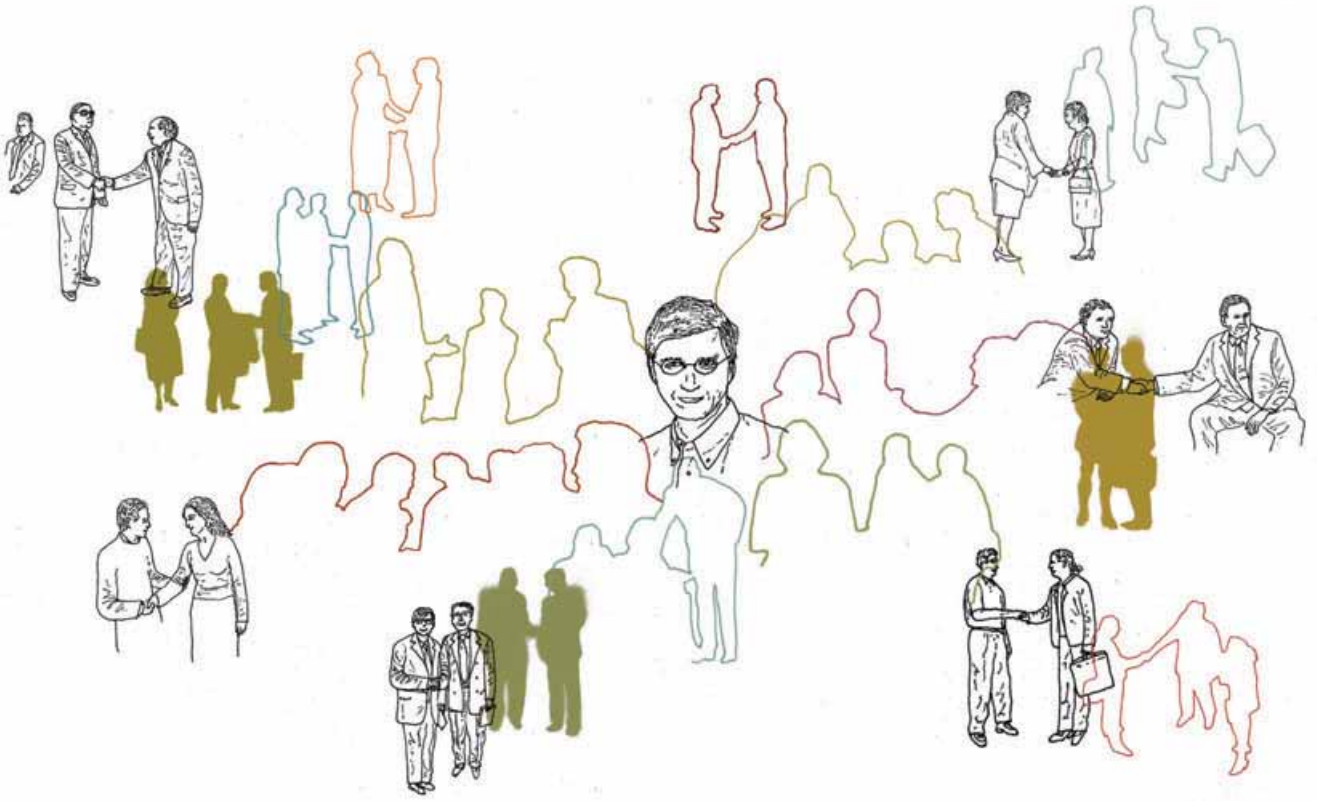


RODERICK MILLS

IF YOU WERE TO ASK your colleagues, "Who was Paul Revere?" most would probably know the answer. He was, after all, immortalized in the Longfellow poem that begins, "Listen, my children, and you shall hear of the midnight ride of Paul Revere." Yet how many of your colleagues, students of American history aside, would be familiar with William Dawes? Both men rode on horseback from Boston on the night of April 18, 1775. Both sounded the alarm that the Revolutionary War had begun. Dawes rode south while Revere rode north, but the towns they traveled through were demographically similar. Both men came from the same social class and had similar educational backgrounds. But only Revere raised a militia, and only Revere's name became famous. What accounts for the difference? In large part, the type of social network each man cultivated.

Paul Revere was an *information broker,* a person who occupies a key role in a social network by connecting disparate groups of people. Because Revere targeted other well-connected people during his ride, his news spread widely and quickly, as explained in Malcolm Gladwell's *The Tipping Point,* for example. William Dawes was not an information broker, so he didn't know which doors to knock on when he entered a new town. As a result, the information he carried was circulated within a small group of people instead of expanding outward. (See the exhibit "The Networks of Paul Revere and William Dawes.")

Now imagine that the information being ferried by messengers isn't about redcoats but about a new product idea or a different way to manage a team. If that information isn't delivered to the right people, it will wither and die. For example, before Microsoft was a household name, Bill Gates had a singular distinction in his network – his mother, Mary Gates, who sat on the board of United Way with John Akers, a high-level IBM executive. At the time, Akers was helping to lead IBM into the desktop



computer business. Mary Gates talked to Akers about the new breed of small companies in the computer industry, which she felt were underappreciated competitors of the larger firms with which IBM traditionally partnered. Maybe she changed Akers's vision of who to go to for the new IBM PC's DOS, or maybe her comments confirmed what he already knew. In either case, after their conversation, Akers took proposals from small companies, one of which was Microsoft. The rest is history: Microsoft won the DOS contract and eventually eclipsed IBM as the world's most powerful computer company. Without Bill Gates's potent network, a sensational new operating system might have faded into obscurity just like William Dawes.

Studies have shown the same correlations between networks like Paul Revere's and success in various commercial ventures. Networks determine which ideas become breakthroughs, which new drugs are prescribed, which farmers cultivate pest-resistant crops, and which R&D engineers make the most high-impact discoveries. In a monumental 1998 study of innovations in science, art, and philosophy, sociologist Randall Collins of the University of Pennsylvania showed that breakthroughs from icons such as the seven sages of antiquity, Freud, Picasso, Watson and Crick, and Pythagoras were the consequence of a particular type of personal network that prompted exceptional individual creativity. In fact, Collins could find only three exceptions in all of recorded history: Taoist metaphysician Wang Chung, Zen spiritualist Bassui Tokusho, and the Arabic philosopher Ibn Khaldun.

In this article, we'll take a close look at the inner workings of networks. We'll also show you how to diagnose your current network, create a more potent one, and then actively manage it.

Brian Uzzi *is a professor of leadership and organizations and a professor of sociology at Northwestern University's Kellogg School of Management in Evanston, Illinois.* ***Shannon Dunlap*** *(snd221@nyu.edu) is a former program associate of Kellogg's Center for Executive Women.*

A Powerful System

Networks deliver three unique advantages: private information, access to diverse skill sets, and power. Executives see these advantages at work every day, but might not pause to consider how their networks regulate them.

When we make judgments, we use both public and private information. These days, public information is easily available from a variety of sources, including the Internet; but precisely because it is so accessible, public information offers significantly less competitive advantage than it used to.

Private information, by contrast, is gathered from personal contacts who can offer something unique that cannot be found in the public domain, such as the release date of a new product, unpublished software code, or knowledge about what a particular interviewer looks for in candidates. Private information, therefore, can give top executives an edge, though it is more subjective than public information because usually it is not verified by an independent party, such as Dun & Bradstreet. Consequently, the value of your private infor-

mation to others–and the value of others' private information to you–depends on how much trust exists in the network of relationships.

Lisa Bristol (not her real name) is the president of a financial institution in the mortgage-lending industry. Historically, her firm had hesitated to share private information with potential alliance partners for fear of appropriation or misinterpretation. Bristol realized, however, that when she began developing trust with them through trade shows and informal shared activities, private information started to flow in both directions. This helped Bristol solve problems and develop financial strategies more efficiently than when she relied solely on public information, which most of her competitors also possessed. For example, the public information concerning her industry indicated that success was based on price points. But, through her network, Bristol became one of the first executives to piece together the features of her industry's new competitive driver: She learned that some companies had been experimenting with value-added services and that they were achieving greater success than companies that relied on price points. By using this information, she was able to position her company at the forefront of this trend and capture market share before other companies attempted to move into the niche.

The next advantage that a network like Paul Revere's confers is access to a diverse array of skill sets. Linus Pauling, one of only two people to win a Nobel Prize in two different areas and considered one of the towering geniuses of the twentieth century, attributed his creative success not to his immense brainpower or luck but to his diverse contacts: "The best way to have a good idea is to have a lot of ideas." While expertise has become more specialized during the past 15 years, organizational, product, and marketing issues have become more interdisciplinary, which means that individual success is tied to the ability to transcend natural skill limitations through others. Highly diverse network ties, therefore, can help you develop more complete, creative, and unbiased views of issues. And when you trade information or skills with people whose experiences differ from your own, you provide one another with unique, exceptionally valuable resources.

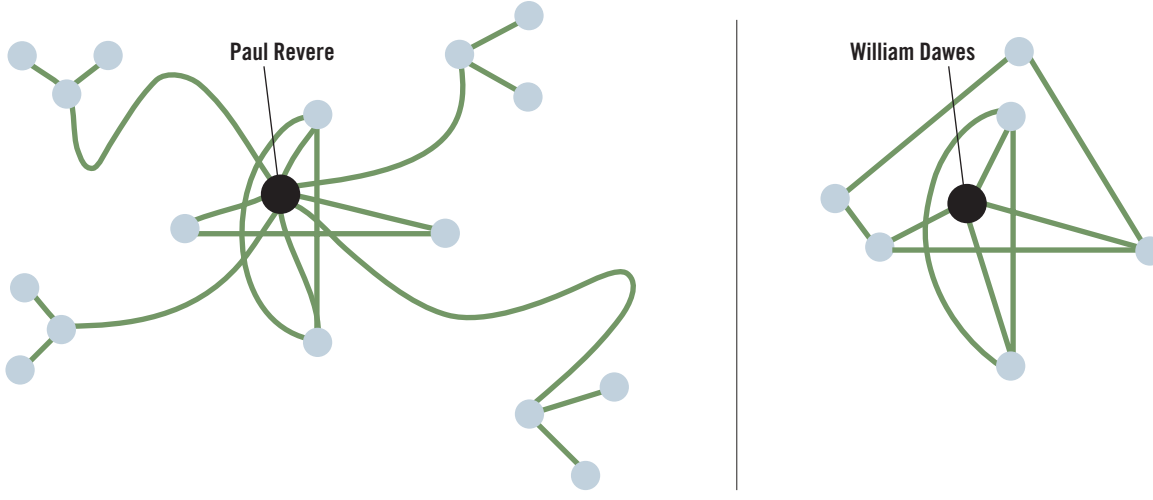
The final advantage of a network like Paul Revere's is power. Traditionally, executive power was embedded in a firm's hierarchy. When corporate organizations became flatter, more like pancakes than pyramids, that power was repositioned in the network's information brokers, who could adapt to changes in the organization, develop clients, and synthesize opposing points of view. These brokers weren't necessarily at the top of the hierarchy or experts in their fields, but they linked specialists in the firm with trustworthy and informative ties.

If you've introduced yourself to your key contacts more than 65% of the time, then your network may be too inbred.

Most personal networks are highly clustered–that is, an individual's friends are likely to be friends with one another

The Networks of Paul Revere and William Dawes

Paul Revere's social network connects multiple clusters of people who are linked through Revere himself, while William Dawes's network is just one big cluster. It's easy to see why news carried by Revere would reach a wider audience than news carried by Dawes.



How to Map Your Network

Name of Contact	Who introduced you to the contact?	To whom did you introduce the contact?
Mark Granovetter	Me	
Greg Duncan	**Steve Alltop**	
Deb Gruenfeld	Me	
Henry Bienen	**Steve Alltop**	
John Wolken	Mitch Petersen	

superconnector

This exhibit reveals part of coauthor Brian Uzzi's completed work sheet. At the top of his list, for example, is Mark Granovetter, who was Uzzi's graduate school adviser. Granovetter shares his research with Uzzi before it reaches the public domain and reads Uzzi's papers before they're sent out for review.

The work sheet also reveals that Uzzi's superconnector is Steve Alltop. He introduced Uzzi to both Greg Duncan and Henry Bienen, who are individually vital to Uzzi's network.

as well. Most corporate networks are made up of several clusters but with few links between them. Brokers are especially powerful because they connect the separate clusters, thus stimulating collaboration and exploiting arbitrage among otherwise independent specialists.

When Bristol actively expanded her network to include people whose expertise and positions differed from her own, she could link with brokers in her own field as well as in other areas that were strategically important to mortgage lending. These ties spurred creative problem solving and prompted invitations for Bristol to speak at industry events that valued and showcased forward thinkers. Soon, she earned a reputation for spotting promising innovations in their preview stages. Informal post-talk discussions spilled over into formal office discussions, and Bristol went on to lead an advisory group made up of ten high-level financial executives. Bristol didn't need to change her work style fundamentally or develop an entirely new expertise to achieve this success. Rather, she used her new network to turn what she already knew into power, both individually and for her firm.

Sometimes, however, the advantages of private information, access to diverse skill sets, and power, can work in opposition to one another. Choosing contacts to maximize a sense of trust in your network, for example, can inadvertently undercut its diversity – that's what thwarted William Dawes's network. You can avoid the pitfalls, but first you must learn how to diagnose your network.

Diagnose Your Network

You can use a work sheet like the one in the exhibit "How to Map Your Network" to determine what type of network you currently have, discover how your networking practices can lead to one kind of network or another, and overcome the key paradoxes of network building. Starting with the left-hand column of the work sheet, fill in the names of the most important contacts in your network – people you rely on for the exchange of private information, specialized expertise, advice, and creative inspiration. A crucial contact could be your former college roommate who has become influential in an area of interest to you and your firm, a current business associate, an old colleague from the first company you ever worked for, or your brother-in-law. As you write in each name, think of the resources you exchange with that person, the quid pro quos, and the strength of your ties.

After you identify your key contacts, think about how you first met them. In the center column of the work sheet, write the name of the person who introduced you to your contact (if you met the person yourself, write "me"). This column will reveal the brokers in your network and help you see the networking practices you used to connect with them. In the right-hand column, write the name of someone you introduced to your key contact. This column will demonstrate how you act as a broker for others.

Once your data is filled in, look at the number of times "me" appears in the center column. According to our studies, if you've introduced yourself to your key contacts more than 65% of the time, then you're probably building your network using the *self-similarity principle* and your network may be too inbred. The self-similarity principle states that, when you make network contacts, you tend to choose people who resemble you in terms of experience, training,

worldview, and so on. We have found that executives, in particular, disproportionately use the self-similarity principle to build their networks. Obviously, it is easier to trust someone who views the world through the same lens you do; you expect that person to act as you would in ambiguous situations. What's more, working with people who share your background is often very efficient: You both recognize concepts that allow you to transfer information quickly, and you are less likely to challenge one another's ideas. Finally, like-minded people will usually affirm your point of view and, as a result, gratify your ego.

Our research shows, however, that these benefits offer diminishing returns – and can even turn negative. Too much similarity restricts your access to discrepant information, which is crucial to both creativity and problem solving. If all your contacts think the way you do, who will question your reasoning or push you to expand your horizon? And because, over time, people tend to introduce their contacts to one another so that everyone becomes friends, the similarity of thought and skill reverberates, creating what we call an echo chamber. (See the exhibit "The Importance of Brokers in Companies.")

The self-similarity principle contains pitfalls, however, and even strategic thinkers can be oblivious to them. An excellent illustration comes from Columbia University management professors Paul Ingram and Michael W. Morris. They conducted a study in 2002 to investigate whether executives in the process of making new contacts would fall prey to the self-similarity principle. As part of Columbia's executive MBA program, students were invited to a "business mixer" for a chance to meet new people. At the event, each student wore an inconspicuous electronic device, similar to ones used by a local dating service, that recorded who they talked to and for how long. A survey taken before the event indicated that the executives' primary goal was to meet as many different people as possible. In practice, however, the students formed new ties with others who were most like them – the investment bankers connected with other investment bankers, the marketing executives talked to other marketing executives, and so on. The most successful networker that evening, in fact, turned out to be the bartender.

Another obstacle to diversity in networks is the *proximity principle,* which holds that workers prefer to populate their networks with the people they spend the most time with, such as colleagues in their department. The reason this principle works against building efficient networks is that the world is organized by like things – people with the same training tend to be in the same department, just as people with similar backgrounds tend to live in the same neighborhood. If you follow your natural tendencies and build networks according to the proximity and self-similarity principles, you will create

echo chambers in your network and reduce opportunities to enrich your networks with greater diversity.

Forge Better Connections

The best way to break through the barriers created by the self-similarity and proximity principles is by using the *shared activities principle.* Potent networks are not forged through casual interactions but through relatively high-stakes activities that connect you with diverse others. Think again about Bill Gates. Schmoozing didn't connect Mary Gates with IBM's Akers; rather, their trust, exchange of private information, and access to each other's diverse skills were by-products of their work on the same nonprofit board–a shared activity. Any executive can participate in and benefit from a variety of shared activities, including sports teams, community service ventures, interdepartmental initiatives, voluntary associations, for-profit boards, cross-functional teams, and charitable foundations.

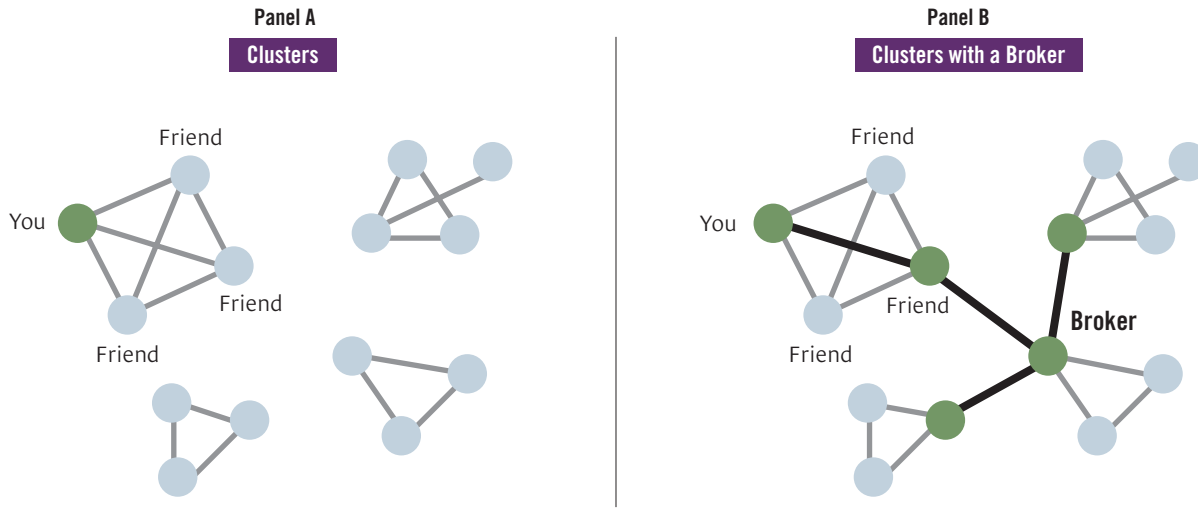
The secret to understanding the power of shared activities in building networks begins with recognizing that not all shared activities are equally potent. Like Gates and Akers's work on a nonprofit board, activities that evoke passion in participants, necessitate interdependence, and have something at stake are more likely to produce networks like Paul Revere's. Someone who cares passionately about an activity will find a way to fit it into his or her busy schedule. And reliance on others to get the job done can build trust quickly, even among diverse individuals. Finally, having something at stake – competing for a prize, breaking a personal record, or achieving a long-term goal – provides opportunities for celebration and commiseration, both of which generate bonds of loyalty that sustain a relationship over time. Consequently, in terms of building your network, an independent activity such as running won't help you nearly as much as joining a running club. And you'll form the strongest ties with other runners in a club when you train with them for a race.

Shared activities bring together a cross-section of disparate individuals around a common point of interest, instead of connecting similar individuals with shared backgrounds. They let you observe your contacts in a wide range of situations. Participation in a shared activity allows for unscripted behaviors and natural responses to unexpected events–things that rarely show up during business lunches or office meetings, where impressions are managed and presentations are carefully rehearsed. Moreover, because these responses are spontaneous, they are more likely to be perceived as genuine, stable attributes of character that apply not only to the current activity but to other pursuits as well, including commercial endeavors. And because the opportunities for celebration and commiseration generate bonds of loyalty, these diverse individuals can enjoy close working relationships that they might not otherwise have formed.

Todd Reding, a client development executive for nonprofit firms, has witnessed the benefits of shared activities firsthand. Whenever he can, he meets with potential donors through shared activities that are outside a typical business setting. In one instance, Reding expressed interest in a potential donor's

The Importance of Brokers in Companies

Panel A shows that social networks are typically separate clusters–friends of friends are also friends with one another, and they share similarities with the creator of the network, creating what we call an echo chamber. Friendship clusters within companies are no different from friendship clusters outside work. But Panel B shows how brokers within companies can connect the specialized pools of knowledge by linking independent clusters together–giving every member of each cluster better access to other parts of the companywide network.



passion for competitive waterskiing. The donor invited Reding to try it himself, then spent several hours coaching him through a challenging slalom course, shortening the rope to the boat after each run so that Reding's turns became sharper and faster. Despite the differences in their backgrounds, the men quickly began to trust each other as they observed their reactions to unexpected events and shared the emotional roller coaster of failing – and then getting it right.

Shared activities also forge ties between diverse individuals by changing their usual patterns of interaction, letting them break out of their prescribed business roles of subordinate, relationship manager, aide, finance whiz, cognoscente, or president and stand out from the crowd. Reding's "I can step up to a challenge" actions distinguished him from other development executives, and the potential donor was able to see aspects of Reding's character that he felt were critical for putting his investment to proper use. Similarly, the donor's increased trust in Reding prompted the donor to reveal personal experiences that helped Reding revise his original proposal and secure a contribution.

Benjamin Weeks (not his real name), an executive at a life insurance company, has learned how to turn work situations into shared activities to manage upward relationships. Weeks, originally trained as a litigator, used his communication skills to write speeches for one of his company's more senior executives. Through this shared activity, Weeks and the executive moved away from the standard superior-subordinate relationship and formed a closer bond, sharing the highs and lows of their work. As they collaborated on the speeches, they learned about each other's "blind spots and boundaries," as Weeks says, perhaps without even realizing what they were revealing. The interaction made them both more vulnerable but also generated opportunities to demonstrate their trustworthiness to each other. Soon Weeks found himself mediating between the executive and others in the company. "They know I'm the one who understands how he works," Weeks concluded.

To build a network rich in social capital, cultivate powerful brokers who aren't in positions of formal authority – the places where everyone else looks.

In essence, the shared activities principle offers the benefits of the self-similarity and proximity principles without their downside – creating a redundant and inefficient network.

Go for Broke(rs)

Returning to your work sheet, take a look at the names of your brokers in the center column. It's important to determine who your brokers are so you can discover what activities bring you into contact with them and how you can further develop those ties. Perhaps the individuals you listed are not obviously powerful broker candidates like CEOs or partners at law firms, but you can reach them and they are well connected to clusters outside your current circles.

Now examine the people listed multiple times in the first column and think about how you met them. The exhibit "How to Map Your Network" displays a partial list of coauthor Brian Uzzi's personal networks and suggests that Steve Alltop is an important broker; he connected Uzzi to Northwestern University's Greg Duncan and Henry Bienen. How did Alltop and Uzzi meet? Not in a business setting but as partners in an unexpected pickup game of squash – a shared activity. After that first encounter and a couple of follow-up rounds, Alltop asked Uzzi to substitute for him in other squash games. That's when Uzzi met Bienen and Duncan, both of whom now figure largely in Uzzi's career.

Indeed Alltop, who is a senior lecturer of music and who also conducts the

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Case Study: How to Fix a Networking Slump

Everyone experiences a lull at some point in his or her career. One way to jump-start your resurgence is to examine your social network for clues about how to get back on track.

Margy Stratton had hit her slump and knew something had to change. A vice president at a manufacturing company, Stratton had been logging more and more hours in her office, but didn't feel like her career was improving. In fact, things seemed to be getting worse. She had stopped getting calls about the kind of projects that she cared deeply about and that energized her creativity at work. She felt disconnected from the community.

When Stratton filled out our network work sheet, she saw interesting patterns emerge. First, she recognized that many of the names in the left-hand column were board members from nonprofit organizations she had been involved with. However, she had stepped down from two of her three board positions 18 months ago, to be more visible at work.

One look at the center column revealed Stratton's broker; Corina Johnson's (not her real name) name appeared in nearly one-third of the spaces. Johnson was dynamic and seemed to know everyone. She was the kind of person it was impossible to say no to–which is how she recruited Stratton for the fine arts board. She had introduced Stratton to lots of people, from members of other boards to the best nanny that Stratton had ever hired. Furthermore, Johnson was a broker of quality as well as quantity, introducing Stratton to business associates who could truly help her career. But it had been more than a year since they had spent time together; Stratton realized that she'd been neglecting her most powerful superconnector.

The right-hand column of Stratton's work sheet showed that she had also served as a broker for others. Stratton had often introduced people to one another across boards, and her key shared activity, her involvement in several boards, had made her feel well connected. That confidence had made her more resourceful in creating links among the people she knew and in winning their gratitude. Now that Stratton understands the importance of her shared activities, she is planning to revitalize her network and galvanize her career.

Northwestern University symphony orchestra, turned out to be a *superconnector*–a powerful broker who shares his diverse contacts. As conductor, he attends most major university events, from professional-school graduations to welcoming events for important donors and celebrity guests. Essentially, Alltop's occupation is one big shared activity, and this–not his level of formal power in the organization–accounts for his broad, diverse network.

To build a network rich in social capital, cultivate powerful brokers who aren't in positions of formal authority–the places where everyone else looks. For example, a crucial superconnector in Todd Reding's network was Pete Barnette (not his real name), an attorney he met through their joint links to a nonprofit board. Barnette was responsible for many of Reding's important business contacts in various locations, such as Chicago, Iowa, and Arkansas.

We've often been asked if a broker should be told of his or her role once an executive is aware of it. On one hand, telling a person that he is disproportionately important to your network could alter the relational dynamics. The broker might feel used or might want something in return that you cannot give. On the other hand, a disclosure could deepen the relationship by revealing gratitude and sincerity, which, in our estimation, is the best principle of action in a network.

When Reding meets brokers like Barnette, he openly tells them that he appreciates their assistance in making new contacts. The brokers are always flattered and willing to help, he says. Similarly, Uzzi's revelation to Alltop that he was a superconnector turned into concrete business implications for Alltop. With new knowledge about how networks operate, Alltop decided to accept an offer to become conductor of the Cheyenne Symphony Orchestra in Wyoming. He took the position not only because it was a great opportunity for him, but also because many of the CSO's musicians worked for other major orchestras in the off-season. Alltop realized that the connections he could make through the CSO could get his name on those other groups' radar screens. After two years in Cheyenne, Alltop's network paid off. Though he hadn't learned special new pieces of music or become more musically talented, he was invited to conduct a weeklong classical music festival in Bologna, Italy–a festival that attracts journalists, photographers, and radio and TV coverage–thus extending his reach even farther.

Research shows that if you create your networks with trust, diversity, and brokerage, you can raise your level of information from *what* you know to *who* you know.

• • •

More than 100 years ago, Ralph Waldo Emerson reportedly declared during a lecture, "If a man can write a better book, preach a better sermon, or make a better mousetrap than his neighbor, though he build his house in the woods, the world will make a beaten path to his door." But Emerson was only half right. Creativity and insight are certainly important, but without an effective network, you may never spark your imagination, reinvent yourself, or declare your sensational news to the world.

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There are two ways of doing business, and any given company is as adroit at the one as it is awkward at the other. Understanding your own organization's handedness will guide you to the right strategic moves.

STRATEGY AND YOUR STRONGER HAND

BY GEOFFREY A. MOORE

Oscar Wilde once wrote, "Men marry because they are tired; women, because they are curious. Both are disappointed." We can repurpose that statement to shed light on the business of strategic acquisitions: Simply substitute acquired and acquiring companies for the principals involved, and then add investors to round out the list of the disappointed.

Indeed, it is a commonplace that the vast majority of acquisitions fail to deliver the synergies, competitive advantages, and shareholder value they promised. Over and over, business strategists set their sights on new territory that appears fertile but is not – or at least, not for them. Such was the case when PC maker Compaq merged

FREDRIK BRODEN

with mainframe vendor Digital Equipment Corporation, when retail broker Charles Schwab merged with institutional banker U.S. Trust, and when entertainment giant Time Warner merged with Internet marketer America Online. In all cases, the problem was not a lack of opportunity. In fact, these management teams had targeted entities with a great deal to offer in markets where others prospered handsomely. The problem was, because of the types of companies Compaq, Schwab, and Time Warner were, they were not the ones to exploit those opportunities. Much of the competitive edge of each business was blunted or canceled when it was fused with an opposing business model.

The best strategic moves for a company are ones that supplement rather than complement that company's current dominant business model. This is a form of saying "stick to your knitting" but requires a new understanding of the knitting involved. A better metaphor would be to say that companies should favor their dominant hand. It's an analogy that works for at least two reasons. First, there are really only two organizational "hands" to choose between, as I will explain in the section to follow. There is no third model that scales. Second, for various reasons, ambidexterity is very rare. The typical organization is likely to be as clumsy with its subordinate hand as it is adroit with its dominant one.

Two Distinct Models of Business

To understand why it's so important to go with organizational strengths, we need to explore just how diametrically opposed the two models of business really are. The first kind of company competes on a complex-systems model. Examples include IBM, Cisco, and SAP; Goldman Sachs, Swiss Re, and the World Bank; Boeing, Tektronix, and Honeywell; Bechtel, Accenture, and IDEO; and Apache, Halliburton, and Burlington Northern. The second kind of company competes on volume operations. Examples include Nestlé, Procter & Gamble, and Nike; Dell, Apple, and Sony; Hertz, Hilton, and United Airlines; Microsoft, Adobe, and Electronic Arts; and eBay, Google, and Amazon.

Most companies in the first category have large enterprises as their primary customers, while many in the second tend to be consumer oriented, but the distinction is not as simple as B2B versus B2C. Rather, it is more deeply rooted in their contrasting economic formulas. In the complex-systems model, vendors seek to grow a customer base of thousands, with no more than a handful of transactions per customer per year (indeed, in some years there may be none) but at an average price per transaction in six to seven figures. In this model, a thousand enterprises paying a million dollars each per year generate a billion dollars in revenue. By contrast, in the volume-operations model, vendors seek to acquire a customer base of millions of consumers, with tens or even hundreds of transactions per consumer per year, at an average price of relatively few dollars per transaction. Here it takes ten million customers each spending $8 per month to generate a billion dollars in annual revenue. As shown in the exhibit "Two Organizational Models," this fundamental distinction gives rise to very different structures, one focused on cultivating relationships, the other on systematizing transactions.

It should not be surprising, therefore, that innovation takes very different forms depending on which of these two platforms plays host to it. In fact, the two models are polar opposites along virtually every dimension of value creation. We can see this by walking through the seven phases of the classic value chain and seeing how each model responds to its demands. (The exhibit "Differences Across the Value Chain" sums up the contrast.)

Research. In the complex-systems model, market research has a qualitative bias because each customer constitutes a market reality unto itself. For example, the commercial airline businesses at Airbus and Boeing have perhaps 200 or so customers worldwide to consider. Statistically averaging insights across such a modest customer population makes no sense. Instead, these companies want to delve deeply into the specific circumstances of each account, seeking out peculiar patterns, not mathematical correlations. This is where war stories and hypothetical scenarios, even just the occasional apt metaphor, can prove so insightful. By contrast, the volume-operations model is all about the uniformity and scalability of transactions. A Palm or an HP needs to sell around one million units of a handheld device to repay the investment in R&D and marketing. Here, quantitative analytics are critical, and teams must guard *against* the compelling war story or apt metaphor. Too often, what appeals to a development or marketing team is not representative of what appeals to the target market at large, and the risk of getting this wrong at scale is frightening. Thus, even the best intuitive insights must be tested in thoughtfully designed, statistically valid experiments, and this is the core focus of volume-operations market research efforts.

Design. The essence of complex systems is that they tackle complexity. Think of a financial portfolio or a computer data center. No two customer implementations are ever exactly the same; no standard approach fits all.

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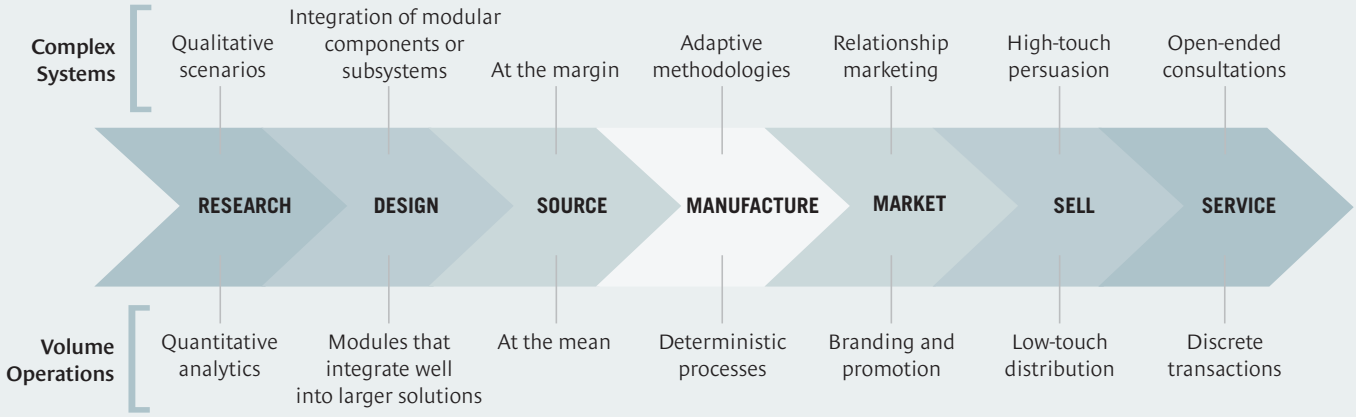
Differences Across the Value Chain

Just how diametrically opposed are the complex-systems model and the volume-operations model? Looking at all seven phases of the classic value chain reveals differences across every element.



Instead, complex-systems vendors must yoke disparate subsystems into a unique design – that is, they must integrate modules. By contrast, the goal of volume operations is to produce atomic output that can be integrated into larger systems without modification. In that world, where all the components are standard and all the possible permutations have been worked out in advance, build to order really means configure to order or assemble to order. Think of fall wardrobes sold at the Gap or entertainment systems at Best Buy. The more modular they are, the more they can be mass customized to meet the preferences of specific customers, though at no time are they genuinely custom.

Source. In a complex-systems solution, sourcing focuses on securing the scarcest elements as opposed to getting the lowest price for the high-volume components. That is because the biggest source of cost overruns is not inventory carrying cost but schedule slippage. Schedules are "gated" by system tests, and testing cannot be completed until the last component is installed; even a marginal component can trigger huge cost overruns by showing up late. Expediting (that is, paying a premium to get faster delivery from a vendor) is a virtue in this system. By contrast, in a volume operation, the focus in sourcing is not at the margin but on the mean – in other words, on minimizing the purchase and carrying costs of the most commonly purchased elements. Here, the fears are paying the wrong price, buying too much and getting stuck with inventory, or buying too little and being unable to meet demand. Avoiding these problems can be accomplished only by installing sophisticated processes and systems and sticking to them rigorously. Expediting is a vice in this model.

Manufacture. In complex systems, there are no truly repeatable processes. No two pieces of heavy equipment, no two projects are ever exactly alike. Continuity, predictability, and reliability derive instead from consistent methodologies that adapt themselves to specific situations. This is the program management expertise of a Lockheed Martin, a Bechtel, or an Accenture. Contrast that with the deterministic processes of a volume-operations effort, the sorts of processes that lead to every pill in a prescription being identical to every other pill. To be sure, there is always some variability, but here the goal is not to embrace it but to design it out. The Toyota Production System, the 99.999% uptime of telephony, the Good Laboratory Practices for pharmaceuticals manufacturing – all are rooted in mechanistic statistical quality control, a far cry from the kind of organic personal judgment needed to run the complex-systems model.

Market. With complex systems, no one member of the value chain can provide all the products and services end to end. The focus of marketing, therefore, is on aligning properly with partners and allies, not to mention the various customer constituencies that must collaborate in order to bring a complex system to fruition. Installing SAP's ERP system, for example, requires direct involvement from companies like HP, Accenture, and Oracle, indirect involvement of companies like Cisco, EMC, and Microsoft, and intense collaborative effort by numerous departmental organizations within the customer company. The most valuable marketing asset a company has in this context is the relationships it can create that give it permission to lead and make others want to align with its efforts. Contrast this with a volume-operations model,

where the entire offer is inside a package, the entire value chain is preassembled, there is only one end user to satisfy, and the only variable to manage is consumer choice. That's what Apple has accomplished, first with the Macintosh, and more recently with the iPod. The challenge here is to win a battle for preference within the mind of each consumer, and the most valuable marketing asset is brand image.

Sell. Complex-systems sales cycles take months of high-touch care to bring together all the customer interest groups that impinge on the buying decision. Think of the effort your company puts into selecting an employee benefits vendor or the HR system to run behind it. By contrast, volume-operations purchases are simple transactions that do not require and often do not benefit from the intervention of a sales assistant. The focus is on *buying,* and whatever selling is to be done is very low touch – probably accomplished through the package itself and any point-of-sale displays accompanying it. Producers of children's toys and breakfast cereals are particularly adept in making the package reach out and speak.

Service. In the complex-systems model, service makes up a major portion of the total solution budget, typically anywhere from 50% to 80%. This is the case whether the end product is a hotel building or a catered wedding inside it. The model involves both presale and postsale engagements, the former to help customers understand and tailor their investments to the specific situations they face, the latter to get them up and running faster and more reliably. In volume operations, by contrast, services are either the offers themselves, as with photo processing or Internet searches, or related transactions after the sale dealing with, for example, repairs and returns. These are on the vendor's terms and the service center's schedule if for no other reason than the alternative paths are not scalable.

Summing up, it's clear that the two models approach the entire task of value creation very differently. Once the differences are appreciated, it's easy to understand why a company probably couldn't excel at both forms. Each type of business supports an end-to-end value chain linking together all the functions necessary to making a market. But switching between them or combining elements from each is asking for trouble.

The Illusion of Greener Pastures

For understandable reasons, companies get drawn into competing with their weaker hand. In fact, the evolution of many markets draws complex-systems companies into market spaces that are more naturally volume-operations territory. That evolution begins when a complex-systems business creates a new solution to a customer's problem. At that point, the solution is like the space shuttle: It's one of a kind, and there are no volume operations to speak of. But when a pioneering offer catches on and proliferates,

portions of what was initially a purely custom system start getting carved out to be made more efficiently in a volume-operations mode. So, for instance, an airliner might still be customized and complex but share component subsystems like avionics, galleys, and seating across models.

At this point in the development of the category, the relationship between businesses pursuing the two models is symbiotic. The complex-systems business needs ongoing cost reductions to maintain margins, and it gets these by substituting volume-produced components. The volume operators, in turn, profit from the predeveloped market opportunities supplied by the complex-systems business. Over time, however, competitive advantage shifts inexorably toward the volume-operations businesses. The various subsystems of components they supply become sufficiently robust to generate end-to-end substitutes for the original complex offer. Initially, these substitutes don't compete well in terms of quality or features, but they do in terms of price, so they attract customers who cannot afford the complex-systems offer. Building on that base, they are able to improve and ultimately displace the offers of complex-systems vendors that had been their customers. In the pattern traced out in Clay Christensen's *The Innovator's Dilemma,* the complex-systems solutions are driven further and further upmarket in search of customers who will pay premium prices for their offerings – and as customers in these rarefied regions are scarce, the result is vendor consolidation at the high end even as volume operations are growing dramatically at the low end.

Over the course of this evolutionary path, each side envies what the other side has. Volume-operations companies envy the fat profit margins and wide open marketplaces of complex-systems enterprises. Complex-systems companies envy the lean operating efficiencies and huge installed bases of volume-operations enterprises. Because the lines between the markets they serve are blurry, with enough money at stake to make things materially interesting, both sides are drawn to the other's turf.

What's more, both sides are under pressure to leverage their technology investments. For example, the printing and copying divisions of Xerox, Kodak, and HP all make both high-end enterprise systems and low-end consumer products. Even though this commits them to support two almost entirely independent value chains with two radically different gross margin models, the temptation to milk the technology in every possible way proves almost irresistible.

Finally, it doesn't help that each side, doing the work of its stronger hand, makes that work look easy. By analogy, if you watch a left-handed friend write a letter in longhand, or play the guitar, or throw a pitch, it looks straightforward enough. But just try it.

Management on the Other Hand

When one type of business – whether volume operations or complex systems – attempts to compete in the other model, subtle but ultimately crippling problems arise. People in such organizations believe they are communicating and working in concert, but, at a fundamental level, they are approaching challenges from opposite ends. When it comes to setting strategy, for instance, complex-systems types focus on creating dramatically differentiated offerings that they then make as cost-effective as they can. Volume-operations strategists do the opposite: They focus on creating dramatically cost-effective offerings that they then make as differentiated as they can. The one organization, in other words, roots itself in effectiveness and goes in search of efficiency, while the other takes the opposite approach.

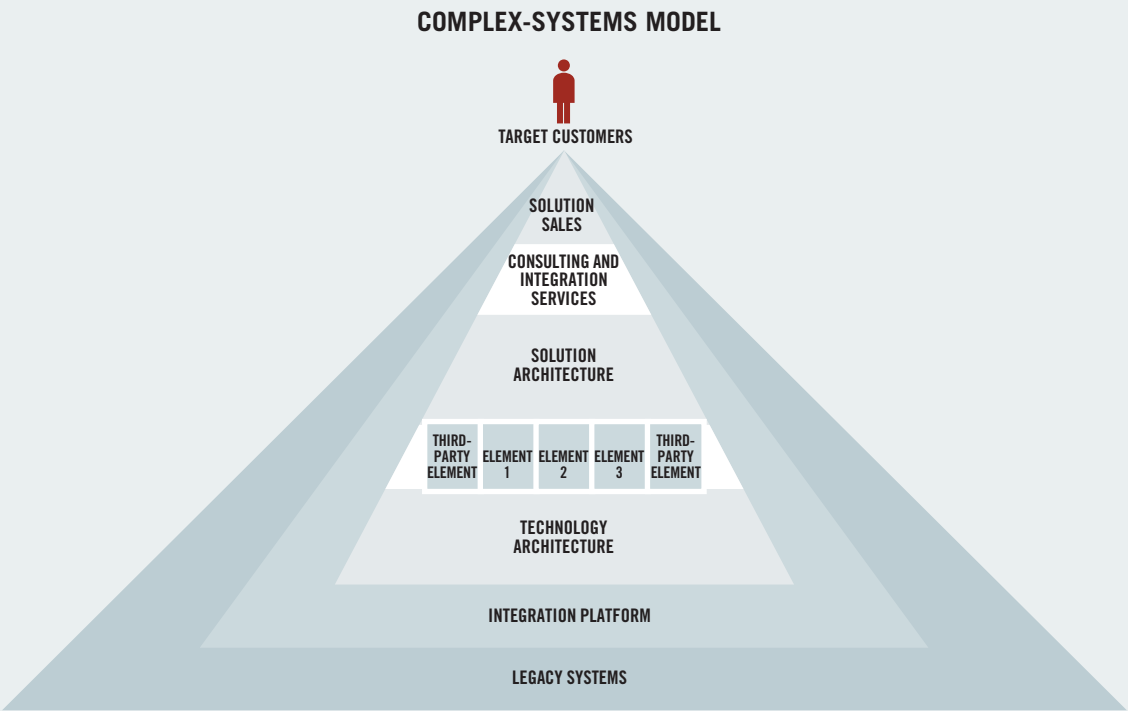
WHEN YOU PAIR OPPOSITE-HANDED ORGANIZATIONS, the hand of the acquiring company normally dominates the merger, putting the other hand at a huge disadvantage.

This leads to very different assumptions about ideal structure and attitudes toward overhead. The complex-systems organization demands enormous overhead to ensure that it is phenomenally effective at the point of attack. By contrast, volume-operations structures pare back overhead investment wherever they can, focusing on increasingly efficient processes, even if that means the customer must make accommodations.

Not surprisingly, these different environments appeal to different people. The skills that complex-systems organizations call for are consultative in nature, regardless of the function being performed. From a staffing perspective, people are expected to be adaptive and demonstrate judgment since every work order has novel elements. By contrast, volume-operations organizations subordinate individual judgment to operational rules, and people are expected to conform to those rules or stop the process. Adaptation in this context means adapting at the level of

Two Organizational Models

If you think business is business, you're simply wrong. In truth, business takes two distinct forms, and they could scarcely be less alike. One kind of business, diagrammed on the left, is geared toward delivering customized solutions to demanding and deep-pocketed customers. The other, diagrammed on the right, is designed to package a company's proprietary strength (its core technology, which may or may not be very high-tech) into standard products that meet the generic needs of mass markets. Let's look at how these two different competitive focal points give rise to wholly different business models.



TARGET CUSTOMERS: The complex-systems model is organized around *target customers,* which are typically large enterprises. (Think Boeing selling to airlines, or Accenture selling to the *Fortune* 1000.) There may be only a handful of transactions per customer per year – and in some years, none at all – but the average price per transaction may be a six- to seven-figure amount.

SOLUTION SALES: To conduct the elaborate courtship of these scarce and valuable customers, the business invests in a *solution sales* organization charged with understanding particular customers' challenges and building long-term, trust-based relationships.

CONSULTING AND INTEGRATION SERVICES: The solution sales organization is supported by a layer of *consulting and integration services*. Resources in this part of the business have deeper and more specialized knowledge of the company's capabilities and how they could be applied to a customer's specific requirements. Thus, an account manager in Fidelity's institutional business would depend on a group of product specialists to clarify how the firm's investment vehicles could help a pension-plan sponsor meet its goals.

SOLUTION ARCHITECTURE: The solution delivered to any given client is the company's best shot at a comprehensive response to the client's problem. Like the blueprint for a skyscraper, the *solution architecture* specifies the elements required and how they will fit together.

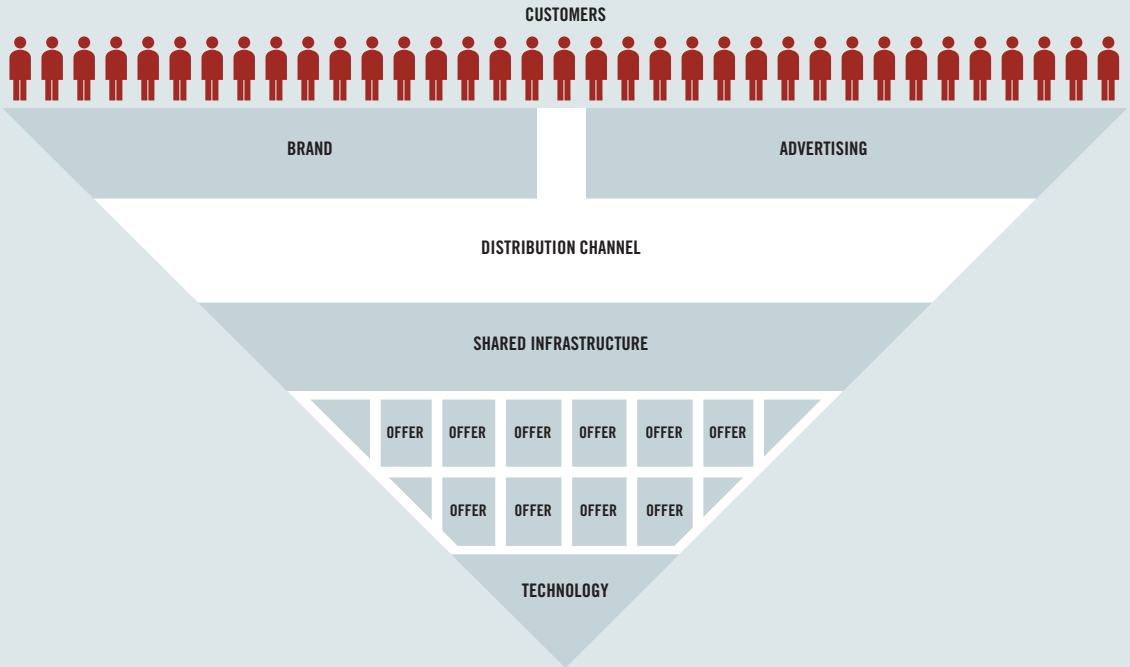
ELEMENTS: The *elements* of the solution are, at a more modular level, what the company sells. SAP, for example, constructs solutions for customers that use some but not all of its software modules and some but not all of its consulting resources. Further, if there are elements necessary to the solution that SAP itself does not produce, the client expects SAP to include these *third-party elements* in the solution design.

TECHNOLOGY ARCHITECTURE: Invisible to the customer, but critical to the company's ability to deliver working solutions, is a *technology architecture* that provides the common ground for elements to work together. In technology solutions, these are the standard protocols and interfaces that vendors adopt to ensure interoperability. But this isn't strictly a tech concept. In a consulting firm, a common methodology might be the foundation that would allow different specialists to drop in to a project and do their bit productively.

INTEGRATION PLATFORM: For customers, the solution does not exist in a vacuum. It draws and impinges on other parts of their operations. Whether it's Ernst & Young providing auditing services to Intel, or Bechtel delivering the Big Dig to Massachusetts taxpayers, the vendor must provide interfaces but create a buffer zone that prevents those peripheral activities from reaching into and compromising the solution.

LEGACY SYSTEMS: Every solution replaces an old way of doing things and often must work with some *legacy systems* that, while not optimal to the new approach, are not onerous enough to justify the cost of replacing. It's the lot of the complex-systems business to ensure that these old systems – whether they are information systems or other kinds of systems – are readily maintainable and nonintrusive.

VOLUME-OPERATIONS MODEL



TECHNOLOGY: In the volume-operations model, the customer as an individual is not the scarce element and hence not the competitive focal point. Instead, the organization of the business proceeds from whatever *technology* or unique capability it has that can create differentiation at scale. Thus, Condé Nast launches magazine after magazine, leveraging its publishing competence into disparate mass markets. It does not see its role as providing a total infotainment solution for Ellen Peebles of Brookline, Massachusetts.

OFFERS: The goal is to spin out a differentiated set of *offers* that can be delivered in high volume at low cost. Thus, the core technology enables and constrains the menu at McDonald's, the running-shoe lineup at Nike, and the service options from FedEx.

SHARED INFRASTRUCTURE: To keep costs as low as possible, the model exploits economies of scale through *shared infrastructure* for manufacturing, logistics, and customer service. Although Procter & Gamble sells products under a broad array of brands, it does not reinvent the supply chain for each one.

DISTRIBUTION CHANNEL: Both the scale of the model and the price points of the offers demand a high-volume, low-touch *distribution channel*. Rather than being called upon by solicitous "relationship managers," customers are presented with end-cap displays at Wal-Mart. The channel does not actually sell the offer so much as enable consumers to buy it.

BRAND/ADVERTISING: Consumers are attracted to the offer by *brand* and *advertising*. The two terms are separated on the diagram to acknowledge that brand can operate without advertising, as can advertising without brand, but they are both more powerful when combined.

CUSTOMERS: In a business model where it takes ten million customers each spending $100 per year to generate a billion dollars in revenue, it's not surprising that the focus shifts at the customer interface. It's not about cultivating relationships; it's about systematizing transactions.

the rules, not the individual – therefore, a division of labor emerges on the staffing front between workers to execute processes and managers to maintain those processes. Systems and automation become central to any volume-operations strategy, whereas even very large complex-systems enterprises can get by with relatively little in this arena.

In general, communications between the two models are difficult. Like the men and women John Gray describes in *Men Are from Mars, Women Are from Venus,* people from complex-systems and volume-operations orientations seem to say the same words but in fact intend very different meanings. Take a phrase like *customer intimacy*. In complex-systems models, it connotes deep domain expertise and developed relationships with decision-making executives in key accounts. In volume operations, the same term refers to the kind of pseudo-intimacy you get from your My Yahoo portal, Amazon.com's book recommendations, or AOL's enthusiastic "You've got mail!"

Another term that carries very different baggage in each system is *pricing*. Within the volume-operations model, pricing is the primary driver of the overall system, and managing street price to break specific price barriers is a critical success factor. There is extensive lore, not to mention very sophisticated algorithmic systems, devoted to it. By contrast, in a complex-systems model, price is relatively private and specific to a particular customer, deriving from the situational dynamics rather than determining them. You still need a pricing strategy, but it is much more qualitative than quantitative.

There are numerous other examples to cite, but at the end of the day they all lead to a single conclusion: Single-handed institutions enjoy a natural synergy across functions. They are internally aligned by a common underlying value-creation platform that ensures a coherent set of shared values. By contrast, organizations that attempt to be ambidextrous create points of contention wherever a handoff crosses the boundaries of the value-creation platform. At each of these junctures, the interfacing processes must stretch to accommodate the values of the other. This is not impossible to accomplish, but it does take time to negotiate, and the end result is inevitably a compromise that is somewhat uncomfortable on both sides. For that very reason, people are loath to revisit such negotiations once they are concluded, and thus the established interfaces tend to get locked in. The net effect is that they become anchors of inertia that interfere with any future process changes touching the area in question.

No wonder strategic acquisitions often prove so disappointing. When you pair opposite-handed organizations, the hand of the acquiring company normally dominates the merger, putting the other hand at a huge disadvantage. The result is that the acquired party, already on probation by virtue of its being on the block, sees its performance deteriorate further because it is being asked to meet standards that are inappropriate to its design. Failure to meet these standards causes the acquiring management team to intervene, leading to further deconstruction of the very processes and values that made the company worth acquiring in the first place. The end result is a complete mess because neither management team ever really understands the other.

Rather than try to solve this problem, the smart move is to avoid it altogether. That's why companies planning strategic acquisitions should think in terms of shaking hands – merging right-handed with right, or left-handed with left – rather than holding hands – merging right-handed with left-handed.

When You Must Hold Hands

When you assemble elements from within a single model, you have a decent shot at getting expected results. Conversely, whenever you mix and match across models, you will create unintended consequences. There are just too many embedded expectations in both systems to account for them all. The problem is, in many industries, you don't have the choice. These industries *require* vendors to join a right- and left-handed model in a single value chain.

Consider, for example, the semiconductor and pharmaceutical industries. Whether you are Intel or AMD, Pfizer or Merck, you design, manufacture, distribute, and service volume-operations products. But you market and sell those products almost entirely through a complex-systems approach. Specifically, in the semiconductor industry, you market to a handful of device manufacturers to get your chip designed into their next-generation systems. This takes years of work and a gambler's nerves, with the vendor absorbing all the engineering costs. In the pharmaceutical industry, vendors must embark on an even longer and more expensive marketing journey, first to win FDA approval, then to win insurance payer approval, then to get onto the hospitals' formularies, and finally to get doctors to actually write the prescriptions.

So are the companies in the semiconductor and pharmaceutical sectors volume-operations or complex-systems organizations? The answer is, they have to be both. That's because they are in a two-tier market where they must influence intermediaries via a complex-systems approach in order to ultimately reach consumers in a volume-operations model. Similar challenges face benefits and insurance companies that take a complex-systems approach to sell employee benefits programs to corporations but use a volume-operations approach to service those same programs as employees utilize them.

The significance of holding hands is that it builds inertial sticking points into the value chains of these industries. In particular, the handoff from volume manufacturing to complex marketing requires a negotiated protocol that is uncomfortable on both sides. Volume

Staying Ahead of the Pack

How does a complex-systems business survive when the solution it offers turns into a commodity? Not by becoming a volume-operations business. It will never excel at that game, and it shouldn't try. Instead, it should relinquish its claims on the current category and redeploy its assets one level up in the systems hierarchy.

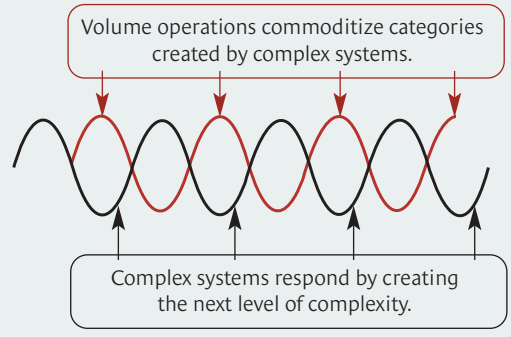
This vertical leap is made possible by the very commoditization that instigates it, as the complex-systems model now utilizes the newly created commodity as an enabling component for a higher-order system. Thus, for example, IBM, faced with the increasing commoditization of the mainframe, is embracing two of its most powerful commoditizing elements – the Linux operating system and the PC – and is using them as components in a next-generation supercomputer based on highly complex clustering software. Similarly, as wireless PDAs and smart phones become increasingly commoditized, companies like HP, Motorola, and Symbol Technologies are looking to leverage them as components of an enterprise mobile computing system for next-generation productivity applications.

Over multiple generations of technology, a pattern of cyclical progression emerges, as illustrated by the diagram on the right:

The black sine curve traces the market fortunes of the complex-systems model; the red curve, those of the volume-operations model. They are 180 degrees out of phase at any point along the curve. Within each pair of cycles, complex-systems enterprises break new ground and capture the early returns while volume-operations companies follow behind to extract the residual value.

Each time a new layer in the systems hierarchy is added, a new level of integration is introduced, and a new market cycle begins. For example, at one time, enterprises bought general ledger software separate from accounts receivable and accounts payable packages. When these systems became commodity items, they started showing up on PCs from volume-operations software companies like Peachtree and Great Plains. Meanwhile, at the high end, complex-systems vendors fused these commoditizing elements into a financial systems suite, where the major beneficiaries were MSA and McCormack & Dodge. When that began to go to the volume-operations vendors on the PC, the complex-systems side incorporated inventory and manufacturing management into the suite, and ASK and Cullinet were the big beneficiaries. Later, order processing, credit, and logistics were added to create what we now call ERP, and SAP and Oracle were big winners.

But note that different complex-systems vendors rose to prominence at different category transitions. In fact, it is not reasonable to expect the winner in any given category to be the winner in the next generation – winners have too much incentive to extend the old franchise beyond the deadline. But it is reasonable to expect them to stay in the game, come in somewhere in the middle of the pack, and be in place to come to the fore in a subsequent transition. While Digital passed IBM in minicomputing, IBM retook the lead in personal computers. Similarly, after Sun took the early lead in Unix workstations, HP passed it in Unix client servers – but Sun retook the lead in Unix-enabled Internet computing.



manufacturing requires forecastability and linearity in order to achieve its efficiencies, but complex-systems marketing is too lumpy to provide either of these outcomes. Meanwhile, complex-systems marketing calls for tailoring of customer-specific solutions that volume manufacturing cannot support. Each tries to accommodate the other, but neither really can.

If you are in an industry that forces these kinds of handoffs, one key to your success is to be aware of your dominant hand, because it's still calling the shots. Any strategy and transformation effort must be grounded in a deep appreciation for the dynamics of the hosting paradigm.

Often, the best way to achieve true dexterity is to set up separate, autonomous organizations. This has the effect of keeping the two hands at, well, arm's length. This is what General Electric does with its lightbulb and aircraft engine businesses, what Johnson & Johnson does with its medical equipment and consumer packaged goods divisions, what Cisco does with its enterprise and consumer networking businesses, and what Canon does with its industrial lens and consumer camera businesses. That said, over time our models suggest that, in each such case, financial results will eventually skew to one side or the other of the balance beam, and the corporation will tend to

become permanently tilted to that side. The holding company structure can still be maintained, but the prevailing handedness will shape subsequent investment decisions. Nokia and Canon, for example, seem destined for an increasingly volume-oriented future, while GE and J&J seem more likely to be complexity-oriented going forward.

The only option for firms that do not adopt a holding company relationship with their diverse business models is to pay very close attention to the handoffs between complex-systems and volume-operations processes. A typical failure happens when the enterprise's dominant hand dictates inappropriate behaviors to the other hand and then complains about that group's inability to meet standards. The problem, of course, is that the standards are biased toward the dominant hand.

If you can succeed in managing hand-holding in your value chain, you may well have a real competitive advantage. By finding truly imaginative ways to make awkward handoffs effective, you might enable faster cycle times and less onerous business processes for your customers as well as greater scalability and more rapid adaptations to meet market demands. It's a safer bet, however, that you'll prosper by remaining single-handed internally and partnering externally for the services required from the opposite hand. Given today's ubiquitous and universal communication networks, such partnering has never been easier.

A TYPICAL FAILURE HAPPENS when the enterprise's dominant hand dictates inappropriate behaviors to the other hand and then complains about that group's inability to meet standards.

Go with Your Strengths

Going with a dominant hand should be the default choice of most enterprises, even when the temptation is great to make a move on the opposite side. Take a lesson from the railroads, which discovered that their volume-operations passenger business was not profitable even though it leveraged much of the infrastructure paid for by their complex-system freight customers. Or from IBM's 2004 divestiture of its volume-operations PC business, a product line that shared component costs with its complex-systems offerings but that was operationally incompatible with corporate commitment to providing solutions to business customers. In both examples, when the gains from category breadth were weighed against the gains from committing to a single value-creation engine, the latter won out.

Although businesses pursuing opposing models inevitably compete at the margins, they can never compete directly for the heart of each other's businesses. To be sure, as they seek additional market growth, they encroach upon each other's domains and frequently quarrels break out. Sun gets cranky with Microsoft, eBay threatens Christie's, Linux challenges Windows. But these are all feints. Neither model can truly displace the other because, were it ever to conquer the other's capital city, it would not have the wherewithal to occupy it. The most the models can do is fight over the boundaries of the demilitarized zone that separates them.

Now, let's not be too cavalier here: There is a lot of money to be made by taking market share in a DMZ. Indeed, the whole strategy of volume operations is to grow markets through systematic occupation of ground originally staked out by complex-systems enterprises. And, for complex-systems businesses, the ability to resist these incursions and postpone the inevitable can make all the difference to the profitability of an offering. It is true that the question is never *if* you are going to capitulate, only *when,* but literally billions of dollars of revenues and profits still depend on the timing, and the most successful complex-systems companies specialize in fighting effective rearguard actions. Still, the wise complex-systems vendor does not cling to its past categories but instead sets out for new pastures to start the cycle all over again. (See the sidebar "Staying Ahead of the Pack.")

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Recognizing that organizations have a handedness – a deep-rooted predilection for either volume operations or complex systems–can help us manage more effectively. It guides us to maximize synergies wherever single-handed organizations are possible and to take great care wherever a mixed model is required. It helps us make better hires and be better partners. It can tell us when we should play offense or defense. It can even point us to competitive advantage opportunities we may have overlooked. Finally, and perhaps most important, it can help us communicate better about what the business needs to achieve. It is the rare company indeed that has no dissension about relative strengths and strategic priorities. Organizational handedness is a concept that may help management teams pull together.

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Marketing executives focus too much on ever-narrower demographic segments and ever-more-trivial product extensions. They should find out, instead, what jobs consumers need to get done. Those jobs will point the way to purposeful products – and genuine innovation.

MARKETING MALPRACTICE

The Cause and the Cure

by Clayton M. Christensen, Scott Cook, and Taddy Hall

THIRTY THOUSAND NEW CONSUMER PRODUCTS are launched each year. But over 90% of them fail – and that's after marketing professionals have spent massive amounts of money trying to understand what their customers want. What's wrong with this picture? Is it that market researchers aren't smart enough? That advertising agencies aren't creative enough? That consumers have become too difficult to understand? We don't think so. We believe, instead, that some of the fundamental paradigms of marketing – the methods that most of us learned to segment markets, build brands, and understand customers – are broken. We're not alone in that judgment. Even Procter & Gamble CEO A.G. Lafley, arguably the best-positioned person in the world to

CHRISTIANE BEAUREGARD

make this call, says, "We need to reinvent the way we market to consumers. We need a new model."

To build brands that mean something to customers, you need to attach them to products that mean something to customers. And to do that, you need to segment markets in ways that reflect how customers actually live their lives. In this article, we will propose a way to reconfigure the principles of market segmentation. We'll describe how to create products that customers will consistently value. And finally, we will describe how new, valuable brands can be built to truly deliver sustained, profitable growth.

Broken Paradigms of Market Segmentation

The great Harvard marketing professor Theodore Levitt used to tell his students, "People don't want to buy a quarter-inch drill. They want a quarter-inch hole!" Every marketer we know agrees with Levitt's insight. Yet these same people segment their markets by type of drill and by price point; they measure market share of drills, not holes; and they benchmark the features and functions of their drill, not their hole, against those of rivals. They then set to work offering more features and functions in the belief that these will translate into better pricing and market share. When marketers do this, they often solve the wrong problems, improving their products in ways that are irrelevant to their customers' needs.

Segmenting markets by type of customer is no better. Having sliced business clients into small, medium, and large enterprises – or having shoehorned consumers into age, gender, or lifestyle brackets – marketers busy themselves with trying to understand the needs of representative customers in those segments and then create products that address those needs. The problem is that customers don't conform their desires to match those of the average consumer in their demographic segment. When marketers design a product to address the needs of a typical customer in a demographically defined segment, therefore, they cannot know whether any specific individual will buy the product – they can only express a likelihood of purchase in probabilistic terms.

Thus the prevailing methods of segmentation that budding managers learn in business schools and then practice in the marketing departments of good companies are actually a key reason that new product innovation has become a gamble in which the odds of winning are horrifyingly low.

There is a better way to think about market segmentation and new product innovation. The structure of a market, seen from the customers' point of view, is very simple: They just need to get things done, as Ted Levitt said. When people find themselves needing to get a job done, they essentially hire products to do that job for them. The marketer's task is therefore to understand what jobs periodically arise in customers' lives for which they might hire products the company could make. If a marketer can understand the job, design a product and associated experiences in purchase and use to do that job, and deliver it in a way that reinforces its intended use, then when customers find themselves needing to get that job done, they will hire that product.

Since most new-product developers don't think in those terms, they've become much too good at creating products that don't help customers do the jobs they need to get done. Here's an all-too-typical example. In the mid-1990s, Scott Cook presided over the launch of a software product called the Quicken Financial Planner, which helped customers create a retirement plan. It flopped. Though it captured over 90% of retail sales in its product category, annual revenue never surpassed $2 million, and it was eventually pulled from the market.

What happened? Was the $49 price too high? Did the product need to be easier to use? Maybe. A more likely explanation, however, is that while the demographics suggested that lots of families needed a financial plan, constructing one actually wasn't a job that most people were looking to do. The fact that they should have a financial plan, or even that they said they should have a plan, didn't matter. In hindsight, the fact that the design team had had trouble finding enough "planners" to fill a focus group should have tipped Cook off. Making it easier and cheaper for customers to do things that they are not trying to do rarely leads to success.

Designing Products That Do the Job

With few exceptions, every job people need or want to do has a social, a functional, and an emotional dimension. If marketers understand each of these dimensions, then they can design a product that's precisely targeted to the job. In other words, the job, not the customer, is the fundamental unit of analysis for a marketer who hopes to develop products that customers will buy.

To see why, consider one fast-food restaurant's effort to improve sales of its milk shakes. (In this example, both the company and the product have been disguised.) Its marketers first defined the market segment by product – milk shakes – and then segmented it further by profiling the demographic and personality characteristics of those cus-

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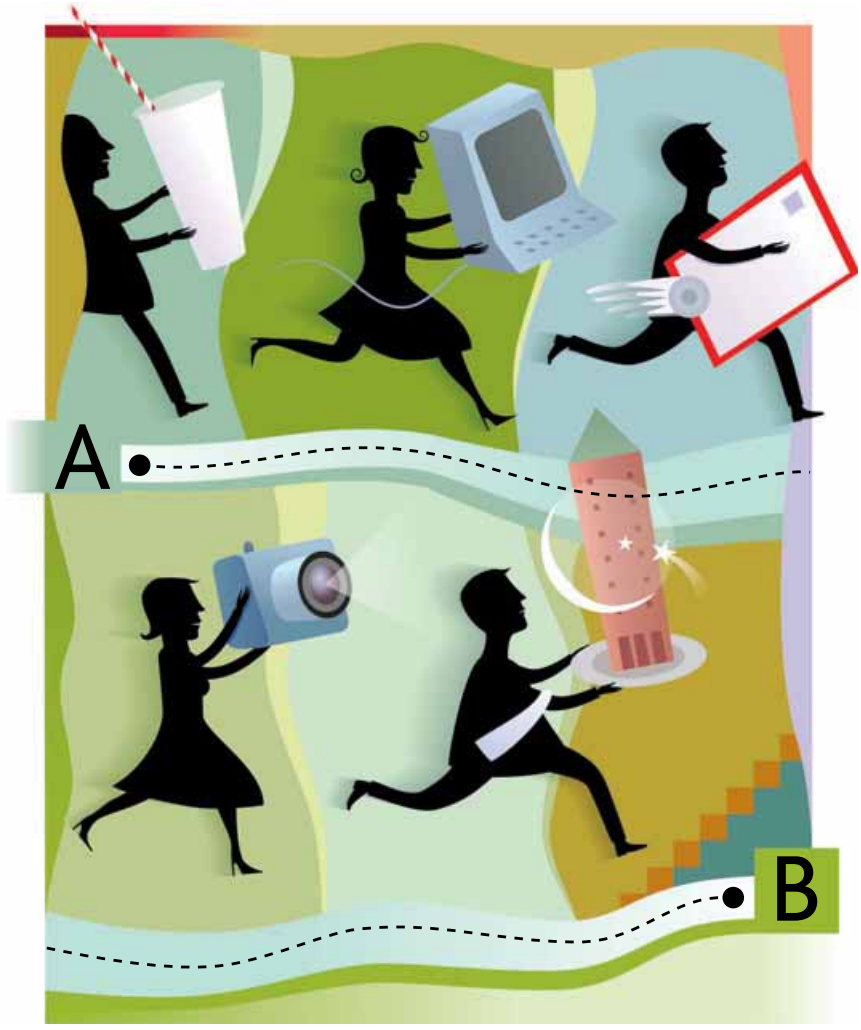
tomers who frequently bought milk shakes. Next, they invited people who fit this profile to evaluate whether making the shakes thicker, more chocolaty, cheaper, or chunkier would satisfy them better. The panelists gave clear feedback, but the consequent improvements to the product had no impact on sales.

A new researcher then spent a long day in a restaurant seeking to understand the jobs that customers were trying to get done when they hired a milk shake. He chronicled when each milk shake was bought, what other products the customers purchased, whether these consumers were alone or with a group, whether they consumed the shake on the premises or drove off with it, and so on. He was surprised to find that 40% of all milk shakes were purchased in the early morning. Most often, these early-morning customers were alone; they did not buy anything else; and they consumed their shakes in their cars.



The researcher then returned to interview the morning customers as they left the restaurant, shake in hand, in an effort to understand what caused them to hire a milk shake. Most bought it to do a similar job: They faced a long, boring commute and needed something to make the drive more interesting. They weren't yet hungry but knew that they would be by 10 AM; they wanted to consume something now that would stave off hunger until noon. And they faced constraints: They were in a hurry, they were wearing work clothes, and they had (at most) one free hand.

The researcher inquired further: "Tell me about a time when you were in the same situation but you didn't buy a milk shake. What did you buy instead?" Sometimes, he learned, they bought a bagel. But bagels were too dry. Bagels with cream cheese or jam resulted in sticky fingers and gooey steering wheels. Sometimes these commuters bought a banana, but it didn't last long enough to solve the boring-commute problem. Doughnuts didn't carry people past the 10 AM hunger attack. The milk shake, it turned out, did the job better than any of these competitors. It took people 20 minutes to suck the viscous milk shake through the thin straw, addressing the boring-commute problem. They could consume it cleanly with one hand. By 10:00, they felt less hungry than when they tried the alternatives. It didn't matter much that it wasn't a healthy food, because becoming healthy wasn't essential to the job they were hiring the milk shake to do.

The researcher observed that at other times of the day parents often bought milk shakes, in addition to complete meals, for their children. What job were the parents trying to do? They were exhausted from repeatedly having to say "no" to their kids. They hired milk shakes as an innocuous way to placate their children and feel like loving parents. The researcher observed that the milk shakes didn't do this job very well, though. He saw parents waiting impatiently after they had finished their own meals while their children struggled to suck the thick shakes up through the thin straws.

Customers were hiring milk shakes for two very different jobs. But when marketers had originally asked individual customers who hired a milk shake for either or both jobs which of its attributes they should improve – and when these responses were averaged with those of other customers in the targeted demographic segment – it led to a one-size-fits-none product.

Once they understood the jobs the customers were trying to do, however, it became very clear which improvements to the milk shake would get those jobs done even

better and which were irrelevant. How could they tackle the boring-commute job? Make the milk shake even thicker, so it would last longer. And swirl in tiny chunks of fruit, adding a dimension of unpredictability and anticipation to the monotonous morning routine. Just as important, the restaurant chain could deliver the product more effectively by moving the dispensing machine in front of the counter and selling customers a prepaid swipe card so they could dash in, "gas up," and go without getting stuck in the drive-through lane. Addressing the midday and evening job to be done would entail a very different product, of course.

By understanding the job and improving the product's social, functional, and emotional dimensions so that it did the job better, the company's milk shakes would gain share against the real competition – not just competing chains' milk shakes but bananas, boredom, and bagels. This would grow the category, which brings us to an important point: Job-defined markets are generally much larger than product category–defined markets. Marketers who are stuck in the mental trap that equates market size with product categories don't understand whom they are competing against from the customer's point of view.

Notice that knowing how to improve the product did not come from understanding the "typical" customer. It came from understanding the job. Need more evidence?

Pierre Omidyar did not design eBay for the "auction psychographic." He founded it to help people sell personal items. Google was designed for the job of finding information, not for a "search demographic." The unit of analysis in the work that led to Procter & Gamble's stunningly successful Swiffer was the job of cleaning floors, not a demographic or psychographic study of people who mop.

Why do so many marketers try to understand the consumer rather than the job? One reason may be purely historical: In some of the markets in which the tools of modern market research were formulated and tested, such as feminine hygiene or baby care, the job was so closely aligned with the customer demographic that if you understood the customer, you would also understand the job. This coincidence is rare, however. All too frequently, marketers' focus on the customer causes them to target phantom needs.

How a Job Focus Can Grow Product Categories

New growth markets are created when innovating companies design a product and position its brand on a job for which no optimal product yet exists. In fact, companies that historically have segmented and measured the size of their markets by product category generally find that when they instead segment by job, their market is much larger (and their current share of the job is much smaller) than they had thought. This is great news for smart companies hungry for growth.

Understanding and targeting jobs was the key to Sony founder Akio Morita's approach to disruptive innovation. Morita never did conventional market research. Instead, he and his associates spent much of their time watching what people were trying to get done in their lives, then asking themselves whether Sony's electronics miniaturization technology could help them do these things better, easier, and cheaper. Morita would have badly misjudged the size of his market had he simply analyzed trends in the number of tape players being sold before he launched his Walkman. This should trigger an action item on every marketer's to-do list: Turn off the computer, get out of the office, and observe.

Consider how Church & Dwight used this strategy to grow its baking soda business. The company has produced Arm & Hammer baking soda since the 1860s; its iconic yellow box and Vulcan's hammer-hefting arm have become enduring visual cues for "the standard of purity." In the late 1960s, market research director Barry Goldblatt tells us, management began observational research to understand the diverse circumstances in which consumers found themselves with a job to do where Arm & Hammer could be hired to help. They found a few consumers adding the product to laundry detergent, a few others mixing it into toothpaste, some sprinkling it on the carpet, and still others placing open boxes in the refrigerator. There was a plethora of jobs out there needing to get done, but most customers did not know that they could hire Arm & Hammer baking soda for these cleaning and freshening jobs. The single product just wasn't giving customers the guidance they needed, given the many jobs it could be hired to do.

Today, a family of job-focused Arm & Hammer products has greatly grown the baking soda product category. These jobs include:

- Help my mouth feel fresh and clean (Arm & Hammer Complete Care toothpaste)
- Deodorize my refrigerator (Arm & Hammer Fridge-n-Freezer baking soda)
- Help my underarms stay clean and fresh (Arm & Hammer Ultra Max deodorant)
- Clean and freshen my carpets (Arm & Hammer Vacuum Free carpet deodorizer)
- Deodorize kitty litter (Arm & Hammer Super Scoop cat litter)
- Make my clothes smell fresh (Arm & Hammer Laundry Detergent).

The yellow-box baking soda business is now less than 10% of Arm & Hammer's consumer revenue. The company's share price has appreciated at nearly four times the average rate of its nearest rivals, P&G, Unilever, and Colgate-Palmolive. Although the overall Arm & Hammer brand is valuable in each instance, the key to this

extraordinary growth is a set of job-focused products and a communication strategy that help people realize that when they find themselves needing to get one of these jobs done, here is a product that they can trust to do it well.

Building Brands That Customers Will Hire

Sometimes, the discovery that one needs to get a job done is conscious, rational, and explicit. At other times, the job is so much a part of a routine that customers aren't really consciously aware of it. Either way, if consumers are lucky, when they discover the job they need to do, a branded product will exist that is perfectly and unambiguously suited to do it. We call the brand of a product that is tightly associated with the job for which it is meant to be hired a *purpose brand*.

The history of Federal Express illustrates how successful purpose brands are built. A job had existed practically forever: the I-need-to-send-this-from-here-to-there-with-perfect-certainty-as-fast-as-possible job. Some U.S. customers hired the U.S. Postal Service's airmail to do this job; a few desperate souls paid couriers to sit on airplanes. Others even went so far as to plan ahead so they could ship via UPS trucks. But each of these alternatives was kludgy, expensive, uncertain, or inconvenient. Because nobody had yet designed a service to do this job well, the brands of the unsatisfactory alternative services became tarnished when they were hired for this purpose. But after Federal Express designed its service to do that exact job, and did it wonderfully again and again, the FedEx brand began popping into people's minds whenever they needed to get that job done. FedEx became a purpose brand – in fact, it became a verb in the international language of business that is inextricably linked with that specific job. It is a very valuable brand as a result.

Most of today's great brands – Crest, Starbucks, Kleenex, eBay, and Kodak, to name a few – started out as just this kind of purpose brand. The product did the job, and customers talked about it. This is how brand equity is built.

Brand equity can be destroyed when marketers don't tie the brand to a purpose. When they seek to build a general brand that does not signal to customers when they should and should not buy the product, marketers run the risk that people might hire their product to do a job it was

PURPOSE BRANDS AND DISRUPTIVE INNOVATIONS

We have written elsewhere about how to harness the potential of disruptive innovations to create growth. Because disruptive innovations are products or services whose performance is not as good as mainstream products, executives of leading companies often hesitate to introduce them for fear of destroying the value of their brands. This fear is generally unfounded, provided that companies attach a unique purpose brand to their disruptive innovations.

Purpose branding has been the key, for example, to Kodak's success with two disruptions. The first was its single-use camera, a classic disruptive technology. Because of its inexpensive plastic lenses, the new camera couldn't take the quality of photographs that a good 35-millimeter camera could produce on Kodak film. The proposition to launch a single-use camera encountered vigorous opposition within Kodak's film division. The corporation finally gave responsibility for the opportunity to a completely different organizational unit, which launched single-use cameras with a purpose brand – the Kodak FunSaver. This was a product customers could hire when they needed to save memories of a fun time but had forgotten to bring a camera or didn't want to risk harming their expensive one. Creating a purpose brand for a disruptive job differentiated the product, clarified its intended use, delighted the customers, and thereby strengthened the endorsing power of the Kodak brand. Quality, after all, can only be measured relative to the job that needs to be done and the alternatives that can be hired to do it. (Sadly, a few years ago, Kodak pushed aside the FunSaver purpose brand in favor of the word "Max," which now appears on its single-use cameras, perhaps to focus on selling film rather than the job the film is for.)

Kodak scored another purpose-branding victory with its disruptive EasyShare digital camera. The company initially had struggled for differentiation and market share in the head-on megapixel and megazoom race against Japanese digital camera makers (all of whom aggressively advertised their corporate brands but had no purpose brands). Kodak then adopted a disruptive strategy that was focused on a job – sharing fun. It made an inexpensive digital camera that customers could slip into a cradle, click "attach" in their computer's e-mail program, and share photos effortlessly with friends and relatives. Sharing fun, not preserving the highest resolution images for posterity, is the job – and Kodak's EasyShare purpose brand guides customers to a product tailored to do that job. Kodak is now the market share leader in digital cameras in the United States.

not designed to do. This causes customers to distrust the brand – as was the case for years with the post office.

A clear purpose brand is like a two-sided compass. One side guides customers to the right products. The other side guides the company's product designers, marketers, and advertisers as they develop and market improved and new versions of their products. A good purpose brand clarifies which features and functions are relevant to the job and which potential improvements will prove irrelevant. The price premium that the brand commands is the wage that customers are willing to pay the brand for providing this guidance on both sides of the compass.

The need to feel a certain way – to feel macho, sassy, pampered, or prestigious – is a job that arises in many of our lives on occasion. When we find ourselves needing to do one of these jobs, we can hire a branded product whose purpose is to provide such feelings. Gucci, Absolut, Montblanc, and Virgin, for example, are purpose brands. They link customers who have one of these jobs to do with experiences in purchase and use that do those jobs well. These might be called aspirational jobs. In some aspirational situations, it is the brand itself, more than the functional dimensions of the product, that gets the job done.

The Role of Advertising

Much advertising is wasted in the mistaken belief that it alone can build brands. Advertising cannot build brands, but it can tell people about an existing branded product's ability to do a job well. That's what the managers at Unilever's Asian operations found out when they identified an important job that arose in the lives of many office workers at around 4:00 in the afternoon. Drained of physical and emotional energy, people still had to get a lot done before their workday ended. They needed something to boost their productivity, and they were hiring a range of caffeinated drinks, candy bars, stretch breaks, and conversation to do this job, with mixed results.

Unilever designed a microwavable soup whose properties were tailored to that job – quick to fix, nutritious but not too filling, it can be consumed at your desk but gives you a bit of a break when you go to heat it up. It was launched into the workplace under the descriptive brand Soupy Snax. The results were mediocre. On a hunch, the brand's managers then relaunched the product with advertisements showing lethargic workers perking up after using the product and renamed the brand Soupy Snax – 4:00. The reaction of people who saw the advertisements was, "That's exactly what happens to me at 4:00!" They needed something to help them consciously discover both the job and the product they could hire to do it. The tagline and ads transformed a brand that had been a simple description of a product into a purpose brand that clarified the nature of the job and the product that was designed to do it, and the product has become very successful.

Note the role that advertising played in this process. Advertising clarified the nature of the job and helped more people realize that they had the job to do. It informed people that there was a product designed to do that job and gave the product a name people could remember. Advertising is not a substitute for designing products that do specific jobs and ensuring that improvements in their features and functions are relevant to that job. The fact is that most great brands were built before their owners started advertising. Think of Disney, Harley-Davidson, eBay, and Google. Each brand developed a sterling reputation before much was spent on advertising.

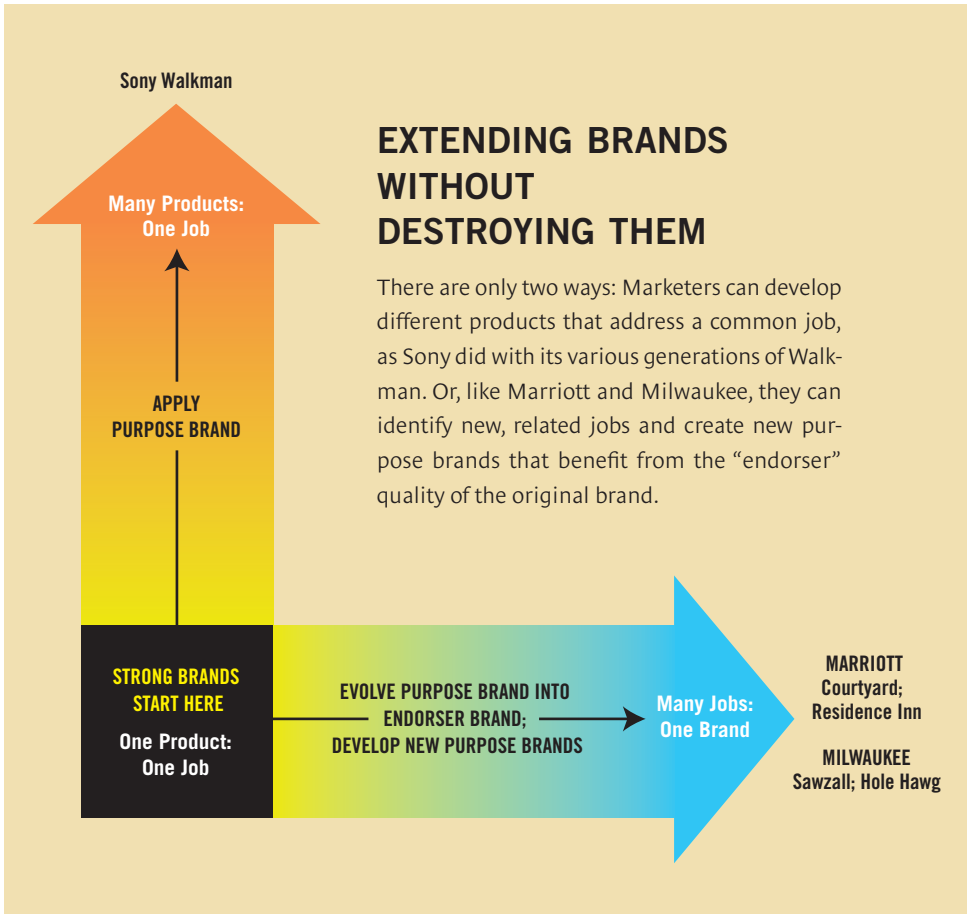
Advertising that attempts to short-circuit this process and build, as if from scratch, a brand that people will trust is a fool's errand. Ford, Nissan, Macy's, and many other companies invest hundreds of millions to keep the corporate name or their products' names in the general consciousness of the buying public. Most of these companies' products aren't designed to do specific jobs and therefore aren't usually differentiated from the competition. These firms have few purpose brands in their portfolios and no apparent strategies to create them. Their managers are unintentionally transferring billions in profits to branding agencies in the vain hope that they can buy their way to glory. What is worse, many companies have decided that building new brands is so expensive they will no longer do so. Brand building by advertising is indeed prohibitively expensive. But that's because it's the wrong way to build a brand.

Marketing mavens are fond of saying that brands are hollow words into which meaning gets stuffed. Beware. Executives who think that brand advertising is an effective mechanism for stuffing meaning into some word they have chosen to be their brand generally succeed in stuffing it full of vagueness. The ad agencies and media companies win big in this game, but the companies whose brands are getting stuffed generally find themselves trapped in an expensive, endless arms race with competitors whose brands are comparably vague.

The exceptions to this brand-building rule are the purpose brands for aspirational jobs, where the brand must be built through images in advertising. The method for brand building that is appropriate for these jobs, however, has been wantonly and wastefully misapplied to the rest of the world of branding.

Extending – Or Destroying – Brand Equity

Once a strong purpose brand has been created, people within the company inevitably want to leverage it by applying it to other products. Executives should consider these proposals carefully. There are rules about the types of extensions that will reinforce the brand – and the types that will erode it.



If a company chooses to extend a brand onto other products that can be hired to do the same job, it can do so without concern that the extension will compromise what the brand does. For example, Sony's portable CD player, although a different product than its original Walkman-branded radio and cassette players, was positioned on the same job (the help-me-escape-the-chaos-in-my-world job). So the new product caused the Walkman brand to pop even more instinctively into customers' minds when they needed to get that job done. Had Sony not been asleep at the switch, a Walkman-branded MP3 player would have further enhanced this purpose brand. It might even have kept Apple's iPod purpose brand from preempting that job.

The fact that purpose brands are job specific means that when a purpose brand is extended onto products that target different jobs, it will lose its clear meaning as a purpose brand and develop a different character instead – an *endorser brand*. An endorser brand can impart a general sense of quality, and it thereby creates some value in a marketing equation. But general endorser brands lose their ability to guide people who have a particular job to do to products that were designed to do it. Without appropriate guidance, customers will begin using endorser-branded products to do jobs they weren't designed to do. The resulting bad experience will cause customers to distrust the brand. Hence, the value of an endorser brand will erode unless the company adds a second word to its brand architecture – a purpose brand alongside the endorser brand. Different jobs demand different purpose brands.

Marriott International's executives followed this principle when they sought to leverage the Marriott brand to address different jobs for which a hotel might be hired. Marriott had built its hotel brand around full-service facilities that were good to hire for large meetings. When it decided to extend its brand to other types of hotels, it adopted a two-word brand architecture that appended to the Marriott endorsement a purpose brand for each of the different jobs its new hotel chains were intended to do. Hence, individual business travelers who need to hire a clean, quiet place to get work done in the evening can hire Courtyard by Marriott – the hotel designed by business travelers for business travelers. Longer-term travelers can hire Residence Inn by Marriott, and so on. Even though these hotels were not constructed and decorated to the same premium standard as full-service Marriott hotels, the new chains actually reinforce the endorser qualities of the Marriott brand because they do the jobs well that they are hired to do.

Milwaukee Electric Tool has built purpose brands with two – and only two – of the products in its line of power tools. The Milwaukee Sawzall is a reciprocating saw that tradesmen hire when they need to cut through a wall quickly and aren't sure what's under the surface. Plumbers hire Milwaukee's Hole Hawg, a right-angle drill, when they need to drill a hole in a tight space. Competitors like Black & Decker, Bosch, and Makita offer reciprocating saws and right-angle drills with comparable performance and price, but none of them has a purpose brand that pops into a tradesman's mind when he has one of these jobs to do. Milwaukee has owned more than 80% of these two job markets for decades.

Interestingly, Milwaukee offers under its endorser brand a full range of power tools, including circular saws,

To build **BRANDS THAT MEAN SOMETHING** to customers, you need to attach them to **PRODUCTS THAT MEAN SOMETHING** to customers.

pistol-grip drills, sanders, and jigsaws. While the durability and relative price of these products are comparable to those of the Sawzall and Hole Hawg, Milwaukee has not built purpose brands for any of these other products. The market share of each is in the low single digits – a testament to the clarifying value of purpose brands versus the general connotation of quality that endorser brands confer. Indeed, a clear purpose brand is usually a more formidable competitive barrier than superior product performance – because competitors can copy performance much more easily than they can copy purpose brands.

The tribulations and successes of P&G's Crest brand is a story of products that ace the customer job, lose their focus, and then bounce back to become strong purpose brands again. Introduced in the mid-1950s, Crest was a classic disruptive technology. Its Fluoristan-reinforced toothpaste made cavity-preventing fluoride treatments cheap and easy to apply at home, replacing an expensive and inconvenient trip to the dentist. Although P&G could have positioned the new product under its existing toothpaste brand, Gleem, its managers chose instead to build a new purpose brand, Crest, which was uniquely positioned on a job. Mothers who wanted to prevent cavities in their children's teeth knew when they saw or heard the word "Crest" that this product was designed to do that job. Because it did the job so well, mothers grew to trust the product and in fact became suspicious of the ability of products without the Crest brand to do that job. This unambiguous association made it a very valuable brand, and Crest passed all its U.S. rivals to become the clear market leader in toothpaste for a generation.

But one cannot sustain victory by standing still. Competitors eventually copied Crest's cavity prevention abilities, turning cavity prevention into a commodity. Crest lost share as competitors innovated in other areas, including flavor, mouthfeel, and commonsense ingredients like baking soda. P&G began copying and advertising these attributes. But unlike Marriott, P&G did not append purpose brands to the general endorsement of Crest, and the brand began losing its distinctiveness.

At the end of the 1990s, new Crest executives brought two disruptions to market, each with its own clear purpose brand. They acquired a start-up named Dr. John's and rebranded its flagship electric toothbrush as the Crest SpinBrush, which they sold for $5 – far below the price of competitors' models of the time. They also launched Crest Whitestrips, which allowed people to whiten their teeth at home for a mere $25, far less than dentists charged. With these purpose-branded innovations, Crest generated substantial new growth and regained share leadership in the entire tooth care category.

The exhibit "Extending Brands Without Destroying Them" diagrams the two ways marketers can extend a purpose brand without eroding its value. The first option is to move up the vertical axis by developing different products that address a common job. This is what Sony did with its Walkman portable CD player. When Crest was still a clear purpose brand, P&G could have gone this route by, say, introducing a Crest-brand fluoride mouth rinse. The brand would have retained its clarity of purpose. But P&G did not, allowing Johnson & Johnson to insert yet another brand, ACT (its own fluoride mouth rinse), into the cavity-prevention job space. Because P&G pursued the second option, extending its brand along the horizontal axis to other jobs (whitening, breath freshening, and so on), the purpose brand morphed into an endorser brand.

Why Strong Purpose Brands Are So Rare

Given the power that purpose brands have in creating opportunities for differentiation, premium pricing, and growth, isn't it odd that so few companies have a deliberate strategy for creating them?

Consider the automobile industry. There are a significant number of different jobs that people who purchase cars need to get done, but only a few companies have staked out any of these job markets with purpose brands. Range Rover (until recently, at least) was a clear and valuable purpose brand (the take-me-anywhere-with-total-dependability job). The Volvo brand is positioned on the safety job. Porsche, BMW, Mercedes, Bentley, and Rolls-Royce are associated with various aspirational jobs. The Toyota endorser brand has earned the connotation of reliability. But for so much of the rest? It's hard to know what they mean.

To illustrate: Clayton Christensen recently needed to deliver on a long-promised commitment to buy a car as a college graduation gift for his daughter Annie. There were

functional and emotional dimensions to the job. The car needed to be stylish and fun to drive, to be sure. But even more important, as his beloved daughter was venturing off into the cold, cruel world, the big job Clay needed to get done was to know that she was safe and for his sweet Annie to be reminded frequently, as she owned, drove, and serviced the car, that her dad loves and cares for her. A hands-free telephone in the car would be a must, not an option. A version of GM's OnStar service, which called not just the police but Clay in the event of an accident, would be important. A system that reminded the occasionally absentminded Annie when she needed to have the car serviced would take a load off her dad's mind. If that service were delivered as a prepaid gift from her father, it would take another load off Clay's mind because he, too, is occasionally absentminded. Should Clay have hired a Taurus, Escape, Cavalier, Neon, Prizm, Corolla, Camry, Avalon, Sentra, Civic, Accord, Senator, Sonata, or something else? The billions of dollars that automakers spent advertising these brands, seeking somehow to create subtle differentiations in image, helped Clay not at all. Finding the best package to hire was very time-consuming and inconvenient, and the resulting product did the job about as unsatisfactorily as the milk shake had done, a few years earlier.

Focusing a product and its brand on a job creates differentiation. The rub, however, is that when a company communicates the job a branded product was designed to do perfectly, it is also communicating what jobs the product should not be hired to do. Focus is scary – at least the carmakers seem to think so. They deliberately create words as brands that have no meaning in any language, with no tie to any job, in the myopic hope that each individual model will be hired by every customer for every job. The results of this strategy speak for themselves. In the face of compelling evidence that purpose-branded products that do specific jobs well command premium pricing and compete in markets that are much larger than those defined by product categories, the automakers' products are substantially undifferentiated, the average subbrand commands less than a 1% market share, and most automakers are losing money. Somebody gave these folks the wrong recipe for prosperity.

• • •

Executives everywhere are charged with generating profitable growth. Rightly, they believe that brands are the vehicles for meeting their growth and profit targets. But success in brand building remains rare. Why? Not for lack of effort or resources. Nor for lack of opportunity in the marketplace. The root problem is that the theories in practice for market segmentation and brand building are riddled with flawed assumptions. Lafley is right. The model is broken. We've tried to illustrate a way out of the death spiral of serial product failure, missed opportunity, and squandered wealth. Marketers who choose to break with the broken past will be rewarded not only with successful brands but with profitably growing businesses as well.

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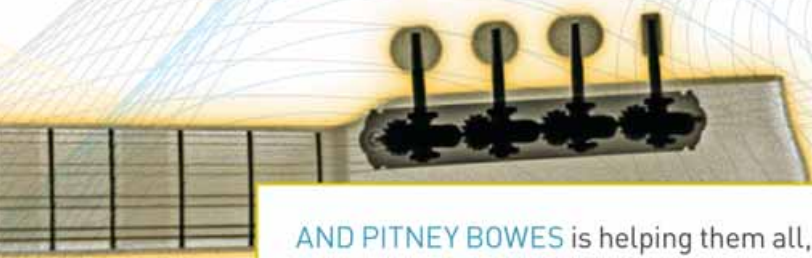

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MANAGING AUTHENTICITY

THE PARADOX OF GREAT LEADERSHIP

by Rob Goffee and Gareth Jones

MATTHEW BANDSUCH

Leadership demands the expression of an authentic self. Try to lead like someone else–say, Jack Welch, Richard Branson, or Michael Dell–and you will fail. Employees will not follow a CEO who invests little of himself in his leadership behaviors. People want to be led by someone "real." This is partly a reaction to the turbulent times we live in. It is also a response to the public's widespread disenchantment with politicians and businesspeople. We all suspect that we're being duped.

Our growing dissatisfaction with sleek, ersatz, airbrushed leadership is what makes authenticity such a desirable quality in today's corporations–a quality that, unfortunately, is in short supply. Leaders and followers both associate authenticity with sincerity, honesty, and integrity. It's the real thing–the attribute that uniquely defines great leaders.

But while the expression of an authentic self is necessary for great leadership, the concept of authenticity is often misunderstood, not least by leaders themselves. They often assume that authenticity is an innate quality – that a person is either authentic or not. In fact, authenticity is a quality that others must attribute to you. No leader can look into a mirror and say, "I am authentic." A person cannot be authentic on his or her own. Authenticity is largely defined by what other people see in you and, as such, can to a great extent be controlled by you. If authenticity were purely an innate quality, there would be little you could do to manage it and, therefore, little you could do to make yourself more effective as a leader.

Indeed, managers who exercise no control over the expression of their authentic selves get into trouble very quickly when they move into leadership roles. Consider Bill, a manager in a large utility company in Pittsburgh. Bill started out as a trainee electrician, but senior management at the company swiftly spotted his talent. The HR department persuaded Bill to go to university, from which he graduated with a good degree. Afterward, he was warmly welcomed back to his job. His work at the utility company often involved managing projects, and he became adept at assembling and leading teams. His technical abilities and his honesty were his biggest leadership attributes.

Things started to unravel when Bill moved to the head office and became an adviser to some of the most senior executives in the company. HR suggested to Bill that this new job would be good preparation for a major leadership position back on the front lines. But the head office was political, and Bill found that his straight talk hit many wrong notes. He started to get feedback that he didn't fully understand the complexity of situations and that he should develop better skills for influencing others. Bill tried to curb his directness, but he could never mimic his superiors' politically savvy behaviors. He started to lose his way. He alternated between indecision, while he tried to understand the office politics, and sudden bursts of outright aggression as he struggled with his old forthrightness. He began to seriously doubt his abilities.

Bill is still at the utility company, but he will not progress further there. Most of you have probably met more than one failed leader like Bill in your organizations. His story illustrates perfectly how difficult it is for leaders to find a balance between expressing their personalities and managing those of the people they aspire to lead or at least influence. Yet the ability to strike that balance – and to preserve one's authenticity in the process – is precisely what distinguishes great leaders from other executives. The challenge of great leadership is exactly that of managing one's authenticity, paradoxical though it undoubtedly sounds.

Let us be absolutely clear: Authenticity is not the product of pure manipulation. It accurately reflects aspects of the leader's inner self, so it can't be an act. But great leaders seem to know which personality traits they should reveal to whom and when. They are like chameleons, capable of adapting to the demands of the situations they face and the people they lead, yet they do not lose their identities in the process. Authentic leaders remain focused on where they are going but never lose sight of where they came from. Highly attuned to their environments, they rely on an intuition born of formative, sometimes harsh experiences to understand the expectations and concerns of the people they seek to influence. They retain their distinctiveness as individuals, yet they know how to win acceptance in strong corporate and social cultures and how to use elements of those cultures as a basis for radical change.

No leader can look into a mirror and say, "I AM AUTHENTIC." A person cannot be authentic on his or her own.

In the following pages, we'll explore the qualities of authentic leadership, drawing on our five years of research as well as our work consulting to leaders at all levels of organizations in diverse industries. To illustrate our points, we will recount some of the experiences and reflections of the authentic leaders we have known and studied. We don't pretend to have the final word on the subject, of course. Artists, philosophers, and social scientists have debated the concept of authenticity for centuries, and it would be foolish for us to imagine that this discussion could be synthesized by us or anyone else. Nonetheless, we believe that our reflections will contribute to a better

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understanding of the relationship between the expression of self and the exercise of leadership. Leaders who know how to manage their authenticity will be all the more effective for it, better able to both energize and retain loyal followers.

Managing the Perception

Establishing your authenticity as a leader is a two-part challenge. First, you have to ensure that your words are consistent with your deeds; otherwise, followers will never accept you as authentic. Everyone acknowledges and understands the need for consistency when establishing authenticity, but a great leader does a lot more than just pay lip service to it. He will live it every moment of the day. Indeed, it's not an exaggeration to say that a great leader is obsessive about embodying his beliefs.

Consider the case of John Latham, who was until recently the head teacher of an award-winning state school in the United Kingdom. Latham was passionate about creating an academic institution where students, teachers, and administrators respected one another and their environment. As at any school, litter and graffiti were major issues. So who picked up the trash and scrubbed the walls? Latham did. If you visited the school at break times, you would probably have found Latham on the grounds picking up litter rather than in his office behind a desk. "It's the simple, mundane things that matter," he told us, "and I personally fix many of them before day is done." This kind of demonstrated personal commitment to a few basic principles is essential to authentic leadership.

But it is not enough just to practice what you preach. To get people to follow you, you also have to get them to relate to you. So the second challenge of authentic leadership is finding common ground with the people you seek to recruit as followers. This means you will have to present different faces to different audiences, a requirement that many people find hard to square with authenticity. But, as Shakespeare recognized long ago, "All the world's a stage…and one man in his time plays many parts." Such role playing doesn't have to be fake or insincere. That's not to say it's easy – far from it. As we've pointed out, people instinctively recognize fraudulent behavior. If a leader is playing a role that isn't a true expression of his authentic self, followers will sooner or later feel like they've been tricked. And once that impression is out there, it's hard for a leader to recover.

Nestlé CEO Peter Brabeck-Letmathe explicitly recognizes that the very different roles he plays as a leader must be true expressions of his personality. The cover of one of Nestlé's annual reports depicts him sitting in the Swiss mountains wearing climbing clothes. But in the pages of *The Nestlé Leadership and Management Principles,* he is dressed in a dark suit and standing outside corporate headquarters. As he explains, "I wanted to use the image

ESTABLISHING YOUR AUTHENTICITY

There's no one right way to establish and manage your authenticity. But there are conscious steps you can take to help others perceive you as an authentic leader. Some of these steps entail building up knowledge about your true self; some involve learning more about others.

Get to know yourself and your origins better by:

- **Exploring your autobiography.** Familiarize yourself with your identity anchors – the people, places, and events that shaped you. Share these discoveries with others who have had similar experiences.
- **Returning to your roots.** Take a holiday with old friends. Spend time away from the normal trappings of the office.
- **Avoiding comfort zones.** Step out of your routines, seek new adventures, and take some risks.
- **Getting honest feedback.** Ask for 360-degree feedback from close colleagues, friends, family, and so on.

Get to know others better by:

- **Building a rich picture of your environment.** Don't view others as one-dimensional; find out about people's backgrounds, biographies, families, and obsessions.
- **Removing barriers between yourself and others.** Selectively show a weakness or vulnerability that reveals your approachability to your direct reports, assistants, secretaries, and so on.
- **Empathizing passionately with your people.** Care deeply about the work your people do.
- **Letting others know what's unique (and authentic) about them.** Give people feedback that acknowledges and validates their origins.

Connect to the organizational context better by:

- **Getting the distance right.** Be wary of creating the wrong first impressions. Use both your sense of self and your understanding of your origins to connect with, or to separate yourself from, others.
- **Sharpening your social antennae.** Seek out foreign assignments and other experiences to help you detect the subtle social clues that may spell the difference between your success and failure in attracting followers.
- **Honoring deeply held values and social mores.** You are unlikely to make connections by riding roughshod over other cultures' strongly held beliefs.
- **Developing your resilience.** You will inevitably experience setbacks when you expose yourself to new contexts and cultures. Prepare yourself by learning about and understanding your own values.

of the mountaineer because water and the environment are emotional issues for many people. But the photo is not artificial. That's what I wear on weekends. I'm a climber. In the mountaineering picture, it's a human being talking. In the [other picture], I am talking for the institution. The photographs are different, but they both capture something essential about me."

A long-successful music industry executive we'll call Dick is also a careful communicator of his multiple selves. Dick is from the Caribbean, and on many occasions in the rough-and-tumble of the music business, we have seen him switch from corporate-speak to an island patois liberally sprinkled with expletives. He is absolutely at home in the cutthroat environment that recording artists and their agents operate in. But, at the same time, Dick's parents are affluent, well-established members of Caribbean society, and, on the occasions that require it, Dick can play up this aspect of himself to create a rapport with the media moguls and celebrities with whom he must also deal. All these facets of his personality ring true; his skill is in deciding which to reveal to whom and when.

Playing multiple roles usually demands a lot of thought and work. "Before I go into a situation, I try to understand what it is [people] will be thinking. I prepare what I am going to say and who I am going to be in that context," explains Jean Tomlin, former HR director at Marks & Spencer and one of the most influential black businesswomen in Britain. "I want to be me, but I am channeling parts of me to context. What you get is a segment of me. It is not a fabrication or a facade – just the bits that are relevant for that situation."

Let's look more closely at just what makes it possible for Brabeck-Letmathe, Tomlin, and executives like them to present fragments of themselves – without seeming inauthentic.

Know Yourself and Others

It goes almost without saying that the exercise of leadership is complex and requires both skills and practice. Over time, and through various life experiences, a leader develops an extensive repertoire of roles, which can make her seem very different to different people in different situations. Indeed, if a leader doesn't acquire this complexity, she will be able to recruit as followers only those people with whom she already shares some common ground.

But it is one thing to develop this complexity and another thing entirely to wield it effectively. Using your complex self (or, rather, selves) requires a degree of *self-knowledge* and the willingness and ability to share that self-knowledge with others, what we call *self-disclosure.* This is not to say that authentic leaders spend a lot of time exploring their inner lives through meditation or therapy. They may be profoundly self-aware and essentially authentic (in the sense that we are giving the term here), but not because of contemplation or analysis; they are not characters in some Woody Allen film. Few authentic leaders will even be conscious that they are engaged in self-expression and self-disclosure, which is probably why they are so hard to imitate.

So how do authentic leaders acquire these attributes? The relative simplicity of their goals often helps. A great leader is usually trying to accomplish no more than three or four big goals at a time. He is unwavering about these goals; he doesn't question them any more than he questions himself. That's because the goals are usually connected in some way to one or another of the leader's authentic selves. His pursuit of the goals, and the way he communicates them to followers, is intense – which naturally promotes the kind of self-disclosure we are talking about and educates him further about his various selves.

If a leader is playing a role that isn't a TRUE EXPRESSION OF HIS AUTHENTIC SELF, followers will sooner or later feel like they've been tricked.

We have also found that great leaders keep close to them people who will give them honest feedback. As Roche Pharmaceuticals head Bill Burns told us, "You have to keep your feet on the ground when others want to put you on a pedestal. After a while on a pedestal, you stop hearing the truth. It's filtered by the henchmen, and they read you so well they know what you want to hear. You end up as the queen bee in the hive, with no relationships with the worker bees. My wife and secretary are fully empowered, if they ever see me getting a bit uppity, to give me a thumping great hit over the head."

As consultants, we often have been called in to do precisely that for senior executives, acting both as priests and spies as we try to make leaders more open to truths about themselves and their relationships with others. This does not necessarily mean helping these leaders develop more of what psychologist Dan Goleman calls emotional intelligence; rather, it means helping them to sharpen their skills in disclosing the emotional intelligence they already have so they can give better performances for their followers.

Consider an executive we'll call Josh, the CEO of one of the world's largest TV production companies for the past ten years. When we first met him, Josh was one of the early innovators in the field of documentary TV. Over the years, as he moved up the corporate ladder, he matured into a highly knowledgeable and effective executive who, in the process, became rather serious – even distant and austere – in the eyes of some of his employees. These perceptions were weakening his ability to attract and retain followers, so we coached Josh to return to the mischievous sense of humor that he had displayed more readily earlier in his career. He has an amazing sense of comic timing, which he has learned to use to devastating effect to disarm opponents and delight his followers. At a recent retirement celebration, for example, people expected him to deliver a rather sober speech concerning the departing senior executive. Instead, they were treated to a comic tour de force, which thrilled the retiring executive and stunned Josh's followers, none of whom would have guessed their boss was so funny. Josh's ability to use humor is an especially important attribute in the entertainment business, and his reputation as a leader has benefited accordingly.

Besides possessing self-knowledge and skills in self-disclosure, great leaders have to be able to recognize which aspects of their authentic selves particular groups of followers are looking for. Most great leaders have highly developed social antennae: They use a complex mix of cognitive and observational skills to recognize what followers are consciously – and unconsciously – signaling to them.

The good news is that while some people seem to be born with these discernment skills, others can, in fact, learn them. We have found that individuals who have had a great deal of mobility early in their lives possess these skills to a higher degree than those who have stayed mostly in one place. It's no coincidence that many CEOs start out in sales and that most senior executives in multinational companies have gone on multiple foreign postings. Exposure to a wide range of experiences during a manager's formative years enhances her ability to read and empathize with different people and situations.

Experiences outside of an individual's comfort zone can also sharpen her social awareness. Marks & Spencer's Jean Tomlin, for example, developed her social skills during her journey to establish credibility as a black businesswoman operating in an environment dominated by white males. And Nestlé's Peter Brabeck-Letmathe learned much from his stint in the military at age 17. The living conditions and treatment were barely tolerable, and several of his fellow soldiers attempted suicide. Brabeck-Letmathe survived by observing his superior officers very closely; the better he anticipated their behavior, the easier it was to stay out of their way.

Use Where You Come From

By the time a manager rises to a senior leadership position, he may seem like – and, indeed, may well be – a very different person than he was at the start of his journey. But despite any role playing that goes on, the leader's

authenticity is still closely linked to his origins. The *Oxford English Dictionary,* for example, defines "authenticity," in part, as "of undisputed origin." As a result, we think it is fair to say that no leader will ever succeed in establishing his authenticity unless he can effectively manage his relationship with his past and his followers' connections to their roots.

Authentic leaders use their personal histories to establish common ground with their followers. The desire to establish his bona fides with his employees as a regular, approachable guy probably explains why Niall FitzGerald, a former cochairman at Unilever, speaks often and with insight about his Irish heritage and the influence of his mother on both his moral and political worldviews. Similarly, Antony Burgmans, a current chairman at Unilever, obstinately remains the Dutch countryman – as demonstrated in his dress, even in his walk – despite his elevated status. In both cases, these executives are comfortable displaying something of their origins, in a very different context, in order to connect with their followers.

Pride in one's roots, however, needs to be carefully handled. An organization whose CEO trumpets his heritage may well be intimidating or offensive to employees – and customers – who hail from elsewhere. This is one reason that so many authentic leaders work to stay curious and open to their followers' origins. We have worked for many years with a senior executive at a U.S. chemicals company. When he meets new team members, he always begins the conversations with the same question: "Tell me, how did you come to be the kind of guy you are now?" He has an almost insatiable interest in the complex factors that reveal where his direct reports come from because he understands that they (and the organization) will be more likely to succeed if they feel comfortable with their origins.

It is important for leaders to recognize that people frame their backgrounds in different ways and that there are differences among and within cultures. The salient characteristics that people use to define themselves include gender, class, race, status, and geography. And these may be expressed in many ways – through dress, speech, food, and even in different styles of walking. Given these variables, we should be cautious about making simple generalizations about status and societies, though we can draw some comparisons. For instance, some societies focus more on people's *ascribed status* – attributes that are perceived as innate to particular individuals. Others focus more on people's *achieved status* – attributes and roles that individuals attain through their own endeavors. At the most general level, American society places great emphasis on achieved status; the belief that where you're going outweighs where you've been lies close to the heart of the American dream. This is not to say that American society always acts according to this belief. Many commentators worry that the growing gap between rich and poor in the United States will decrease the prospects of social mobility for many. Even so, the idea that you will get your chance remains strong.

In other societies, elite status remains relatively fixed. For example, the French business elite comprises individuals educated in the grand *écoles* – often from all the same rather privileged backgrounds. In Asian societies, especially in China, family and geography remain highly relevant to people's understanding of their origins.

The variability of social status has important implications for leaders. The relative fluidity of American society, with an avowed emphasis on aspirations, is reflected in followers' attitudes toward their leaders. The Yale-educated Yankee aristocrat George W. Bush, for example, can pose as a regular guy from Texas and be believed because Americans, unlike Europeans, will accept that he can transform himself, and they will respect his aspiration to do so. That kind of metamorphosis simply wouldn't

A MAN FOR ALL SEASONS

Critics of British Prime Minister Tony Blair often contend that because of his desire to maximize his personal appeal, Blair moves between different, contradictory selves, lacking any central personal beliefs. We would argue, however, that Blair's winning ways stem not from sacrificing himself on the altar of electability but rather from his consummate skill in managing his authenticity. His behavior in a single dramatic week in early July 2005 exemplified how well he does this.

The week began with the Bob Geldof- and Bono-inspired Live 8 pop concert, an event to raise awareness about poverty in Africa. That was followed by Blair's trip to Singapore to lobby the International Olympic Committee, during which he danced a gleeful jig in public when the UK bid to land the 2012 Summer Games was successful. Also that week, he attended the G8 summit in Scotland, where he was able to make headway in addressing some of his most passionate concerns. Then Blair was urgently called back to London because of the terrorist bombings there.

In each of these instances, Blair played different roles to attract followers in different ways. Yet despite the different behaviors he exhibited, Blair was able to communicate a core self; he always connected powerfully with his known personal passions – for pop music, sport, the elimination of poverty in Africa, and the defeat of terrorism. Indeed, his performance that week wrung praise even from his critics. As Andrew Rawnsley wrote in the *Observer,* "People turn admiring when they observe [Blair's] capacity to read, articulate, and mould critical political moments."

seem authentic in Britain; to the working-class voter, once an aristocrat, always an aristocrat.

Authentic leaders are comfortable in their skin; they know where they come from and who they are, and they know how to use their backgrounds to build a rapport with followers. Authentic leaders are not threatened by people with other origins; they welcome them. They are sensitive in communicating their origins and are aware of the differences in cultural attitudes toward their backgrounds. As Albert Einstein once said, "I speak to everyone in the same way, whether he is the garbageman or the president of the university." That statement reflects not only Einstein's comfort with himself but also with the more open society he chose to live in.

Leaders may be profoundly SELF-AWARE AND ESSENTIALLY AUTHENTIC but not because of contemplation or analysis; they are not characters in some Woody Allen film.

Conform – But Only Just Enough

When picking which aspects of themselves to reveal, and to whom, authentic leaders must judge just how much they need to conform to social and organizational norms. The challenge for these executives is to create just enough distance from the norms so followers will perceive the leaders as special and attractive. It's a very fine judgment call: Too much conformity can render leaders ineffective; too little can isolate them.

Graham, a dynamic sales guy in a fast-moving, Boston-based consumer goods business that we advise, provides a good illustration of what happens when a leader conforms too much. He was, and is, a very effective salesman, albeit in an old-fashioned, in-your-face kind of way. Some people found him brash. We thought he was very bright but a little too forthright for the rather polite culture in which he worked. We urged his managers to give him a chance to grow, though, feeling that his high-energy leadership style could help bring about some much-needed change in the organization.

Graham moved from sales to marketing, then briefly into a production role at a factory, and then back into a senior marketing role. We were amazed and disappointed at the transformation in him when we saw him again. He spoke in nuanced phrases, and he carefully weighed his opinions before expressing them. He defended the status quo, remarking that our proposed change agenda for the organization was "a little simplistic." He even told us that he preferred the quiet corridors of headquarters to the hurly-burly of the marketplace. Graham had attempted to fit in to the dominant culture. Instead, he had merely conformed – and lost the chance to be an effective change leader.

At the other end of the spectrum, Disney's former president, Michael Ovitz, provides a cautionary tale about not conforming enough. As his boss, Michael Eisner, told Britain's *Telegraph* newspaper: "He started to rub people the wrong way. He was controversial, and it got worse as things went on.…We'd all take a bus [at the corporate retreat] and he had a limousine; a special driver. Everyone had a walkie-talkie, and you heard [people] saying, 'Who was this guy, and why was he demanding this?' It was a bad vibe, let's put it that way." Ovitz lasted 14 months at Disney.

Authentic leaders know how to strike a balance between their distinctiveness and the cultures in which they operate. They do not immediately seek out head-on confrontations because they recognize that their survival as leaders (and, by extension, the survival of their initiatives) requires a measured introduction to, and adaptation of, the organization's established business networks and social relationships. To influence others, authentic leaders must first gain at least minimal acceptance as members of their organizations.

Perhaps the best example we've seen of this was the case of an executive we'll call Miyako, one of the first female finance directors in a Japanese company. Miyako was an outstanding leader. She helped the company modernize its accounting practices, brought in new talent, and succeeded in breaking up the cozy male cabal at the top. But even as she broke new ground, Miyako was careful to play the role expected of a Japanese woman in social settings. Her situation highlights the universal challenge that women face in establishing themselves as authentic leaders: Unless female leaders acknowledge and validate some of the prevailing organizational norms surrounding gender roles, they will find it hard to obtain acceptance from male followers.

In complex organizations, leaders can select the specific norms and elements they want to be identified with and those they need to reject. Greg Dyke, former director general of the BBC, one of the world's largest media organizations, understands very well how to play different organizational norms against one another. When he took over

at the BBC in January 2000, employees across the organization were unhappy. Shortly after coming into the job, Dyke began poking his nose into offices and studios to understand the staffers' situation better. The more visits he made, the more he came to see that he could win broad acceptance for the major changes he needed to introduce by appealing to the organization's rank and file.

To that end, Dyke began phasing out the cars and chauffeurs that had been assigned to each member of his executive board. The program producers and support staffers were pleased by this move: In an organization with a strong egalitarian aspiration, the long line of expensive black cars parked outside headquarters had been a source of irritation – even alienation – for many staffers. Dyke also cut the large budget spent on outside consultants – in one year, it went from £22 million to £3 million – symbolizing the faith the director general had in the people already inside the organization. He was implicitly saying, "I know we have the talent here."

But it wasn't enough to identify with people near the bottom of the hierarchy. Unlike a typical CEO, Dyke needed the approval of the BBC's very powerful board of governors as well as its chairman at the time, the patrician Sir Christopher Bland. To win their acceptance, Dyke had to show respect for their established mores even while he was appealing to the antiestablishment instincts of most of his employees. For a while, he proved quite adept at managing this relationship. In public, at least, he always addressed Sir Christopher and the other governors in formal language. He was also careful to rein in his own iconoclastic instincts. He moderated his language, dressed more formally than was his normal taste, and publicly emphasized those of his interests (notably museums and science education) that appealed most to the board. In the end, however, the political machinations of the BBC overwhelmed even Dyke, and he was forced to resign.

• • •

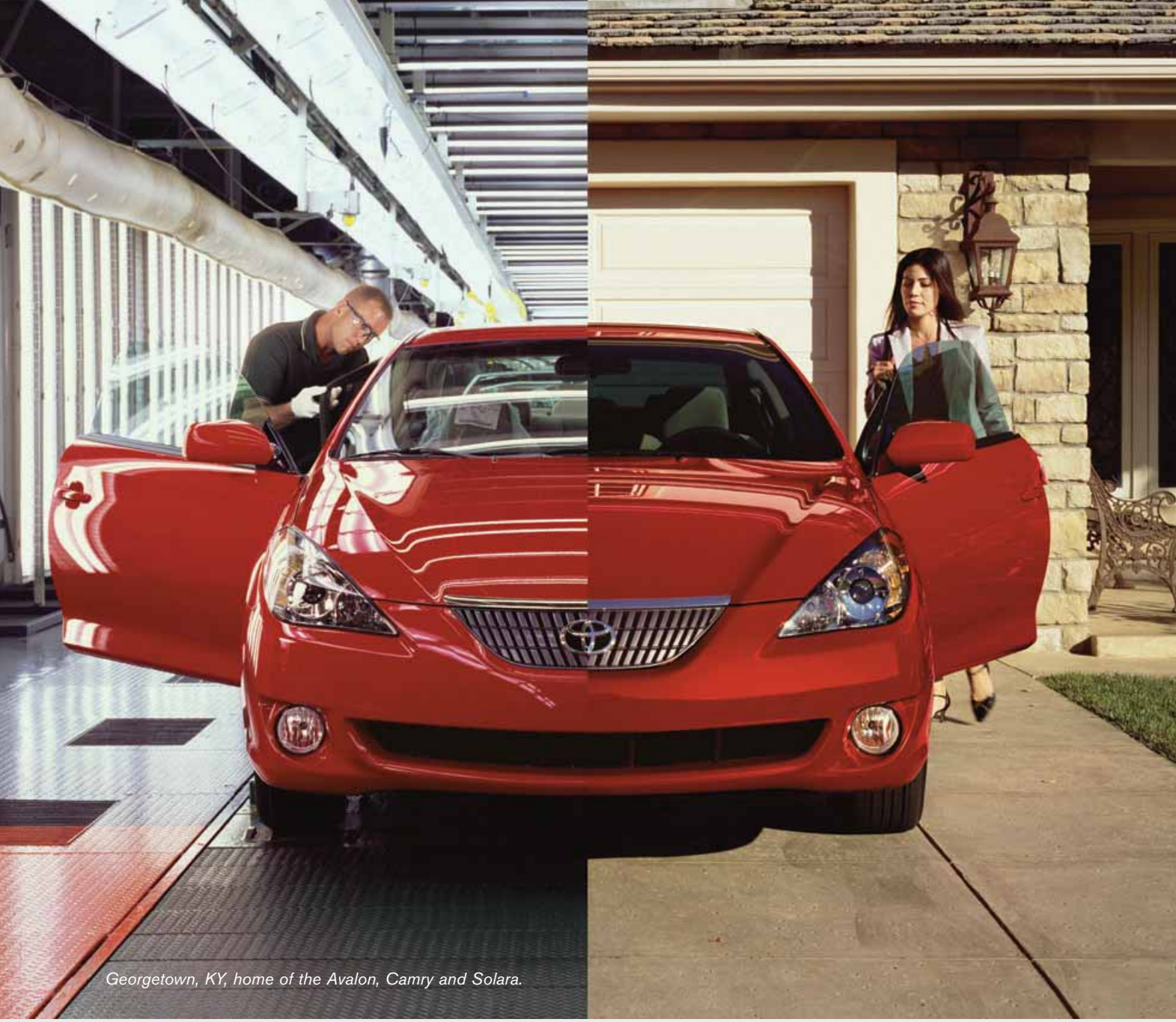
Authenticity has often been thought of as the opposite of artifice – something that is straightforward, sincere, and uncomplicated. But that conception of authenticity is not only simplistic, it is also wrongheaded. Managers who assume that their authenticity stems from an uncontrolled expression of their inner selves will never become authentic leaders. Great leaders understand that their reputation for authenticity needs to be painstakingly earned and carefully managed.

The comic George Burns once said of honesty, "If you can fake that, you've got it made." He could equally have been talking about authenticity. Of course, authentic leaders don't really fake it to make it, but Burns's joke resonates precisely because it acknowledges what we might be reluctant to admit – that the expression of one's authentic self is a complicated and contrived act. All authentic leaders are complicated and contrived. Many Americans revere the late Ronald Reagan for his authenticity as president – but he was also the first professional actor to make it to the White House.

Reprint R0512E
To order, see page 155.

"Do me a favor and call Bob. It looks like Jerry is on to something."

MARK ANDERSON



Our vehicles don't just take people to work, they put people to work.

For many Americans, Toyota is more than just a source of transport, it's a source of income. With our plants, sales and marketing operations, research and design facilities, and through our dealers and suppliers, Toyota's U.S. operations are responsible for more than 386,000 jobs.* Last year, more than one million Toyota vehicles rolled off the line. And as we continue to expand our operations here, we're working to create even more jobs and opportunities in the communities where we do business.

*2005 Center for Automotive Research study. Includes jobs created through direct/dealer/supplier employee spending. ©2005

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The Interview

"[A]llowing the interviewee to relate too much information can be dangerous. Any inadvertently revealed facts or incidents may bring about severe anxiety feelings when he or she reflects on them later."

Samuel G. Trull
"Strategies of Effective Interviewing"
Harvard Business Review
January–February 1964

"You left your last place of employment to chase a string?"

"Thank God you finally hired me. I couldn't keep up this absurd charade of bright-eyed enthusiasm one moment longer!"

ROY DELGADO, SCOTT ARTHUR MASEAR, P.C. VEY, BOB VOJTKO, AND CHRIS WILDT

"We appreciate the appearance of candor."

"I work best when someone is looking over my shoulder and telling me that I'm a screwup."

"Your people work Monday through Friday... EVERY Monday through Friday?"

It's often a mistake to set out to create a worldwide strategy. Better results come from strong regional strategies, brought together into a global whole.

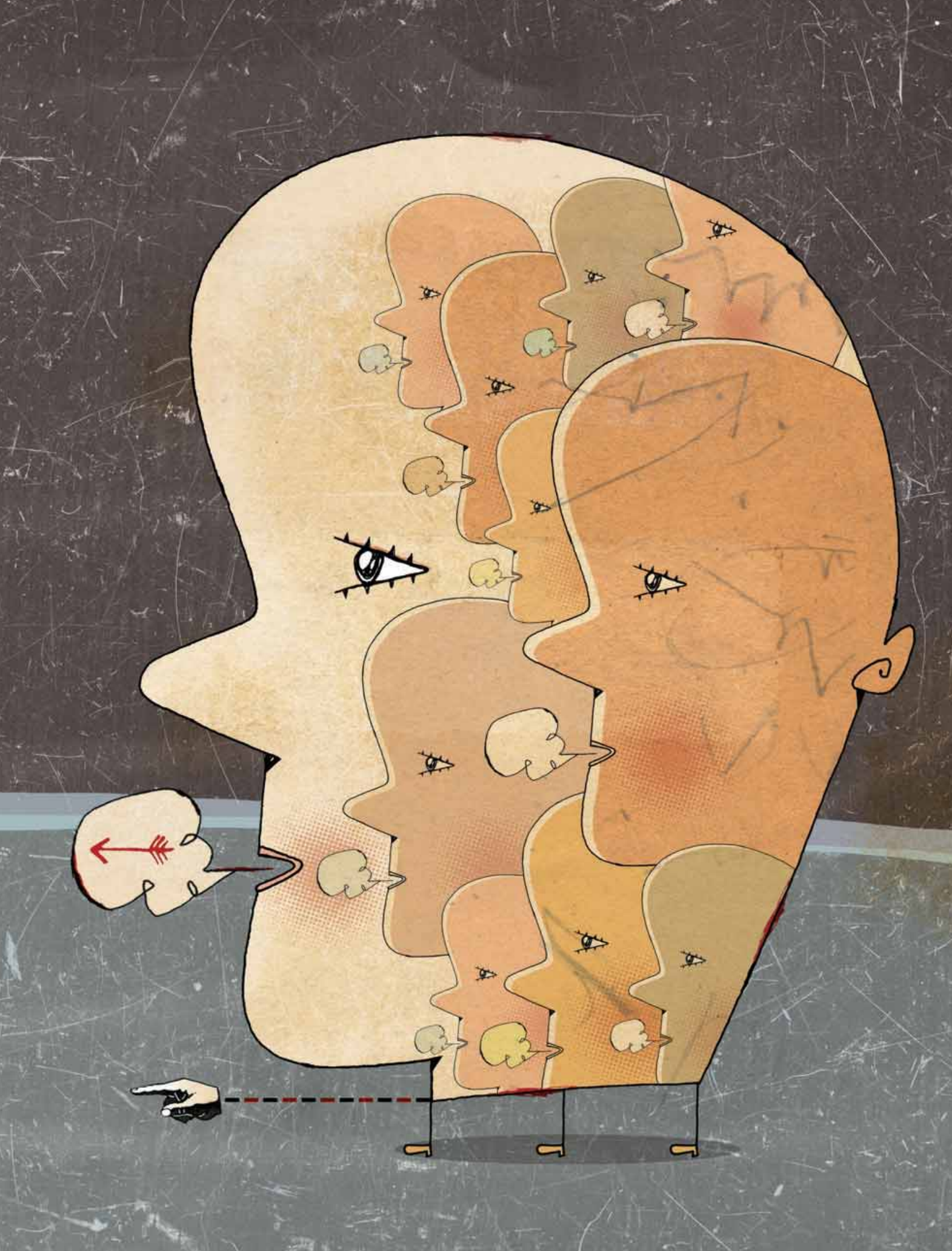
Regional Strategies for Global Leadership

by Pankaj Ghemawat

LET'S ASSUME that your firm has a significant international presence. In that case, it probably has something called a "global strategy," which almost certainly represents an extraordinary investment of time, money, and energy. You and your colleagues may have adopted it with great fanfare. But, quite possibly, it has proven less than satisfactory as a road map to cross-border competition.

Disappointment with strategies that operate at a global level may explain why companies that do perform well internationally apply a regionally oriented strategy in addition to–or even instead of–a global one. Put differently, global as well as regional companies need to think through strategy at the regional level.

WALTER VASCONCELOS



Jeffrey Immelt, CEO of GE, claims that regional teams are the key to his company's globalization initiatives, and he has moved to graft a network of regional headquarters onto GE's otherwise lean product-division structure. John Menzer, president and CEO of Wal-Mart International, tells employees that global leverage is about playing 3-D chess – at the global, regional, and local levels. Toyota may have gone furthest in exploiting the power of regionalized thinking. As Vice Chairman Fujio Cho says, "We intend to continue moving forward with globalization…by further enhancing the localization and independence of our operations in each region."

The leaders of these successful companies seem to have grasped two important truths about the global economy. First, geographic and other distinctions haven't been submerged by the rising tide of globalization; in fact, such distinctions are arguably increasing in importance. Second, regionally focused strategies are not just a halfway house between local (country-focused) and global strategies but a discrete family of strategies that, used in conjunction with local and global initiatives, can significantly boost a company's performance.

In the following pages, I'll describe the various regional strategies successful companies have employed, showing how they have switched among the strategies and combined them as their markets and businesses have evolved. I'll begin, though, by looking more closely at the economic reasons why regions are often a critical unit of analysis for cross-border strategies.

The Reality of Regions

The most common pitch for taking regions seriously is that the emergence of regional blocs has stalled the process of globalization. Implicit in this view is a tendency to see regionalization as an alternative to further cross-border economic integration.

In fact, a close look at the country-level numbers suggests that increasing cross-border integration has been accompanied by high or rising levels of regionalization. In other words, regions are not an impediment to but an enabler of cross-border integration. As the exhibit "Trade: Regional or Global?" shows, the surge of trade in the second half of the twentieth century was driven more by activity within regions than across regions. The numbers also cast doubt on the idea (held implicitly by advocates of pure global strategies) that economic vitality is promoted more by cross-regional trade. It turns out that regions whose internal trade flows are the lowest relative to trade flows with other regions – Africa, the Middle East, and some of the Eastern European transition economies – are also the poorest economic performers.

Country-level numbers also suggest that foreign direct investment (FDI) is quite regionalized, which is even more surprising than the regionalization of trade. Data from the United Nations Conference on Trade and Development show that for the two dozen countries that account for nearly 90% of the world's outward FDI stock, the median share of intraregional FDI in total FDI was 52% in 2002, the most recent year for which data are available.

The extent and persistence of regionalization in economic activity reflect the continuing importance not only of geographic proximity but also of cultural, administrative, and, to some extent, economic proximity.[1] These four factors are interrelated: Countries that are relatively close to one another are also likely to share commonalities along the other dimensions. What's more, those similarities have intensified in the past few decades through free trade agreements, regional trade preferences and tax treaties, and even currency unification, with NAFTA and the European Union supplying the two most obvious examples. Ironically, some differences between countries within a region can combine with the similarities to expand the region's overall economic activity. For instance, we see U.S. firms in many industries nearshoring production facilities to Mexico, thereby arbitraging across economic differences between the two countries while retaining the advantages of geographic proximity and administrative and political similarities, which more distant countries, such as China, do not enjoy.

Evidence from companies' international sales also points to considerable regionalization. According to data analyzed by Susan Feinberg at Rutgers Business School, among U.S. companies operating in only one foreign country, there is a 60% chance that the country is Canada. Even the largest multinational corporations exhibit a significant regional bias. A study published by Alan Rugman and Alain Verbeke in the *Journal of International Business Studies* shows that around 88% of the world's biggest multinationals derive at least 50% of their sales – the weighted average is 80% – from their home regions. Just 2% (a total of nine companies) derive 20% or more of their sales from each of the triad of North America, Europe, and Asia.

Zooming in on large companies with relatively broad regional footprints – roughly akin to the top 12% of the previous sample – we find that even here competitive interactions are often regionally focused. Take the case of the aluminum-smelting industry. As we see in the exhibit "Industry: Regional or Global?" in the last ten years the industry has experienced some increase in concentration as measured by the Herfindahl index (a standard measure of industry concentration; the higher the index, the larger the market shares of the largest firms). But that increase

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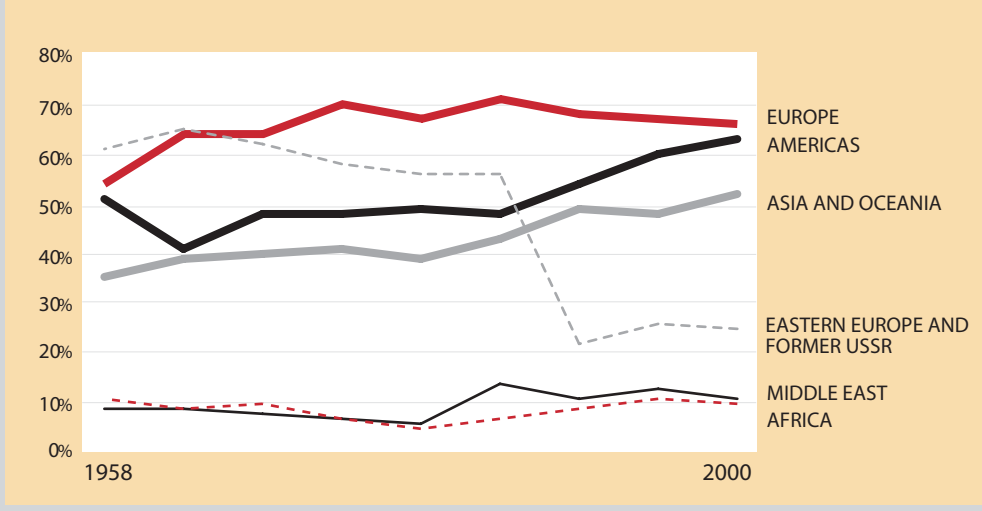
Trade: Regional or Global?

In many parts of the world, intraregional trade increased steadily as a percentage of a region's total trade in the second half of the twentieth century. For example, in 1958 some 35% of trade in Asia and Oceania took place between countries in that geographic region. In 2000, the proportion was more than 50%. Globally, the proportion of trade within regions rose from about 47% to 55% between 1958 and 2000. The only significant decline has been in Eastern Europe, but that is explained by the collapse of communism. In general, the numbers indicate that increasing economic integration through international trade has been accompanied by increasing rather than decreasing regionalization.

Intraregional Trade as a Percentage of Total Trade



Source: United Nations, *International Trade Statistics Yearbooks,* 1958 to 2000.

in concentration reverses less than one-half of the decline of the previous 20 years, or about one-tenth of the decline experienced since 1950. In contrast, concentration in North America has doubled in the last ten years after holding more or less steady for the previous 20 years. Similar patterns appear in a range of other industries: personal computers, beer, and cement, to name just three. In other words, regions are often the level at which global oligopolists try to build up powerhouse positions.

Let's now take a closer look at the menu of regional strategies from which your company can choose.

The Regional Strategy Menu

Broadly speaking, regional strategies can be classified into five types, each with distinct strengths and weaknesses. I have ordered the strategies according to their relative complexity, starting with the simplest, but that does not mean companies necessarily progress through the strategies as they evolve. Whereas some companies may indeed adopt the strategies in the order in which I present them, others may find themselves abandoning more-advanced strategies in favor of simpler ones–good business is about striving to maximize value, not complexity. And capable companies will often use elements of several strategies simultaneously.

The Home Base Strategy. Except for the very few companies that are virtually born global, such as Indian software services firms, companies generally start their international expansion by serving nearby foreign markets from their home base, locating all their R&D and, usually, manufacturing in their country of origin. The home base is also where the bulk of the *Fortune* Global 500 still focuses. Even companies that have since moved on to more complex regional strategies nonetheless rely on a home base strategy – at the regional level – for long periods.

Thus, for decades, Toyota's international sales came exclusively from direct exports. And some companies that move on eventually return to a home base strategy: GE did so in home appliances, as did Bayer in pharmaceuticals.

For other companies, however, a focus on the home region is a matter of neither default nor devolution but, instead, the desired long-term strategy. Take the case of Zara, the Spanish fashion company. In a cycle that takes between two and four weeks, Zara designs and makes items near its manufacturing and logistics hub in northwestern Spain and trucks those goods to Western European markets. This rapid response lets the company produce what is selling during a fashion season instead of committing to merchandise before the season starts. The enhanced customer appeal and reduced incidence of markdowns have so far more than offset the extra costs of producing in Europe instead of Asia.

The surge of trade in the second half of the twentieth century was driven more by activity within regions than across regions.

As Zara illustrates, home base strategies work well when the economics of concentration outweigh the economics of dispersion. Fashion-sensitive items do not travel easily from the Spanish hub to other regions, because the costs of expedited air shipments compromise the company's low-price positioning. More generally, the presence of any factor that collapses distance *within* the local region (such as regional grids in energy) will encourage companies to favor a single-region, home base strategy.

For some companies, the "region" that can be served from the home base is actually the globe. Operating in the highly globalized memory chip business, the Korean giant Samsung has one of the most balanced worldwide sales distributions of any major business, but it considers the colocation of most R&D and production at one site in South Korea to be a key competitive advantage. Transport costs are so low relative to product value that geographic concentration–which permits rapid interactions and iteration across R&D and production–dominates geographic dispersion even at the global level.

But cases like Samsung are rare. Typically, doing business from the home base effectively limits a company to its local region. As a result, the biggest threats to companies pursuing a home base strategy are running out of room to grow or failing to hedge risk adequately. Growth within Europe will soon be an issue for Zara. And risk has already emerged as a major concern: As of this writing, the sharp decline of the dollar against the euro has inflated Zara's costs of production relative to competitors that rely more on dollar-denominated imports from Asia.

The Portfolio Strategy. This strategy involves setting up or acquiring operations outside the home region that report directly to the home base. It is usually the first strategy adopted by companies seeking to establish a presence outside the markets they can serve from home. The advantages of this approach include faster growth in nonhome regions, significant home positions that generate large amounts of cash, and the opportunity to average out economic shocks and cycles across regions.

A good example of a successful portfolio strategy is provided by Toyota's initial investments in the United States, which seemed tied together by little more than the desire to build up a manufacturing presence in the company's most important overseas market. What prevented this approach from destroying value was Toyota's distinct competitive advantage: the celebrated Toyota Production System (TPS), which was developed and still works best at home in Japan but could be applied to factories in the United States.

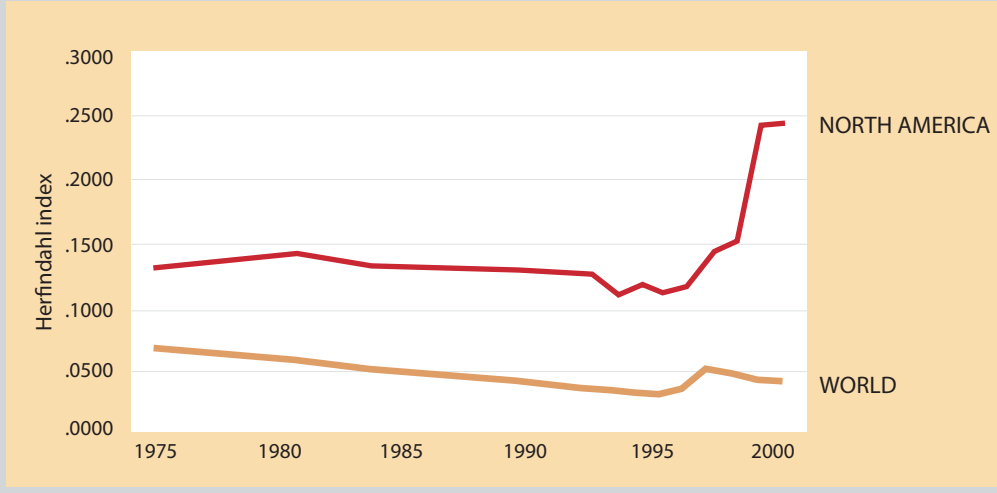
Although the portfolio strategy is conceptually simple, it takes time to implement, especially if a company tries to expand organically. It took Toyota more than a decade to establish itself in North America – a process that began with a joint venture with General Motors in the early 1980s. For an automaker lacking an advantage like TPS, the organic buildup of a significant presence in a new region could take far longer. Of course, companies may build a regional portfolio more quickly through acquisitions, but even that can take a decade or more. When Jack Welch began GE's globalization initiative in the second half of the 1980s, he targeted expansion in Europe, giving a trusted confidant, Nani Beccalli, wide latitude for deal making. Thanks to Beccalli's acquisitions, GE built up a strong presence in Europe, but the process of assembling the regional portfolio lasted until the early 2000s.

Companies that adopt a portfolio strategy often struggle to deal with rivals in nonhome regions. That's largely because portfolio strategies offer limited scope for letting regional – as opposed to local or global – considerations influence what happens on the ground at the local level. Indeed, this was precisely the experience of GE, whose European businesses reported to the global headquar-

Industry: Regional or Global?

In many "global" industries, competition is playing out at a regional level. The chart below measures concentration in the aluminum-smelting industry as a summary measure of the distribution of market shares within it. The metric used is the Herfindahl index, which measures the degree to which the industry is fragmented (lots of small to medium-sized companies splitting most of the business) or concentrated (a few players controlling most of the business). The higher the index, the larger the market shares of the largest companies. As the chart shows, the level of global competition was relatively flat from 1975 to 2000, while concentration in North America over the same period increased dramatically.

Concentration in the Aluminum-Smelting Industry



Source: Fariborz Ghadar, Center for Global Business Studies, Penn State University.

ters in the United States, run by purported "global leaders"–many of whom were Americans who had never lived or worked abroad. Meanwhile, most of GE's toughest competitors in its nonfinancial businesses were European companies that knew their increasingly regionalized home turf and were prepared to compete aggressively there. During a talk at Harvard Business School in 2002, Immelt described the results: "I think we stink in Europe today."

The Hub Strategy. Companies seeking to add value at the regional level frequently begin by adopting this strategy. Originally articulated by McKinsey consultant Kenichi Ohmae, a hub strategy involves building regional bases, or hubs, that provide a variety of shared resources and services to local (country) operations. The logic is that such resources may be hard for any one country to justify, but economies of scale or other factors may make them practical from a cross-country perspective.

Hub strategies often involve transforming a foreign operation into a stand-alone unit. In the early 1990s, for instance, Toyota began producing a limited number of locally exclusive models in its principal foreign plants – previously a taboo – thereby signaling the company's intention to build complete organizations in each of its regions. These plants thus started to serve as regionally distinct hubs, each with its own platform, whose products were designed for sale within the region.

In its purest form, a hub strategy is simply a multiregional version of the home base strategy. For example, if Zara were to add a second hub in, say, Asia by establishing an operation in China to serve the entire Asian market, it would shift from being home based to being a multiregional hubber. Therefore, some of the same conditions that favor a home base strategy also favor hubs. It should also be noted that multiple hubs can be very independent of one another; the more regions differ in their

requirements, the weaker the rationale for hubs to share resources and policies.

A regional headquarters can be seen as a minimalist version of a hub strategy. After the European Commission blocked GE's merger with Honeywell, GE felt the need to dedicate more corporate infrastructure and resources to Europe, partly to attract, develop, and retain the best European employees and partly to acquire a more European face for political reasons. In 2001, therefore, GE switched from a portfolio to a hub strategy by establishing a regional HQ structure in Europe – complete with a CEO for GE Europe. The company followed up in 2003 by establishing a parallel organization in Asia.

The impact of the typical regional HQ is limited, however, by its focus on support functions and its weak links to operating activities. For example, the regional presidents within Wal-Mart International perform a communication-and-monitoring role, but otherwise their influence on strategy and resource allocation seems to be mainly personal. In any event, a regional HQ is seldom a sufficient basis for a regional strategy, even though it may be a necessary part of one. (See the sidebar "A Regional HQ Is Not Enough.")

The challenge in executing a hub strategy is achieving the right balance between customization and standardization. Companies too responsive to interregional variation risk adding too much cost or sacrificing too many opportunities to share costs across regions. As a result, they may find themselves vulnerable to attacks from companies taking a more standardized approach. On the other hand, companies that try to standardize across regional hubs – and in so doing overestimate the degree of commonality from region to region – are vulnerable to competition from local players. Thus we see Dell, whose product is relatively standard across its regional operations, forced to modify its plans in China to respond to local companies competing aggressively on cost by producing less-sophisticated, lower quality products.

The Platform Strategy. Hubs, as we've seen, spread fixed costs across countries within a region. Interregional platforms go a step further by spreading fixed costs across regions. They tend to be particularly important for back-end activities that can deliver economies of scale and scope. Most major automakers, for example, are trying to reduce the number of basic platforms they offer worldwide in order to achieve greater economies of scale in design, engineering, administration, procurement, and operations. It is in this spirit that Toyota has been reducing the number of its platforms from 11 to six and has invested in global car brands such as the Camry and the Corolla.

It's important to realize that the idea behind platforming is *not* to reduce the amount of product variety on offer but to deliver variety more cost-effectively by allowing customization atop common platforms explicitly engineered for adaptability. Ideally, therefore, platform strategies are almost invisible to a company's customers. Platforming runs into difficulties when managers take standardization too far.

Let's look again at the automobile industry. Sir Nick Scheele, outgoing COO of Ford, points out, "The single biggest barrier to globalization [in the automobile industry]…is the relatively cheap cost of motor fuel in the United States. There is a tremendous disparity between the United States and…the rest of the world, and it creates an accompanying disparity in…the most fundamental of vehicle characteristics: size and power." This reality is precisely what Ford ignored with its Ford 2000 program. Described by one analyst as the biggest business merger in history, Ford 2000 sought to combine Ford's regional operations – principally North America and Europe – into one global operation. This attempt to reduce duplication across the two regions sparked enormous internal turmoil and largely destroyed Ford's European organization. Regional product development capabilities were sacrificed, and unappealingly compromised products were pushed into an unreceptive marketplace. The result: nearly $3 billion in losses in Europe through 2000 and a fall in regional market share from 12% to 9%.

The Mandate Strategy. This cousin of the platform strategy focuses on economies of *specialization* as well as scale. Companies that adopt this strategy award certain regions broad mandates to supply particular products or perform particular roles for the whole organization. For example, Toyota's Innovative International Multi-purpose

A Regional HQ Is Not Enough

Many companies with explicitly global ambitions have reacted to the regionalization of the world economy by establishing a set of regional headquarters. This kind of organizational response has, in fact, also been the focus of most of the management literature on regions. Michael Enright, for example, has described some interesting patterns in recent articles in the *Management International Review* on the functions performed by regional management centers. But to focus on regional HQs or any other organizational structure as *the* primary object of interest is a little like focusing on the briefcase rather than its contents. Without a clear sense of how a regional structure is supposed to add value, it is impossible to specify what the structure should try to achieve. A company with no regional HQs may still use regions as the building blocks of its overall strategy, and a company with many regional HQs may still not have a clearly articulated regional strategy. In other words, having regional headquarters doesn't mean that you actually have a regional strategy.

Vehicle (IMV) project funnels common engines and manual transmissions for pickup trucks, SUVs, and minivans from Asian plants to four assembly hubs there and in Latin America and Africa, and then on to almost all the major markets around the world except the United States, where such vehicles are larger. Similarly, Whirlpool is sourcing most of its small kitchen appliances from India, and a host of global companies are in the process of broadening the mandates of their production operations in China.

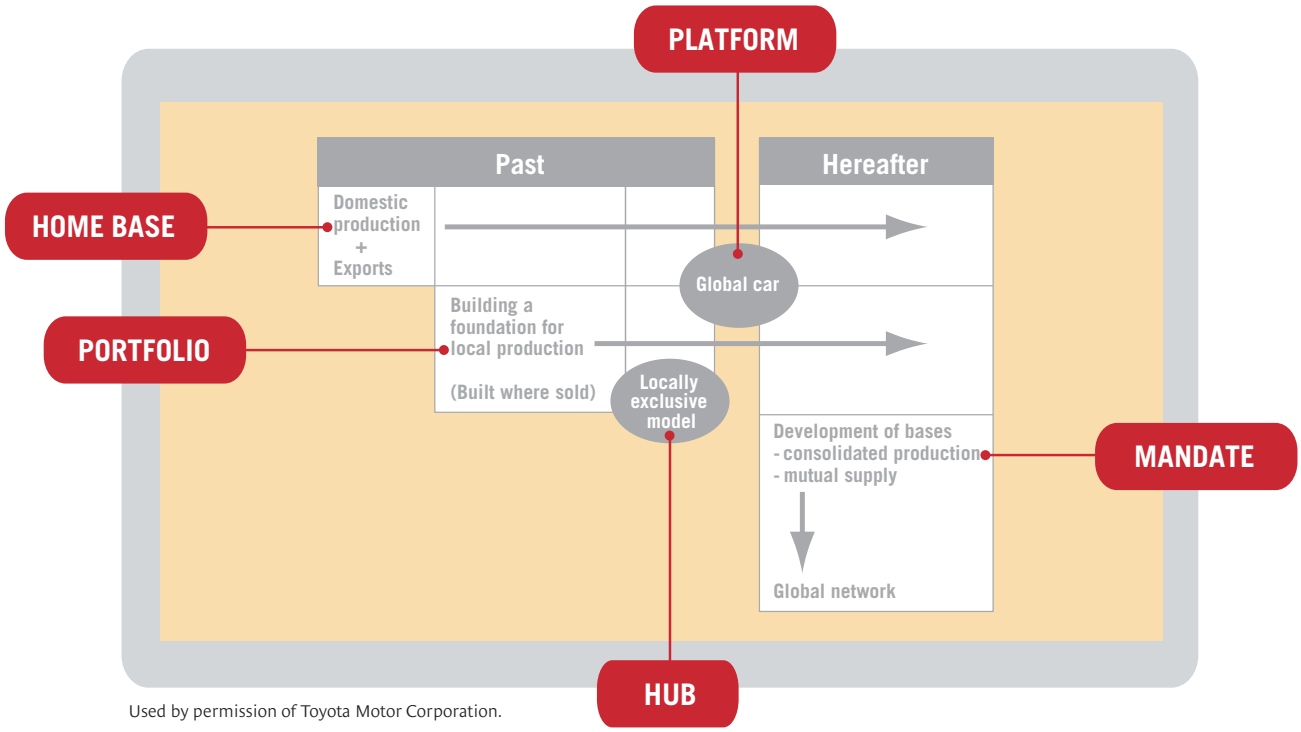
As with platforms, the scope for mandates generally increases with the degree of product standardization around the world, even though the mandate strategy involves focused resource deployments at the regional and local levels. But interregional mandates can be set up in some businesses that afford little room for conventional platforms. For instance, global firms in consulting, engineering, financial services, and other service industries often feature centers of excellence that are recognized as repositories of particular knowledge and skills, and are charged with making that knowledge available to the rest of the firm. Such centers are often concentrated in a single location, around an individual or a small group of people, and therefore have geographic mandates that are much broader than their geographic footprints.

There are of course several risks associated with assigning broad geographic mandates to particular locations. First, such mandates can allow local, national, or regional interests to unduly influence, or even hijack, a firm's overall strategy: More than one professional service firm can be cited in this context. Second, broad mandates cannot handle variations in local, national, or regional conditions, which is why the near-global mandate for Toyota's Asian pickup engine and transmission plants excludes the United States. And finally, carrying the degree of specialization to extremes can create inflexibility. A company that produces everything based on global mandates would be affected worldwide by a disruption at a single location.

The reader will have noticed that Toyota figures as an illustration in all the foregoing descriptions. Indeed, this is because Toyota provides perhaps the most compelling and complete example of how the effective application of regional strategies can produce a global powerhouse. The success is apparent: Toyota surpassed Ford as the world's

The Toyota Way

This exhibit is an almost exact reproduction of a slide presented to Toyota investors at an informational event in New York City in September 2004. The only change I have made is to label the slide to highlight how the various elements identified in the Toyota strategy correspond to the five strategies described in this article. Toyota's "global network," which combines all the other approaches, can be considered a sixth strategy.



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Is a Regional Strategy Right for Your Company?

Before moving on to the next article in this issue, take a couple of minutes to complete this short questionnaire. First, circle one option for each of the following eight categories. Then complete the scoring. Give yourself –1 for each "a" response, 0 for each "b" response, and 1 for each "c" response, and then add up the numbers. A positive score may indicate a significant need for strategy at the regional level. The higher the score, the greater is your need.

Of course, this kind of questionnaire is no substitute for analyzing your company's situation—and regionalization options—in detail. But if the results prompt you to look at your regional strategy more carefully, the exercise will have been useful.

SCORING:
–1 for each (a) response
0 for each (b) response
1 for each (c) response

COMPANY FOOTPRINT

Number of countries with significant operations — **SCORE**

a. **1–5**
b. **6–15**
c. **>15** _____

Percentage of sales from the home region

a. **>80%**
b. **50%–80%**
c. **<50%** _____

COMPANY STRATEGY

Objective for interregional dispersion

a. **Decrease**
b. **Maintain**
c. **Increase** _____

Number of bases of aggregation (or grouping) to be pursued

a. **1**
b. **2**
c. **>2** _____

COUNTRY LINKS

Percentage of trade that is intraregional

a. **<50%**
b. **50%–70%**
c. **>70%** _____

Percentage of FDI that is intraregional

a. **<40%**
b. **40%–60%**
c. **>60%** _____

COMPETITIVE CONSIDERATIONS

Differences in profitability across regions

a. **Small**
b. **Short-term**
c. **Long-term** _____

Key competitors' strategies

a. **Deregionalizing**
b. **Unchanged**
c. **Regionalizing** _____

TOTAL SCORE _____

second-largest automaker in 2004 and is poised to overtake General Motors in the next two to three years. The exhibit "The Toyota Way" reproduces a slide that the company uses to summarize the evolution of its strategy. It shows both that Toyota looks at strategy through a regional lens and that it has, in fact, progressed through all the strategies I've just described.

What is also interesting about Toyota is that new modes of value creation at the regional level have supplemented old ones instead of replacing them. Although Toyota has moved beyond a Japanese manufacturing base (the home base strategy), exports from Japanese manufacturing facilities to the rest of the world continue to account for more than one-quarter of the company's volume and a significantly larger share of its profits. In regions other than the two in which it has strong positions – East and Southeast Asia and North America – Toyota is still following a portfolio approach. In terms of regional hubs, the promotion of a production and procurement specialist to succeed Fujio Cho as president signals an increased commitment to transplanting the Toyota Production System from Japan to the newer production hubs at a time when overseas production is being ramped up rapidly. But even as its hubs gain strength, Toyota continues to reduce the number of its major production platforms and pursue additional specialization through interregional mandates. The IMV project described earlier plays a critical role in all three respects.

The picture that emerges is not one of Toyota progressing through the various regional strategies one at a time but of a company trying to cover all the bases. One can

even argue that the application of all five regional strategies itself represents a new form of strategy – the "global network" in Toyota's slide – in which various regional operations interact with one another and the corporate center in multiple ways and at multiple levels.

Of course, Toyota's ability to employ a complex mix of regional strategies to create value is inseparable from the company's basic competitive advantage: TPS's ability to produce high-quality, reliable cars at low cost. Without this fundamental advantage, some of Toyota's coordination attempts would drown in a sea of red ink.

Defining Your Regions

As companies think through the risks and opportunities of various regional strategies, they also need to clarify what they mean by the word "region." I have so far avoided a definition, although most of my examples imply a continental perspective. My goal is not to be elusive but to avoid restricting the strategies to a particular geographic scale. Particularly with large countries, the logic of the strategies can apply to intranational as well as international regions. Oil companies, for example, consider the market for gasoline in the United States to consist of five distinct regions. Other large markets where transport costs are relatively high in relation to product value, such as cement in Brazil or beer in China, can be similarly broken down.

The general point is that one can interpret the regional strategies at different geographic levels. Assessing the level – global, continental, subcontinental, national, intranational, or local – at which scale is most tightly tied to profitability is often a helpful guide to determining what constitutes a region. Put differently, the world economy is made up of many overlapping geographic layers – from local to global – and the idea is to focus not on one layer but on many. Doing so fosters flexibility by helping companies adapt ideas about regional strategies to different geographic levels of analysis.

In addition to reconsidering what might constitute a geographic region, one can imagine being even more creative and redefining distance – and regions – according to nongeographic dimensions: cultural, administrative and political, and economic. Aggregation along nongeographic dimensions will sometimes still imply a focus on geographically contiguous regions. Toyota, for instance, groups countries by existing and expected free trade areas. At other times, however, such definitions will yield regions that aren't geographically compact. After making its first foreign investments in Spain, for example, the Mexican cement company Cemex grew through the rest of the 1990s by aggregating along the economic dimension – that is, by expanding into markets that were emerging, like its Mexican home base. This strategy created the so-called ring of gray gold: developing markets that mostly fell in a band circling the globe just north of the equator, forming a geographically contiguous but dispersed region.

At times, the parts of a region aren't even contiguous. Spain, for example, can be thought of as "closer" to Latin America than to Europe because of long-standing colony-colonizer links. Between 1997 and 2001, 44% of a surge in FDI from Spain was directed at Latin America – about ten times Latin America's share of world FDI. Europe's much larger regional economy was pushed into second place as a destination for Spanish capital.

Finally, it's important to remember that the definition of "region" often changes in response to market conditions and, indeed, to a company's own strategic decisions. By serving the U.S. market from Japan, Toyota in its early days implicitly considered that market to be on the periphery of its own region. The North American West Coast was easy to access by sea, the United States was open to helping the Japanese economy get off the ground, and the company's business there was dwarfed by its domestic business. But as Toyota's U.S. sales grew, political pressures increased the political and administrative distance between the two countries, and it became apparent that Toyota needed to look at the United States as part of its own self-contained region.

Leading-edge companies are starting to grapple with these definitional issues. For example, firms in sectors as diverse as construction materials, forest products, telecommunications equipment, and pharmaceuticals have invested significantly in modern mapping technology, using such innovations as enhanced clustering techniques, better measures for analyzing networks, and expanded data on bilateral, multilateral, and unilateral country attributes to visualize new definitions of regions. At the very least, this sort of mapping sparks creativity.

Facing the Organizational Challenge

Regional strategies, as I've noted, can take a long time to implement. One deep-seated reason for this is that an organization's existing structures may be out of alignment with – or even inimical to – a superimposed regional strategy. The question then becomes how best to mesh such strategies with a firm's existing structures, especially when the established organizational players command most of the power.

For some pointers, consider Royal Philips Electronics, which has been a border-crossing enterprise for virtually all of its 114-year history. Philips's saga not only points to alignment challenges but also reminds us that regionalization is rarely a triumphal march from the home base to interregional platforms or mandates.

Starting in the 1930s, Philips evolved into a federal system of largely autonomous national organizations

presided over by a cadre of 1,500 elite expatriate managers who championed the country-oriented approach. But as competition emerged in the 1960s and 1970s from Japanese companies that were more centralized and had fewer, larger plants, this highly localized structure became expensive to maintain. Philips responded by installing a matrix organization – with countries and product divisions as its two legs – and spent roughly two decades trying, without much success, to rebalance the matrix away from the countries and toward the product divisions. Finally, in 1997, CEO Cor Boonstra abolished the geographic dimension of the matrix as a way of forcing the organization to align itself around global product divisions.

Given this long and sometimes painful history, it would be unrealistic for today's champions of regional strategies within Philips to expect to overthrow the product division structure. Would-be regionalists have to work within it. Jan Oosterveld, who served as CEO of Asia Pacific from 2003 to 2004 – a position created after Philips announced the combination of two Asia Pacific subregions into one – saw that his first task was to facilitate the sharing of resources and knowledge across product divisions within the region. Ultimately, however, he aimed to help develop an Asia Pacific strategy for the company. So although the new Asian regional structure has initially focused on coordinating governmental relations, key account management, branding, joint purchasing, and IT, HR, and other support functions, Oosterveld and others can imagine a day when much more power might be vested in regional headquarters in, say, New York, Shanghai, and Amsterdam than at the corporate level. They also recognize, however, that achieving that kind of regional strategy could take many years.

The obvious implication is that strategic initiatives can be pursued at the regional level only if some decision rights are reallocated – whether from the local or global levels, or from the other repositories of power within the organization (in Philips's case, product divisions). And just as obviously, no one likes to give up power. Leadership from the top, aimed at promoting a "one-company" mentality, is often the only way forward. One of Oosterveld's conditions for taking the job at Philips was that the board of directors hold regional conclaves twice a year to show its commitment to the regional initiative. Such conclaves might be mainly symbolic, but symbolism can go a long way.

Philips has approached regional strategy flexibly, putting in place a wide variety of arrangements that take into account not only the company's existing structure but also competitive realities, region by region. In North America, for example, Philips's principal objective continues to be to rebuild its positions and achieve satisfactory levels of performance in the all-important U.S. market. Its activities there are organized entirely around the global product divisions, which, because of the size of the market and Philips's stake in it, are thought to be capable of achieving the requisite geographic focus.

In Europe, where Philips is better established, the company has rethought the role and status of the large operations in the home country of the Netherlands within the broader regional structure. In April 2002, when Philips announced plans to set up a regional superstructure in Asia Pacific, it also folded the Netherlands into an expanded region comprising Europe, the Middle East, and Africa. The point is that irregular or asymmetric structures (in which some regions seem to be much larger than others) are often preferable to an aesthetically pleasing (and in some respects simpler) symmetry of the sort implicitly evoked by much of the discussion up to this point. Even Toyota seems to be focusing separately on China while its other markets are grouped into multicountry regions.

• • •

If your company has a significant international presence, it already has a regional strategy – even if that strategy has been arrived at by default. But given the variety of regional strategies, and the fact that no one approach is best or most evolved, there is no substitute for figuring out which ways of coordinating within or across regions make sense for your company. As we have seen, however, embracing regional strategies calls for flexibility, creativity, and hard-nosed analysis of the changing business context – all of which take time and effort.

In a highly regionalized world, the right regional strategy (or strategies) can create more value than purely global or purely local ones can. But even so, the regional approaches I have been exploring may not make sense for your company. In that case, here is what you can take away from this article: Regions represent just one way of aggregating across borders to achieve greater efficiencies than would be achievable with a country-by-country approach. Other bases of cross-border aggregation that companies have implemented include products (the global product divisions at Philips), channels (Cisco, which uses channels and partners as its primary basis), customer types or global accounts (many IT services firms), functions (most major oil companies), and technologies (ABB recently, before and after trying some of the bases that are listed above and others that aren't). Each of these bases of aggregation offers, as regions do, multiple possibilities for crafting strategies intermediate to the local and global levels by grouping things. In a world that is neither truly local nor truly global, such strategies can deliver a powerful competitive advantage.

1. For a systematic way to think about cultural, administrative, geographic, and economic distance, see the CAGE framework described in my article "Distance Still Matters: The Hard Reality of Global Expansion" (HBR September 2001).

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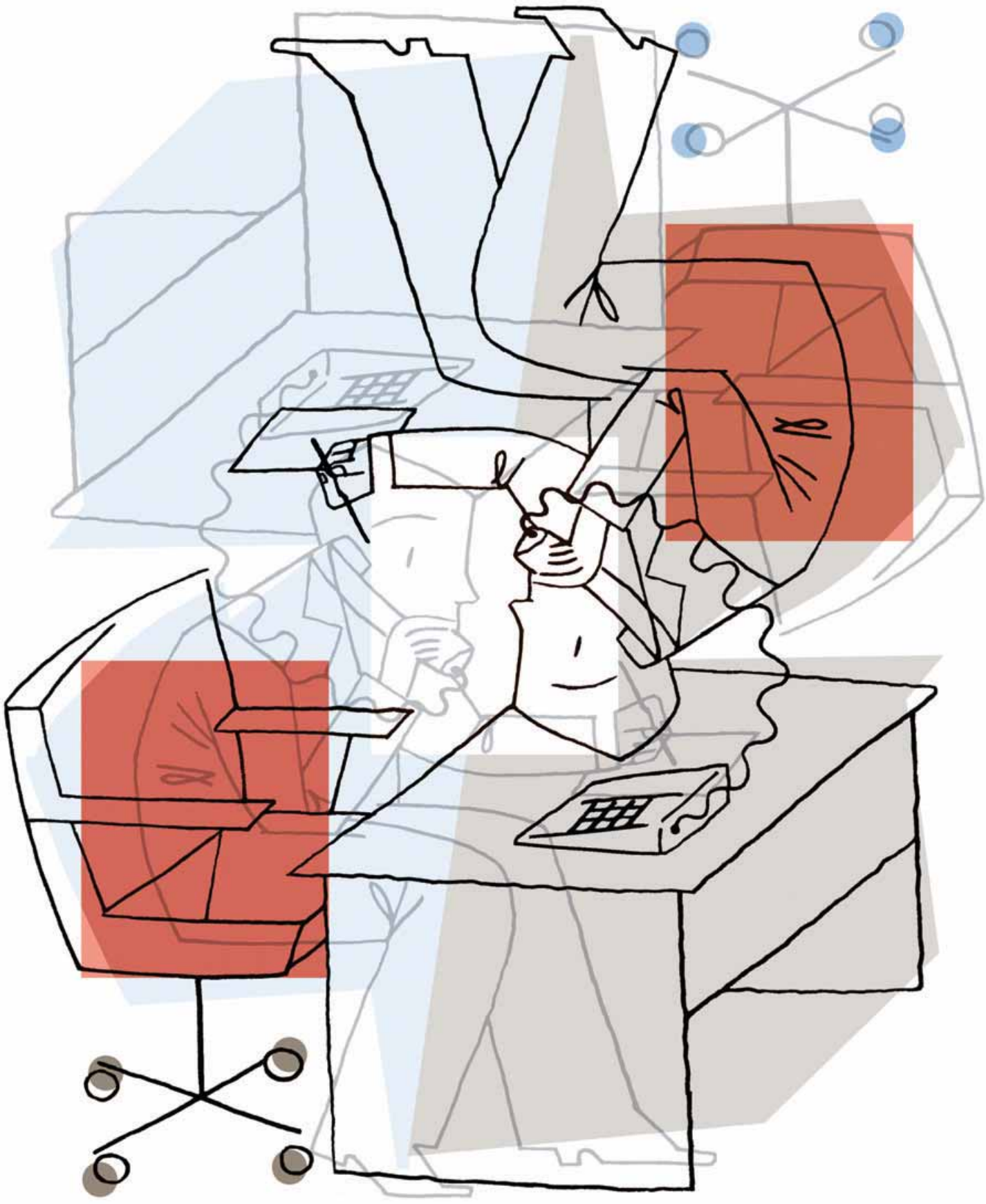
A Players or Positions?

THE STRATEGIC LOGIC OF WORKFORCE MANAGEMENT

by Mark A. Huselid, Richard W. Beatty, and Brian E. Becker

A single-minded focus on finding and developing A players misses the point. A better approach is first to identify strategically critical jobs, then to invest disproportionately to ensure that the right people – doing the right things – are in those positions.

A GREAT WORKFORCE is made up of great people. What could be more intuitively obvious? Is it any wonder, then, that so many companies have devoted so much energy in recent years to identifying, developing, and retaining what have come to be known as "A players"? Firms like GE, IBM, and Microsoft all have well-developed systems for managing and motivating their high-performance and high-potential employees – and for getting rid of their mediocre ones. Management thinkers have widely endorsed this approach: Larry Bossidy, in the best-selling book *Execution*, for example, calls this sort of differentiation among employees "the mother's milk of building a performance culture."



WHITNEY SHERMAN

But focusing exclusively on A players puts, well, the horse before the cart. High performers aren't going to add much value to an organization if they're smoothly and rapidly pulling carts that aren't going to market. They're going to be effective only when they're harnessed to the right cart – that is, engaged in work that's essential to company strategy. This, too, may seem obvious. But it's surprising how few companies systematically identify their strategically important A *positions* – and *then* focus on the A players who should fill them. Even fewer companies manage their A positions in such a way that the A players are able to deliver the A performance needed in these crucial roles.

While conventional wisdom might argue that the firms with the most talent win, we believe that, given the financial and managerial resources needed to attract, select, develop, and retain high performers, companies simply can't afford to have A players in all positions. Rather, we believe that the firms with the *right* talent win. Businesses need to adopt a portfolio approach to workforce management, placing the very best employees in strategic positions, good performers in support positions, and eliminating nonperforming employees and jobs that don't add value.

We offer here a method for doing just that, drawing on the experience of several companies that are successfully adopting this approach to workforce management, some of which we have worked with in our research or as consultants. One thing to keep in mind: Effective management of your A positions requires intelligent management of your B and C positions, as well.

Identifying Your A Positions

People traditionally have assessed the relative value of jobs in an organization in one of two ways. Human resource professionals typically focus on the level of skill, effort, and responsibility a job entails, together with working conditions. From this point of view, the most important positions are those held by the most highly skilled, hardest-working employees, exercising the most responsibility and operating in the most challenging environments.

Economists, by contrast, generally believe that people's wages reflect the value they create for the company and the relative scarcity of their skills in the labor market. Thus, the most important jobs are those held by the most highly paid employees. The trouble with both of these approaches is that they merely identify which jobs the company is currently treating as most important, not the ones that actually are. To do that, one must not work backward from organization charts or compensation systems but forward from strategy.

That's why we believe the two defining characteristics of an A position are first, as you might expect, its disproportionate importance to a company's ability to execute some part of its strategy and second – and this is not nearly as obvious – the wide variability in the quality of the work displayed among the employees in the position.

Plainly, then, to determine a position's strategic significance, you must be clear about your company's strategy: Do you compete on the basis of price? On quality? Through mass customization? Then you need to identify your strategic capabilities – the technologies, information, and skills required to create the intended competitive advantage. Wal-Mart's low-cost strategy, for instance, requires state-of-the-art logistics, information systems, and a relentless managerial focus on efficiency and cost reduction. Finally, you must ask: What jobs are critical to employing those capabilities in the execution of the strategy?

Such positions are as variable as the strategies they promote. Consider the retailers Nordstrom and Costco. Both rely on customer satisfaction to drive growth and shareholder value, but what different forms that satisfaction takes: At Nordstrom it involves personalized service and advice, whereas at Costco low prices and product availability are key. So the jobs critical to creating strategic advantage at the two companies will be different. Frontline sales associates are vital to Nordstrom but hardly to be found at Costco, where purchasing managers are absolutely central to success.

The point is, there are no inherently strategic positions. Furthermore, they're relatively rare – less than 20% of the workforce – and are likely to be scattered around the organization. They could include the biochemist in R&D or the field sales representative in marketing.

So far, our argument is straightforward. But why would variability in the performance of the people currently in a job be so important? Because, as in other portfolios, variation in job performance represents upside potential – raising the average performance of individuals in these critical roles will pay huge dividends in corporate value. Furthermore, if that variance exists across companies, it may also be a source of competitive advantage for a particular firm, making the position strategically important.

Sales positions, fundamental to the success of many a company's strategy, are a good case in point: A salesperson whose performance is in the 85th percentile of a com-

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pany's sales staff frequently generates five to ten times the revenue of someone in the 50th percentile. But we're not just talking about greater or lesser value creation – we're also talking about the potential for value creation versus value destruction. The Gallup organization, for instance, surveyed 45,000 customers of a company known for customer service to evaluate its 4,600 customer service representatives. The reps' performance ranged widely: The top quartile of workers had a positive effect on 61% of the customers they talked to, the second quartile had a positive effect on only 40%, the third quartile had a positive effect on just 27% – and the bottom quartile actually had, as a group, a negative effect on customers. These people – at the not insignificant cost to the company of roughly $40 million a year (assuming average total compensation of $35,000 per person) – were collectively destroying value by alienating customers and, presumably, driving many of them away.

Companies simply can't afford to have A players in all positions.

Although the $40 million in wasted resources is jaw-dropping, the real significance of this situation is the huge difference that replacing or improving the performance of the subpar reps would make. If managers focused disproportionately on this position, whether through intensive training or more careful screening of the people hired for it, company performance would improve tremendously.

The strategic job that doesn't display a great deal of variability in performance is relatively rare, even for those considered entry-level. That's because performance in these jobs involves more than proficiency in carrying out a task. Consider the job of cashier. The generic mechanics aren't difficult. But if the position is part of a retail strategy emphasizing the customers' buying experience, the job will certainly involve more than scanning products and collecting money with a friendly smile. Cashiers might, for example, be required to take a look at what a customer is buying and then suggest other products that the person might want to consider on a return visit. In such cases, there is likely to be a wide range in people's performance.

Some jobs may exhibit high levels of variability (the sales staff on the floor at a big-box store like Costco, for example) but have little strategic impact (because, as we have noted, Costco's strategy does not depend on sales staff to ensure customer satisfaction). Neither dramatically improving the overall level of performance in these jobs nor narrowing the variance would present an opportunity for improving competitive advantage.

Alternatively, some jobs may be potentially important strategically but currently represent little opportunity for competitive advantage since everyone's performance is already at a high level. That may either be because of the standardized nature of the job or because a company or industry has, through training or careful hiring, reduced the variability and increased the mean performance of workers to a point where further investment isn't merited. A pilot, for example, is a key contributor to most airlines' strategic goal of safety, but owing to regular training throughout pilots' careers and government regulations, most pilots perform well. Although there definitely is a strategic downside if the performance of some pilots were to fall into the unsafe category, improving pilot performance in the area of safety is unlikely and, even if

marginal gains are possible, unlikely to provide an opportunity for competitive advantage.

So a job must meet the dual criteria of strategic impact and performance variability if it is to qualify as an A position. From these two defining characteristics flow a number of others – for example, a position's potential to substantially increase revenue or reduce costs – that mark an A position and distinguish it from B and C positions. B positions are those that are either indirectly strategic through their support of A positions or are potentially strategic but currently exhibit little performance variability and therefore offer little opportunity for competitive advantage. Although B positions are unlikely to create value, they are often important in maintaining it. C positions are those that play no role in furthering a company's strategy, have little effect on the creation or maintenance of value – and may, in fact, not be needed at all. (For a comparison of some attributes of these three types of positions, see the exhibit "Which Jobs Make the Most Difference?")

There are no inherently strategic positions. What's more, they're relatively rare–less than 20% of the workforce.

It's important to emphasize that A positions have nothing to do with a firm's hierarchy – which is the criterion executive teams so often use to identify their organizations' critical and opportunity-rich roles. As natural as it may be for you, as a senior executive, to view your own job as among a select group of vital positions in the company, resist this temptation. As we saw in the case of the cashier, A positions can be found throughout an organization and may be relatively simple jobs that nonetheless need to be performed creatively and in ways that fit and further a company's unique strategy.

A big pharmaceutical firm, for instance, trying to pinpoint the jobs that have a high impact on the company's success, identifies several A positions. Because its ability to test the safety and efficacy of its products is a required strategic capability, the head of clinical trials, as well as a number of positions in the regulatory affairs office, are deemed critical. But some top jobs in the company hierarchy, including the director of manufacturing and the corporate treasurer, are not. Although people in these jobs are highly compensated, make important decisions, and play key roles in maintaining the company's value, they don't *create* value through the firm's business model. Consequently, the company chooses not to make the substantial investments (in, say, succession planning) in these positions that it does for more strategic jobs.

A positions also aren't defined by how hard they are to fill, even though many managers mistakenly equate workforce scarcity with workforce value. A tough job to fill may not have that high potential to increase a firm's value. At a high-tech manufacturing company, for example, a quality assurance manager plays a crucial role in making certain that the products meet customers' expectations. The job requires skills that may be difficult to find. But, like the airline pilots, the position's impact on company success is asymmetrical. The downside may indeed be substantial: Quality that falls below Six Sigma levels will certainly destroy value for the company. But the upside is limited: A manager able to achieve a Nine Sigma defect rate won't add much value because the difference between Six Sigma and Nine Sigma won't be great enough to translate into any major value creation opportunity (although the difference between Two- and Three-Sigma defect rates may well be). Thus, while such a position could be hard to fill, it doesn't fit the definition of an A position.

Managing Your A Positions

Having identified your A positions, you'll need to manage them – both individually and as part of a portfolio of A, B, and C positions – so that they and the people in them in fact further your organization's strategic objectives.

A first and crucial step is to explain to your workforce clearly and explicitly the reasons that different jobs and people need to be treated differently. Pharmaceutical company GlaxoSmithKline is identifying those positions, at both the corporate and business-unit levels, that are critical to the company's success in a rapidly changing competitive environment. As part of that initiative, the company developed a statement of its workforce philosophy and management guidelines. One of these explicitly addresses "workforce differentiation" and reads, in part: "It is essential that we have key talent in critical positions and that the careers of these individuals are managed centrally."

But communication is just the beginning. A positions also require a disproportionate level of investment. The performance of people in these roles needs to be evaluated in detail, these individuals must be actively developed, and they need to be generously compensated. Also, a pipeline must be created to ensure that their successors are among the best people available. IBM is a company making aggressive investments on each of these four fronts.

In recent years, IBM has worked to develop what it calls an "on-demand workforce," made up of people who can

Which Jobs Make the Most Difference?

An A position is defined primarily by its impact on strategy and by the range in the performance level of the people in the position. From these two characteristics flow a number of other attributes that distinguish A positions from B and C jobs.

	A Position STRATEGIC	B Position SUPPORT	C Position SURPLUS
DEFINING CHARACTERISTICS	**Has a direct strategic impact** AND **Exhibits high performance variability among those in the position, representing upside potential**	**Has an indirect strategic impact by supporting strategic positions and minimizes downside risk by providing a foundation for strategic efforts.** OR **Has a potential strategic impact, but exhibits little performance variability among those in the position**	**May be required for the firm to function but has little strategic impact**
Scope of authority	Autonomous decision making	Specific processes or procedures typically must be followed	Little discretion in work
Primary determinant of compensation	Performance	Job level	Market price
Effect on value creation	Creates value by substantially enhancing revenue or reducing costs	Supports value-creating positions	Has little positive economic impact
Consequences of mistakes	May be very costly, but missed revenue opportunities are a greater loss to the firm	May be very costly and can destroy value	Not necessarily costly
Consequences of hiring wrong person	Significant expense in terms of lost training investment and revenue opportunities	Fairly easily remedied through hiring of replacement	Easily remedied through hiring of replacement

quickly put together or become part of a package of hardware, software, and consulting services that will meet the specific needs of an individual customer. As part of this effort, IBM has sought to attract and retain certain individuals with what it terms the "hot skills" customers want in such bundled offerings.

In the past year or so, the company has also focused on identifying its A positions. The roster of such positions clearly will change as IBM's business does. But some, such as the country general manager, are likely to retain their disproportionate value. Other strategic roles include mid-level manager positions, dubbed "deal makers," responsible for the central strategic task of pulling together, from both inside and outside the company, the diverse set of products, software, and expertise that a particular client will find attractive.

Evaluation. Because of their importance, IBM's key positions are filled with top-notch people: Obviously, putting A players in these A positions helps to ensure A performance. But IBM goes further, taking steps to hold its A players to high standards through an explicit process – determining the factors that differentiate high and

low performance in each position and then measuring people against those criteria. The company last year developed a series of ten leadership attributes – such as the abilities to form partnerships with clients and to take strategic risks – each of which is measured on a four-point scale delineated with clear behavioral benchmarks. Individuals assess themselves on these attributes and are also assessed by others, using 360-degree feedback.

Development. Such detailed evaluation isn't very valuable unless it's backed up by a robust professional development system. Drawing on the strengths and weaknesses revealed in their evaluations and with the help of tools available on the company's intranet, people in IBM's A positions are required to put together a development program for themselves in each of the ten leadership areas.

This is only one of numerous development opportunities offered to people in A positions. In fact, more than $450 million of the $750 million that IBM spends annually on employee development is targeted at either fostering hot skills (both today's and those expected to be tomorrow's) or the development of people in key positions. A senior-level executive devotes all of his time to programs designed to develop the executive capabilities of people in these jobs.

Compensation. IBM supports this disproportionate investment in development with an even more disproportionate compensation system. Traditionally at IBM, even employees with low performance ratings had received regular salary increases and bonuses. Today, annual salary increases go to only about half the workforce, and the best-performing employees get raises roughly three times as high as those received by the simply strong performers.

Succession. Perhaps most important, IBM has worked to formalize succession planning and to build bench strength for each of its key positions, in part by investing heavily in feeder jobs for those roles. People in these feeder positions are regularly assessed to determine if they are "ready now," "one job away," or "two jobs away" from promotion into the strategically important roles. "Pass-through" jobs, in which people can develop needed skills, are identified and filled with candidates for the key strategic positions. For example, the position of regional sales manager is an important pass-through job on the way to becoming a country general manager. In this way, IBM ensures that its A people will in fact be ready to fill its top positions.

Managing Your Portfolio of Positions

Intelligently managing your A positions can't be done in isolation. You also need strategies for managing your B and C positions and an understanding of how all three strategies work together. We find it ironic that managers who embrace a portfolio approach in other areas of the business can be slow to apply this type of think-

Are We Differentiating Enough?

Managers who know that differentiated strategies are the key to competitive success all too often fail to differentiate in strategies for their most important asset – their workforce. This checklist can help you determine if you are differentiating enough in the treatment of your company's positions and people. If you check off any of these, you have work to do.

POSITIONS

___ Position descriptions are based on history, not strategic value.

___ Most positions are paid at about the market midpoint.

___ Recruitment and retention for all positions involve the same effort and budget.

___ The same selection process is used for all positions.

___ Little developmental rotation occurs.

___ Few C positions are eliminated or outsourced.

PLAYERS

___ Performance evaluation forms are completed rarely or only at salary review.

___ There is little candor in performance reviews.

___ Many or most employees are rated the same.

___ Forced distribution of ratings is used.

___ Those receiving the middle rating are labeled "proficient" or "successful" and receive regular pay raises despite being viewed as average or marginal.

___ Both very tough and very lenient raters operate without consequences.

___ Poor performers stay yet don't improve.

___ Top management is not rigorously evaluated.

ing to their workforce. All too frequently, for example, companies invest in their best and worst employees in equal measure. The unhappy result is often the departure of A players, discouraged by their treatment, and the retention of C players.

To say that you need to disproportionately invest in your A positions and players doesn't mean that you ignore the rest of your workforce. B positions are important either as support for A positions (as IBM's feeder positions are) or because of any potentially large downside implications of their roles (as with the airline pilots). Put another way, although you aren't likely to win with your B positions, you can certainly lose with them.

As for those nonstrategic C positions, you may conclude after careful analysis that, just as you need to weed out C players over time, you may need to weed out your C positions, by outsourcing or even eliminating the work.

Roche is one firm that is placing more emphasis on the strategic value of positions themselves. Over the past few years, the pharmaceutical company has been looking at different positions to determine which are necessary for maintaining competitive advantage. Regardless of how well a person performs in a role, if that position is no longer of strategic value, the job is eliminated. For example, Roche looked at the strategic value provided by data services in a recent project and as a result decided which positions need to be added, which needed to change (or be moved)–and which, such as data center services (DCS) engineer, needed to be eliminated. In a similar manner, another pharmaceutical firm, Wyeth Consumer Healthcare, following a strategic decision to focus on large customers, eliminated what had been a strategic position for the company–middle-market account manager–as well as staff that supported the people in this position.

The ultimate aim is to manage your portfolio of positions so that the right people are in the right jobs, paying particular attention to your A positions. First, using performance criteria developed for determining who your A, B, and C players are, calculate the percentage of each currently in A positions. Then act quickly to get C players out of A positions, replace them with A players, and work to help B players in A positions become A players. GlaxoSmithKline currently is engaged in an initiative to push both line managers and HR staff to ensure that only top-tier employees (as determined by their performance evaluations) are in the company's identified key positions.

Making Tough Choices

Despite the obvious importance of developing high-performing employees and supporting the jobs that contribute most to company success, firms that routinely make difficult decisions about R&D, advertising, and manufacturing strategies rarely show the same discipline when it comes to their most valuable asset: the workforce. In fact, in our long experience, we've found that firms with the most highly differentiated R&D, product, and marketing strategies often have the most generic or undifferentiated workforce strategies. When a manager at one of these companies does make a tough choice in this area, the decision often relates to the costs rather than the value of the workforce. (The exhibit "Are We Differentiating Enough?" can help you determine whether you are making the distinctions likely to create workforce value.)

It would be nice to live in a world where we didn't have to make hard decisions about the workforce, but we don't. Strategy is about making choices, and correctly assessing employees and roles are two of the most important. For us, the essence of the issue is the distinction between equality and equity. Over the years, HR practices have evolved in a way that increasingly favors equal treatment of most employees within a given job. But today's competitive environment requires a shift from treating everyone the same to treating everyone according to his or her contribution.

Many managers will mistakenly equate workforce scarcity with workforce value, but A positions aren't defined by how hard they are to fill.

We understand that this approach may not be for everyone, that increasing distinctions between employees and among jobs runs counter to some companies' cultures. There is, however, a psychological as well as a strategic benefit to an approach that initially focuses on A positions: Managers who are uncomfortable with the harsh A and C *player* distinction–especially those in HR, many of whom got into the business because they care about people – may find the idea of first differentiating between A and C *positions* more palatable. But shying away from making the more personal distinctions is also unwise. We all know that effective business strategy requires differentiating a firm's products and services in ways that create value for customers. Accomplishing this requires a differentiated workforce strategy, as well.

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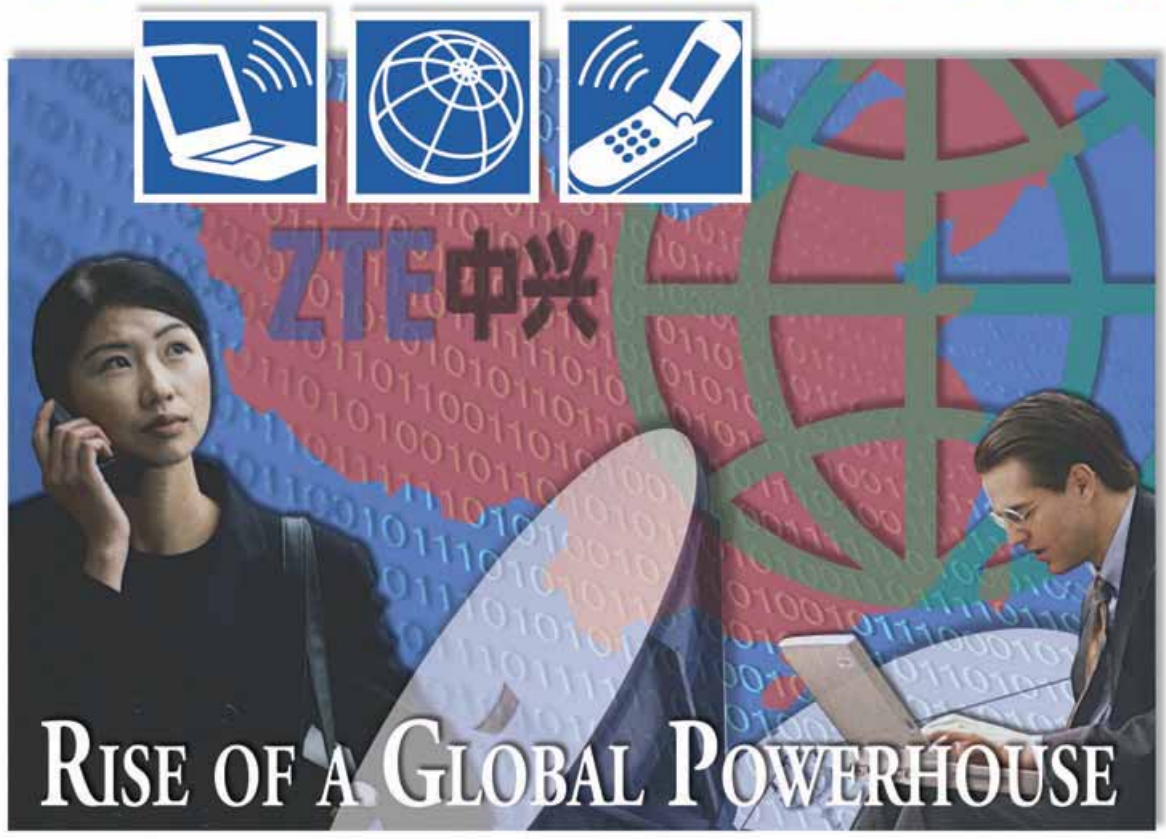
To order, see page 155.

THE ZTE STORY:



by Karen A. Edelman

The story of China stepping into its role as economic superpower is well-known to the Western world. But many people are still unfamiliar with some of the most dynamic Chinese-born enterprises—companies that are becoming global powerhouses by carefully balancing growth and value creation as they enter new regions. One such company is ZTE Corporation.

You may not have heard about ZTE, but its story is worth telling. ZTE has been able to achieve dramatic and persistent growth in its 20-year history by excelling on three fronts: technology innovation; customized technology solutions and services; and respectful corporate culture.

A Fast-Growing Global Player

Founded in 1985 and headquartered in Shenzhen, ZTE is China's largest publicly traded telecommunications equipment manufacturer and wireless solutions provider. With the most complete package of products and services, ZTE develops and manufactures equipment for fixed, mobile, data, and optical networks; intelligent networks; next generation networks; and mobile phones for telecom carriers worldwide. Its main product lines include: switching, access, transmission, mobile communications, data communications, and videoconferencing.

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ZTE has operations in more than 100 countries. The company has cast its widest net with its DSL offerings. ZTE has deployed more than 12 million DSL products in more than 40 countries, including Romania, Greece, Egypt, India, and Pakistan. In March, Gartner reported that ZTE had risen to become the third-largest DSL provider in the world.

ZTE was chosen to be the first Chinese company to supply telecommunications equipment to the 2004 Olympic Games in Athens. ZTE provided round-the-clock DSL coverage for 16 venues and press centers throughout the event. Also in 2004, ZTE launched the world's smallest 3G WCDMA cell phone, featuring video calling and other multimedia functions. These recent breakthroughs reflect how ZTE's efforts to become a world leader in the telecommunications industry are garnering attention.

Established in 2002, ZTE's Global Customer Support Center comprises nine sub-centers, 61 hotlines nationwide, 17 overseas local centers and 11 advanced labs. In addition, well-trained technical engineers are situated around the globe, each with online troubleshooting capability and 24/7 accessibility. The company has also set up ZTE University in Shenzhen, designed to provide comprehensive and customized training programs to its workforce. "ZTE has built a reliable, efficient technology support and after-sale service network in more than 80 countries, so you can obtain quick response and professional support anytime, anywhere," ZTE President Yin Yimin says.

Fostering In-House Innovation

With the aim to be the best quality and most innovative provider of telecommunications solutions, ZTE's promise is that customers will benefit not only from customized solutions but also from its leading-edge technology innovations and customer service. To keep its promise, ZTE has invested heavily in research and development as a means of fostering continuous innovation.

The company devotes a full 10 percent of annual revenue to R&D. And 41 percent of its workforce—far more than any other division—is dedicated to R&D. Yin explains that these extensive resources are utilized to continue to create value for customers. By leveraging these resources, Yin says, "ZTE has been keeping up with the most advanced telecom technology and gradually is playing a lead role in the commercial applications such as wireless and fixed network." To date, ZTE has more than 3,000 patent applications to its name, 90 percent of which were innovative inventions.

ZTE has established itself as China's top wireless brand and the country's number-one equipment vendor. By the end of 2004, ZTE equipment supported 25 million CDMA lines in more than 60 countries. The company also has developed real expertise with GSM equipment, successfully entering the market in more than 20 countries. ZTE is one of the few companies in the world that develop products for all three 3G standards (CDMA, CDMA2000, and TD-SCDMA). The company expects demand for 3G equipment in China to rise dramatically in the coming years.

Furthermore, in 2004 ZTE introduced GoTa, the world's first CDMA-based Global Open Trunking Architecture system (GoTa). ZTE has since become the first Chinese telecommunications manufacturer to grant patent licenses to other internationally renowned vendors. The GoTa products have entered dozens of countries, including Malaysia, Norway, and Russia. The hope is that GoTa may usher in a new era for the international digital trunking market.

Global Breakthroughs

ZTE has done exceptionally well in developing nations, especially in Africa, Asia, and Latin America, largely because of China's own recent development. Having lived through China's rise to economic superpower, ZTE leaders innately understand the needs and challenges of building a business in a growing region.

The company has made considerable progress in its ability to gain a foothold in Europe. Some European telecommunications companies that have recently chosen ZTE as a partner include: Alcatel (France), France Telecom, Invitel (Hungary), Portugal Telecom,

and OTE (Greece), among others. And, from February to July this year, ZTE ran its successful "Let's 3G" Roadshow, a branding campaign that allowed the company to effectively showcase its three modes of 3G technologies across Europe.

In the United States, ZTE has set up three research and development offices in San Diego, Dallas, and New Jersey. Earlier this year, ZTE announced a collaboration with Intel Corporation to jointly deliver global wireless solutions using WiMAX technology. To date, it has established alliances with other high-tech leaders, including Microsoft and IBM. "As the telecom vendor with the most complete package of product line covering wireline, wireless, and terminals in the world, ZTE can provide global customers with customized and diversified integrated telecom networking equipment and solutions," says Yin. "This makes ZTE easily stand out among the global telecom giants."

To date, ZTE has experienced growth in multiple industry sectors. For example, in 2004, sales of ZTE mobile phones, base stations, switches, software, and broadband networking gear grew 35 percent, to $4.1 billion; profits, meanwhile, increased 50 percent, to approximately $186 million. In addition, exports jumped 170 percent, to $1.6 billion, according to brokerage firm DBS Vickers Securities.

A Partnership Story

One of the reasons behind ZTE's impressive growth rate is its ability to be a great partner. It has an excellent track record with the telecommunications and technology companies it serves. Here are some examples of recent ZTE partnerships:

- Alcatel, to provide base stations for cellular networks using the CDMA standard.
- China Telecom, China Unicom, China Mobile, China Netcom and China Railcom, to build next-generation networks in Beijing, Shanghai, Guangzhou, and other major Chinese cities.
- Corisat America, which services North and South America, to provide next- generation network—including VoIP, Internet, and multimedia—services.
- Ericsson, to deliver TD-SCDMA solutions in China.
- Qualcomm, to actively promote CDMA.
- OTE, Greece's telecommunications carrier, provided 24/7 broadband Internet access to 16 venues at the 2004 Athens Olympics—a major boost to ZTE's European credentials. As a consequence, OTE awarded ZTE a DSL contract to serve its client base in Greece.
- Telecom Egypt, to set up a CDMA and 3G laboratory.
- Telefonica, the world's third-largest telecommunications company, to provide DSL equipment to Telefonica Brazil, a deal that represents 50 percent of the contracts awarded by that division.
- Telemar, Brazil's largest fixed-line operator—for DSL equipment to serve Rio de Janeiro's population of more than 12 million.
- VIVO, the only CDMA mobile operator in Brazil, to supply CDMA cell phones.

One example of ZTE's ability to work well with partners is the company's long-standing promise to bring 3G to Africa. ZTE began working in Africa more than eight years ago, joining regional telecommunications companies to complete multi-faceted infrastructure development projects. In September of 2004, after just three months of co-development with Tunisia's telecommunications provider PTT CERT, ZTE successfully placed the first-ever 3G call in Tunisia—beating out all of its competitors. "This is an important milestone for ZTE in 3G network construction, both geographically in North Africa and generally around the world," Ye Weimin, VP and general manager, mobile products, said at the time. "It shows we can deliver quickly and efficiently to our customers."

Now ZTE and PTT CERT are continuing their quest to bring wireless to Tunisia's two key cities: Sousse and Tunis. To showcase its success in the region, at the ITU World Summit on Information Technology, which was held in Sousse this year, ZTE's WCDMA, CDMA

2000 1X/EVDO/GOTA and ADSL equipments system provided multiple 3G services for more than 20,000 attendees from more than 190 countries. ZTE's advanced technology enables the city's visitors to enjoy the same quality of 3G services that they experience at home.

A Company for the Public

ZTE first went public on the Shenzhen Stock Exchange in 1997. In December 2004, ZTE was successfully listed on the Main Board of The Stock Exchange of Hong Kong, becoming the first Chinese company to hold both A shares and H shares. By making its shares available in Hong Kong, where foreigners can buy them, ZTE was able to attract an additional $430 million—a good portion of which will be reinvested into R&D and marketing.

The management team at ZTE thought it important to go public, not only to raise capital, but also to increase brand awareness, attract more international talent, and to offer advancements in business operations to better manage the company globally. ZTE's official statements attest to the company's interest in upholding "prudent and practical financial policies," by "attaching high importance to the returns of our investors." Experts who follow the Asia-Pacific region attest to ZTE's solid reputation and good name—a reputation that is one of its key strengths as the company takes its brand into new markets.

ZTE's Unique Corporate Culture

With 27,000 employees, ZTE is proud of its highly educated workforce: 70 percent of ZTE employees have Bachelor's degrees or higher. More than 7,800 employees have Master's degrees, and more than 500 have Ph.Ds.

"We offer our people adequate growth opportunities and competitive compensation packages," Yin says. "In addition, the corporate culture of respecting each other helps ZTE build a good reputation in the job market for all kinds of talents."

These are just some of the reasons why, sooner than some might expect, ZTE is poised to become a household name around the globe. "As a leader of such a large and fast-growing company, I quite enjoy what I have done in achieving my goals and making my dreams real together with my team and our partners," Yin says. "I am aware that we will face many challenges and difficulties from time to time, but I am confident that with my excellent team and their wisdom and effort, we will reach those goals."

Karen A. Edelman *is HBR's freelance editorial director of special advertising sections. She also serves as a writer and consultant to corporate and media clients.*

GLOSSARY OF TERMS

Digital Subscriber Line, or DSL, is a family of technologies that provide a digital connection over the wires of the local network.

3G is short for **third-generation.** The services associated with 3G provide the ability to transfer both voice data (a telephone call) and non-voice data, such as e-mail and instant messaging.

- **CDMA, CDMA2000,** and **TD-SCDMA** are types of 3G technology.
- **GoTa,** or **Global Open Trunking Architecture,** the world's first Trunking System Based on CDMA technology, is designed for public trunking radio networks and for private trunking radio systems (PMR). It promises rich services, open platform interfaces, economies of scale, and smooth evolution to future technology.

Voice over Internet Protocol (VoIP) is the routing of voice conversations over the Internet or any other IP-based network.

WiMAX stands for **Worldwide Interoperability for Microwave Access,** point-to-multipoint broadband wireless access. Early products are likely to be aimed at network service providers and businesses, not at consumers. It has the potential to enable millions of people to have wireless Internet connectivity, cheaply and easily.

Source: www.wikipedia.org

Up to Code

Does Your Company's Conduct Meet World-Class Standards?

by Lynn Paine, Rohit Deshpandé, Joshua D. Margolis, and Kim Eric Bettcher

New research reveals an emerging global consensus on basic standards of corporate behavior.

CODES OF CONDUCT have long been a feature of corporate life. Today, they are arguably a legal necessity – at least for public companies with a presence in the United States. As of 2004, both the New York Stock Exchange and the Nasdaq require listed companies to adopt and disclose a code of conduct. And under the Sarbanes-Oxley Act, public issuers of securities must disclose whether they have adopted a code for their senior executives (and if not, why not). Similarly, federal guidelines direct judges to take into account the adoption of a code when determining whether a company convicted of a crime had an effective ethics and compliance program in place – and thus when setting a fine. The legal case for a code is further bolstered by various requirements and enforcement policies in specific areas of the law. The EPA, for example, considers a company's compliance efforts when it assesses penalties for environmental infractions. Moreover, the courts of Delaware, legal home to more than half of all U.S. publicly traded companies and 58% of the *Fortune* 500, have held that boards are responsible for ensuring that management implements a compliance and reporting system informed by the federal sentencing guidelines.

The matter goes beyond U.S. legal and regulatory requirements, however. Calls for defined standards of corporate conduct have issued from many corners of the globe. Sparked by corruption and excess of various types – from garden-variety deception and bribery to labor abuses and elaborate schemes of market manipulation – dozens of industry, government, investor, and multisector groups worldwide have proposed codes and guidelines to govern corporate behavior. Examples include the United Nations Global Compact and the Con-

CHRISTIANE GRAUERT

sumer Charter for Global Business. Meanwhile, the European Commission has endorsed conduct codes as a tool for promoting corporate responsibility and urged companies to embrace, at a minimum, the Fundamental ILO Conventions and the OECD Guidelines for Multinational Enterprises. And in other regions, bodies as varied as Hong Kong's Independent Commission Against Corruption, South Africa's King Committee on Corporate Governance, the Brazilian Institute of Corporate Governance, and the Japanese prime minister's 2002 advisory panel on the quality of life have advised companies to develop codes.

While they do not have the force of law – at least, not yet – these initiatives reflect an increasingly global debate on the nature of corporate legitimacy. They are slowly defining the terms and conditions of companies' license to operate – or what is sometimes called the corporate social contract – around the world. By adopting its own code, a company can clarify for all parties, internal and external, the standards that govern its conduct and can thereby convey its commitment to responsible practice wherever it operates.

Company codes serve myriad other practical purposes. A code can help employees from diverse backgrounds work more effectively across geographic and cultural boundaries. It can also serve as a reference point for decision making, enabling companies to operate with fewer layers of supervision and to respond quickly and cohesively in times of crisis. It can even aid in recruitment, helping attract individuals who want to work for a business that embraces world-class standards. Of course, a code can also help a company manage risk by reducing the likelihood of damaging misconduct. And as part of managing their own brands, some companies examine the codes of their potential suppliers and partners. India's Tata Group, for example, requires any company that wants to use the Tata name to adhere to the group's code of ethics.

Given all the legal, organizational, reputational, and strategic considerations, few companies will want to be without a code. But what should it say? Apart from a handful of essentials spelled out in Sarbanes-Oxley regulations and NYSE rules, authoritative guidance is sorely lacking. The codes and guidelines promulgated by business, government, and civic groups in recent years contain a lengthy and confusing menu of possibilities.

In search of some reference points for managers, we undertook a systematic analysis of a select group of codes. After distilling and comparing their content, we sought to identify the motivating

principles behind them. We were surprised to find that, despite the codes' seeming variety, they share many similarities in the standards of conduct they put forth and the ethical principles to which they give expression. We also found that differences among the codes are in many cases complementary rather than conflicting, although the codes do differ on some crucial points that are not easily reconciled.

In this article, we present our findings in the form of a "codex," a reference source on code content. It contains a set of overarching principles and a set of conduct standards for putting those principles into practice. Standards and principles are the bricks and mortar for formulating a code. Standards capture how companies and their personnel should treat their major constituencies, while principles give the standards their legitimacy. Although rarely expressed explicitly, principles answer the question, "Why do we accept these standards as guidelines for our conduct?"

Like any tool, a code of conduct can be used well or poorly – or left on the shelf to be admired or to rust. But the better it is made, the greater the chance it will fulfill its intended purpose.

Our Global Business Standards Codex is intended not as a "model code" that companies should adopt as is, but as a benchmark for those wishing to create their own world-class code. It represents our attempt to gain a comprehensive, but simplified, picture of the conduct expected of today's corporations. The provisions of the codex must be customized to a company's specific business and situation, and individual companies' codes will include their own distinctive elements as well. What the codex provides is a starting point grounded in ethical fundamentals and aligned with an emerging global consensus on basic standards of corporate behavior.

Of course, a world-class code is no guarantee of world-class conduct. A code of ethics can no more ensure ethical conduct than a code of laws can ensure legal conduct. A code is only a tool, and like any tool, it can be used well or poorly – or left on the shelf to be admired or to rust. But the better it is made, the greater the chance it will fulfill its intended purpose.

Collecting the Data

We began by reviewing five widely recognized sets of conduct guidelines for multinational companies: The Caux Round Table Principles for Business (CRT Principles), the OECD Guidelines for Multinational Enterprises (OECD Guidelines), the UN Global Compact, the Interfaith Center on Corporate Responsibility's Principles for Global Corporate Responsibility (ICCR Principles), and the Global Reporting Initiative (GRI). We focused on guidelines for first-order conduct, largely ignoring those for implementation and oversight. We refer to these five sources as "codes" even though only the first four appear in a traditional code format. We tried to infer the governing precepts for conduct behind the GRI's proposed performance indicators.

We chose these codes for several reasons. First, they are meant for companies in general, not for a single company or a specific sector, such as apparel or extractive industries, for which specialized codes have recently been developed. Second, they relate to a broad spectrum of corporate activity rather than a single issue (such as corruption), function (procurement), or constituency (employees). Third, they speak to companies worldwide. Fourth, they are multinational in origin. Finally, each was developed through a multiparty process involving many individual and organizational participants. To date, more than 2,200 companies, including 98 of *Fortune*'s Global 500, have joined the UN Global Compact, and 39 governments have endorsed the OECD Guidelines. Taken together, the multiparty codes reflect a range of views from different sectors of society: business, government, and nonprofit (which includes civic, religious, and environmental organizations).

We also examined the codes of 14 of the world's largest companies, including the top ten in the *BusinessWeek* Global 1000 for 2003 (all from the United States or the United Kingdom) and the top two companies from continental Europe and Asia as shown on the *Financial Times* 2003 list of the World's Most Respected Companies. Since we looked only at companies' codes, however, and not at other documents these companies have issued on specific topics such as conflicts of interest, we do not claim to have a complete picture of the companies' policies.

For U.S. legal and regulatory requirements on code content, we reviewed the Sarbanes-Oxley Act, along with the SEC's implementing regulations and the NYSE and Nasdaq corporate governance rules. We distilled the precepts for corporate conduct found in the 23 sources (the five multiparty codes, the 14 individual company codes, and the four legal and regulatory sources) and categorized them by the constituencies whose interests were principally at stake. (Go to gbscodexresearch.hbr.org to see our background analysis of the combined codes.) As a check on our research, we reviewed numerous other code-of-conduct studies by academics as

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well as organizations such as the Conference Board and the OECD. And to protect against cultural blind spots, we compared the codes of nine companies from five emerging markets: Brazil, China, India, Nigeria, and Russia.

The Common Ground

Viewed together, the source codes contain provisions relating to the six traditional corporate stakeholders: customers, employees, investors, competitors, suppliers/partners, and the public. Although the stances toward these constituencies vary–companies are urged to "create value for," "deal fairly with," or "fulfill obligations to" their constituencies–the codes uniformly recognize that companies have responsibilities to several groups.

A number of general provisions, applying to all activities and all parties, appeared in many documents. Nearly all the codes enjoin companies to observe the law, protect the environment, avoid bribery, and conduct business in a truthful manner. Other recurring provisions include disclosing relevant information in a timely fashion, keeping accurate records, honoring agreements, respecting human dignity and human rights, protecting health and safety, and contributing to society through innovation.

Among the guidelines that apply to specific constituencies, we found those concerning customers to be the most similar. Companies are consistently called upon to meet the quality requirements of customers, protect their health and safety, and treat them fairly. Environmentally safe products and services are also frequently called for, and provisions relating to truthfulness and transparency in customer dealings are among the most common. Privacy and the protection of confidential customer data also receive a moderate level of attention.

Regarding employees, the codes consistently mandate that companies protect workers from injury and illness in the workplace, avoid discrimination, provide equal employment opportunity, and respect their dignity and human rights. Provisions forbidding retaliation against

>> The GBS Codex

For companies that want to assess their code of conduct or craft a new one, we offer the Global Business Standards Codex, a roundup of widely endorsed conduct guidelines for companies around the world. We arranged the standards according to eight underlying ethical principles:

I. **FIDUCIARY PRINCIPLE** page 125
II. **PROPERTY PRINCIPLE** page 127
III. **RELIABILITY PRINCIPLE** page 127
IV. **TRANSPARENCY PRINCIPLE** page 127
V. **DIGNITY PRINCIPLE** page 128
VI. **FAIRNESS PRINCIPLE** page 129
VII. **CITIZENSHIP PRINCIPLE** page 130
VIII. **RESPONSIVENESS PRINCIPLE** page 131

Although many standards are informed by more than one principle, we have listed each standard only once. We also included several supplementary provisions (shown in italics) that are worthy of managers' consideration even though they did not meet our criteria for inclusion in the core group. For clarity, we have indicated which constituency (customers, employees, investors, suppliers/partners, competitors, the public, or even the company itself) is most affected by each. Grounded in ethical fundamentals, this codex can be taken as a first approximation of global best practices for companies and their directors, officers, and employees.

I. FIDUCIARY PRINCIPLE: Act as a fiduciary for the company and its investors. Carry out the company's business in a diligent and loyal manner, with the degree of candor expected of a trustee.

Key Concept	Constituency	Standard
Diligence	Company	Promote the company's legitimate interests in a diligent and professional manner.
		Maintain the company's economic health.
		Safeguard the company's resources and ensure their prudent and effective use.
		Refrain from giving excessive gifts and entertainment.
	Investors	Provide a fair and competitive (or better) return on investment.
Loyalty	Company	Use position and company resources only for company purposes (not for personal gain).
		Disclose potential conflicts between personal and company interests.
		Refrain from activities involving actual conflicts of interest, such as self-dealing and competing with the company.

GBS Codex continued on page 127

employees who report misconduct are also widespread. Various codes mention open communication, responsiveness to suggestions and complaints, fair and reasonable compensation, and assistance in developing skills.

Similarities in provisions relating to investors, suppliers/partners, competitors, and the public are less numerous and less pronounced. Those that do occur are often specific applications of the general provisions. The standards covering suppliers, for example, pick up the fair-dealing, environmental protection, antibribery, and human rights themes introduced earlier.

The Differences

We unearthed a fault line between codes written by people who represent business and those written by groups that represent multiple sectors of society. The business sector codes – those created by the Caux Round Table and by individual companies for their own use – are much more attentive to the economic health of the enterprise and to employees' responsibilities to the corporate entity. By contrast, the four multisector codes (OECD Guidelines, UN Global Compact, ICCR Principles, and GRI) are largely silent on such matters as diligence in carrying out the company's business, prudence in using company resources, and care in protecting company assets. Infrequently mentioned in the multiparty codes are provisions concerning conflicts of interest and self-dealing, issues that were central to the corporate scandals of 2001 and 2002 and that appear prominently in the company codes and the regulators' guidelines. Indeed, conflict of interest has historically been among the most frequently covered topics in company codes.

Not surprisingly, the business sector codes place more emphasis on responsibilities to investors. Only one of the multisector codes (GRI) addresses financial returns to investors, and none mentions insider trading, whose prohibition is required by regulatory guidelines and which is in fact prohibited by the majority of company codes. Investor and financial concerns are not wholly neglected in the multisector codes. Two codes call on companies to provide investors with accurate and timely information, and one requires them not to obstruct share owners' legal rights. Moreover, the multisector codes include general precepts on financial disclosure, accounting, audits, and financial reporting. But the specific requirements of economic trusteeship – insofar as it involves the creation of economic value – receive little attention.

The multisector codes also have comparatively little to say about business-to-business conduct, especially between competitors. While the multisector codes issue broad guidelines such as "adhere to competition laws" and "cooperate with competition authorities," the business sector codes call explicitly for free and fair competition, respect for rivals' property rights, and appropriate gathering of competitive information. In the supplier/partner domain, the multisector codes focus on labor and environmental standards, while the business codes address a wider set of issues.

Compared with the business sector codes, the multisector codes are more oriented toward employees and the general public. For example, all the multisector codes call on companies to recognize employees' right to free association and collective bargaining, whereas only four of the business sector codes do (and three of those are from non-U.S. companies). Similarly, all the multisector codes include restrictions on using forced and child labor; only five company codes do. While topics such as employment safeguards and reasonable notice of major employment changes receive attention from multisector groups, the NYSE governance rules explicitly state that codes may preserve at-will employment arrangements. That is, under the NYSE's rules, companies may follow the long-standing and unique-to-the-U.S. legal

principle that, in the absence of an employment contract of specific duration, an employee may be dismissed at any time – with or without notice.

The themes of stakeholder responsiveness and engagement are much more prominent in the multisector codes. For example, the GRI and the ICCR Principles call for worker participation in certain decisions and activities, and the OECD Guidelines call for cooperation with government authorities and community officials. The ICCR document even proposes that companies go beyond dialogue and actually abide by the recommendations put forth by some stakeholders, though it is the only code that makes such a recommendation.

The two groups of codes also reflect different postures toward public policy concerns. The multisector codes ask companies to actively address such issues as corruption, labor practices, human rights, and environmental protection. Apart from the CRT Principles, few of the business codes take an activist stance on these issues. The business codes typically condemn bribery, labor abuses, and environmental degradation in companies' own operations; but the multisector codes go further, advocating that companies reach out to persuade others – in their value chain, in their community, in the society at large – to address these issues as well.

The appropriate scope of corporate activism is up for debate. Many of the codes–especially the multiparty codes–ask companies to collaborate on, contribute to, or otherwise support causes that are of broad public significance. Under the UN Global Compact, companies are even charged with providing health, education, and housing for employees in certain circumstances. The CRT Principles say that companies should promote free trade, open markets, and democratic institutions. But such activity is arguably an incursion into the powers of the state. By the dictates of classical liberalism, such matters should be handled by public officials following democratic ideals of participation and due process. To be sure, the multiparty codes enjoin companies

GBS Codex: FIDUCIARY PRINCIPLE, continued

Loyalty	Company	Refrain from receiving excessive gifts and entertainment.
		Refrain from pursuing for personal benefit opportunities discovered through position or company resources.
	Investors	Refrain from trading in the company's securities on the basis of confidential company information.

II. PROPERTY PRINCIPLE: Respect property and the rights of those who own it. Refrain from theft and misappropriation, avoid waste, and safeguard the property entrusted to you.

Key Concept	Constituency	Standard
Protection	Company	Protect company assets, including confidential and proprietary information, funds, and equipment.
Theft	Company	Do not misappropriate company resources through theft, embezzlement, or other means.
	Competitors	Respect rivals' property rights, including those regarding intellectual property.

III. RELIABILITY PRINCIPLE: Honor commitments. Be faithful to your word and follow through on promises, agreements, and other voluntary undertakings, whether or not embodied in legally enforceable contracts.

Key Concept	Constituency	Standard
Contracts	Suppliers/ Partners	Pay suppliers and partners on time and in accordance with agreed-on terms.
Promises	All	Honor promises and agreements.
Commitments	All	Fulfill implicit and explicit obligations to all constituencies.

IV. TRANSPARENCY PRINCIPLE: Conduct business in a truthful and open manner. Refrain from deceptive acts and practices, keep accurate records, and make timely disclosures of material information while respecting obligations of confidentiality and privacy.

Key Concept	Constituency	Standard
Truthfulness	All	Be honest and respect truth in all activities.
		Record transactions in a fair and accurate manner.
	Suppliers/ Partners	Deal with suppliers and partners honestly.
Deception	Customers	Avoid deceptive and misleading statements and omissions in customer-related activities, such as marketing, sales, and research.
	Competitors	Do not acquire commercial information by dishonest or unethical means.

GBS Codex continued on page 128

GBS Codex: TRANSPARENCY PRINCIPLE, continued

Disclosure	All	Make timely disclosures of relevant financial and nonfinancial information.
		Engage in transparent accounting and financial reporting.
	Investors	Provide investors with relevant, accurate, and timely information.
	Customers	Give customers adequate health and safety information, warnings, and labels.
		Provide accurate information about the content, use, and maintenance of products.
	Employees	*Give reasonable notice of operational changes likely to have a major effect on employees' livelihood.*
Candor	Employees	Communicate in an open and honest manner, subject to legal and competitive constraints.
	Public	Communicate and consult with communities affected by environmental, health, and safety impacts of the enterprise.
Objectivity	All	Adhere to independent auditing and financial-reporting standards.

V. DIGNITY PRINCIPLE: Respect the dignity of all people. Protect the health, safety, privacy, and human rights of others; refrain from coercion; and adopt practices that enhance human development in the workplace, the marketplace, and the community.[1]

Key Concept	Constituency	Standard
Respect for the Individual	All	Respect the dignity and human rights of others.
	Employees	Adopt work practices that respect employees' dignity and human rights.
		Prevent harassment in the workplace.
	Suppliers/ Partners	Prefer suppliers and partners whose employment practices respect dignity and human rights.
	Public	Support and protect human rights within the company's sphere of influence.
Health & Safety	All	Protect human health and safety.
	Customers	Ensure that products and services sustain or enhance customer health and safety.
	Employees	Protect employees from avoidable injury and illness in the workplace.
		Provide a work environment that is free from substance abuse.
	Suppliers/ Partners	*Prefer suppliers and partners whose work practices respect international labor standards on health and safety.*

GBS Codex continued on page 129

to recognize the government's jurisdiction over society at large, to avoid improper involvement in politics, and to pay their taxes in a timely manner. And the individual companies' codes seem to concur – at least with the first two provisions. (Company codes rarely discuss tax obligations.)

Yet the proper division of labor among companies, governments, and civic actors is far from settled. Differences may well reflect disparate underlying assumptions about democracy and due process. In democratic societies that have accountable governments, corporate activism may seem unnecessary or unjustified, whereas the absence of a legitimate and well-functioning government may make corporate activism seem essential.

To the extent that individual companies do adopt an activist position, it is likely to be issue specific – focused, for example, on the environment, bribery, or human rights. Companies also seem less reluctant to use their influence to shape the practices of their suppliers and partners than to embrace general public advocacy. Indeed, more than half the company codes require suppliers and partners to refrain from bribery, and a similar number say preference should be given to those who observe applicable environmental standards. Overall, though, while the multisector codes are more activist than the business codes, individual companies can be found on all points of the activism spectrum.

Not all differences among the codes track the divide between business and nonbusiness perspectives, and some follow no obvious pattern. One example is the treatment of compensation, a topic addressed explicitly by the CRT Principles, two multisector codes, and four company codes. While the CRT Principles call for "compensation that improve[s] workers' living conditions," the company codes favor pay that is "fair" or "competitive." Depending on market conditions and how these terms are interpreted, the required pay levels could be quite similar – or they could be radically different.

Governing Principles

Despite such differences in emphasis and content, we found that most of the roughly 130 precepts we identified in the 23 source documents could be seen as practical applications of just eight basic principles, most of which echo long-standing themes in ethical and legal thought. Without insisting on a rigid system of classification, we found that the standards cluster loosely around the following principles:

The Fiduciary Principle. By law, the officers and directors of a corporation are fiduciaries for the company and its shareholders. However, all employees stand in a fiduciary relationship to the corporate entity in that they are entrusted to protect its resources and act on its behalf in carrying out their job-related responsibilities. Traditionally, trusteeship has included duties of diligence, candor, and loyalty to the beneficiary over the self. Thus, disclosing conflicts of interest and prohibitions on unauthorized self-dealing have been traditional guidelines for trustees. The same logic dictates that fiduciaries may not benefit themselves at the expense of the entity they serve – by, for example, pursuing for their own personal benefit business opportunities that belong to the corporation. At the core of the fiduciary principle, however, is the notion of diligence, prudence, and energetic effort applied in the service of another. Negligence, carelessness, and half-hearted effort are clear, if less frequently discussed, violations of this principle. Although fiduciary concepts are not covered in the multisector codes, they are central to the functioning of the economy and should, under recent regulations on code content, be included in any company's code.

The Property Principle. Whether justified by arguments from the standpoint of human dignity and liberty or from that of wealth maximization and economic development, the property principle is today regarded as central to individual and societal well-being, the ultimate test of any ethical system. Theft and embezzlement of tangible property are the classic violations of this

GBS Codex: DIGNITY PRINCIPLE, continued

Privacy & Confidentiality	Customers	Respect customers' privacy.
		Protect confidential customer information.
	Employees	Respect employee privacy.
		Protect confidential employee information.
Use of Force	Employees	Abstain from directly or indirectly using forced or child labor.
	Public	Ensure that security personnel respect international standards on the use of force.
		Contribute to the elimination of forced labor and abusive labor practices.
Association & Expression	Employees	Recognize employees' right to free association and collective bargaining.
	Suppliers/ Partners	*Prefer suppliers and partners whose work practices respect international labor standards on free association and collective bargaining.*
	Customers	*Respect customers' cultures.*
	Public	Respect local cultures.
Learning & Development	Employees	Assist employees in developing skills and knowledge.
		Create employment opportunities that enhance human development.
Employment Security	Employees	Safeguard employment and employability.

VI. FAIRNESS PRINCIPLE: Engage in free and fair competition, deal with all parties fairly and equitably, and practice nondiscrimination in employment and contracting.

Key Concept	Constituency	Standard
Fair Dealing	All	Deal fairly with all parties.
	Investors	Deal fairly with minority share owners.
	Customers	Treat customers fairly in all aspects of transactions.
		Set prices that are reasonable and commensurate with quality.
	Employees	Offer fair and reasonable compensation.
	Suppliers/ Partners	Deal fairly in all activities, including pricing, licensing, and rights to sell.
Fair Treatment	Employees	Practice nondiscrimination and provide equal employment opportunity.
	Suppliers/ Partners	*Provide equal opportunity to suppliers owned by minorities and women.*

GBS Codex continued on page 130

GBS Codex: FAIRNESS PRINCIPLE, continued

Fair Treatment	Suppliers/ Partners	*Prefer suppliers and partners whose employment practices respect international labor standards on nondiscrimination.*
Fair Competition	Competitors	Engage in free and fair competition.
		Refrain from colluding with competitors on prices, bids, output, or market allocations.
		Refrain from seeking or participating in questionable payments or favors to secure competitive advantage.
	Suppliers/ Partners	Require suppliers and partners to refrain from bribery and improper payments.
Fair Process	Employees	Do not retaliate against employees who report violations of law or company standards.

VII. CITIZENSHIP PRINCIPLE: Act as responsible citizens of the community. Respect the law, protect public goods, cooperate with public authorities, avoid improper involvement in politics and government, and contribute to community betterment.

Key Concept	Constituency	Standard
Law & Regulation	All	Obey applicable laws and regulations.
		Do not participate in money laundering or other illegal activities that support terrorism, drug traffic, or other organized crime.
	Investors	Do not obstruct legal rights of share owners.
	Competitors	Adhere to competition laws.
	Public	Adhere to environmental laws and standards domestically and internationally.
		Adhere to the letter and spirit of tax laws and make timely payments of tax liabilities.
Public Goods	All	Do not condone or participate in bribery or other forms of corruption.
		Protect and, where possible, improve the natural environment.
		Promote sustainable development.
	Customers	Ensure that products and services sustain or enhance the natural environment.
	Suppliers/ Partners	Prefer suppliers and partners who observe applicable environmental standards.
	Public	Do not use lack of scientific certainty as a reason to postpone cost-effective measures to address threats of serious damage to the environment.

GBS Codex continued on page 131

principle, and injunctions against these behaviors are found across the ages. As intangible property has grown in importance, definitions of theft have expanded to include misappropriation of intellectual property and other types of proprietary information. Respect for property continues to mean safeguarding the property in one's rightful possession, avoiding waste, and not infringing on the property rights of others. The codes we examined make relatively few explicit references to these mandates – perhaps because they are so ingrained as to be assumed – but a few provisions specifically enjoin the protection and maintenance of property and forbid theft and other forms of misappropriation.

The Reliability Principle. Several directives invoke the principle of reliability, or fidelity to commitments. To cope with uncertainty, most societies have developed ethical norms around keeping promises, fulfilling contracts, and even carrying out one's stated intentions – especially if meant to induce reliance by others. Complex schemes of cooperation would not be possible without these ways of forming binding commitments, as they allow different parties to coordinate their activities into an unknown future. They bring an element of predictability to an otherwise unpredictable flow of events. The law of contract is an elaboration of this basic idea. As legal scholar Charles Fried has observed, "By promising we transform a choice that was morally neutral into one that is morally compelled." Classic violations of the reliability principle include breach of promise, breach of contract, and other less formal types of betrayal or going back on one's word. More generally, the reliability principle implies care in making commitments – not promising more than one can deliver – and in following through on agreements and other obligations that are voluntarily incurred.

The Transparency Principle. A number of directives are concerned with accuracy, truth, and disclosure of information – or what has come to be called "transparency." Although this term does not signify total openness, its core ideas

of honesty and respect for truth have been treated as fundamental ethical imperatives from time immemorial. Injunctions against fraud and deceit – the characteristic violations of this precept – are found in many ethical traditions and virtually all legal systems. Transparency also implies taking care to present information accurately and not to mislead. And it may mean correcting misinformation or offering information that is material to the recipient in important ways – affecting personal or financial well-being, for instance. Justifications for such transparency requirements include promoting dignity and freedom, enabling wise decision making, advancing knowledge, enabling cooperation, promoting society's ability to function, ensuring economic efficiency, preventing corruption, and, simply, upholding the intrinsic value of truth.

The Dignity Principle. Although corporate officials and employees have fiduciary obligations to protect and promote the company's interests, they are nonetheless expected to do so in a way that respects other people – whether those people are other employees, customers, supply chain workers, or members of the general public. Indeed, respect for the person is perhaps the starting point for all ethical thought. It leads directly to protections for health, safety, expression, and privacy, and to proscriptions on humiliation, coercion, and offenses against basic human rights. It also implies affirmative efforts to develop human potential, and it often means special concern for those who are incapacitated or otherwise particularly vulnerable. All of the codes include at least some provisions that ensure respect for the person.

The Fairness Principle. The concept of fairness has been central to ethical thought throughout the ages. Its importance rests on its role in facilitating cooperation, securing legitimacy, and ensuring group survival. Four types of fairness have received particular attention: reciprocal fairness, or fairness in exchange; distributive fairness, or equity in allocating benefits and burdens

GBS Codex: CITIZENSHIP PRINCIPLE, continued

Cooperation with Authorities	Customers	Cooperate with public authorities to address threats to public health and safety from the company's products and services.
	Employees	Cooperate with employee groups, government, and others to address employment dislocations created by business decisions.
Political Noninvolvement	Public	Recognize government's obligation and jurisdiction concerning society at large.
		Avoid improper involvement in political activities and campaigns.
Civic Contribution	All	Contribute to the economic and social development of local communities and the world.
		Develop innovations in technology, products, processes, and practices.
	Public	Contribute to charitable causes.
		Support employee involvement in civic affairs.
		Take a leading role in preserving and enhancing the physical environment.

VIII. RESPONSIVENESS PRINCIPLE: Engage with parties who may have legitimate claims and concerns relating to the company's activities, and be responsive to public needs while recognizing the government's role and jurisdiction in protecting the public interest.

Key Concept	Constituency	Standard
Addressing Concerns	Investors	Respect share owners' requests, suggestions, complaints, and formal resolutions.
	Customers	Offer products and services whose quality meets or exceeds customers' requirements.
		Provide timely service and remedies for customer complaints.
	Employees	Engage in good-faith negotiation in cases of conflict.
		Respond to employees' suggestions, requests, and complaints.
Public Involvement	Public	Collaborate with community groups, and support public policies that promote economic and social development.
		Cooperate in efforts to eliminate bribery and corruption.
		Support and protect democratic institutions.
		Support diversity and social integration.

1. In corporate codes, the term "human rights" typically refers to the issues of nondiscrimination, health and safety, and rights to free association. The term "international labor standards" generally refers to this set of issues as well.

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among members of a group; fair competition, which concerns conduct among rivals; and procedural fairness, which entails due process.

Fairness has many interpretations, but treating like cases alike is a core aspect. Unfairness almost always involves differential treatment – favorable or unfavorable – among parties that are similarly situated. Although some forms of differential treatment are quite legitimate, the vast majority of the codes we reviewed forbid discrimination among employees on the basis of non-work-related characteristics, and equal pay for equal work is a recurrent idea. Many of the codes also call more generally for fair treatment, as well as fair competition and fair dealing.

We offer the codex not as a minimum code but as a reference that companies can use to assess their current code or to craft a new one.

The Citizenship Principle. The various codes differ considerably on the degree to which companies should be activists on public and societal issues, but they agree on several basic issues of citizenship. Perhaps the most fundamental civic duty is respect for law, and all the codes call for observation of relevant laws and regulations. In addition, citizens are generally thought to bear some responsibility for maintaining the "commons" – such shared and indivisible goods as the natural environment, public spaces, or legitimate government. Just as individuals should clean up after themselves, companies, too, should repair any damage to the commons resulting from their activities. Beyond this baseline, citizenship implies a willingness to deal with public authorities in good faith and may even imply some additional contribution by way of charity, civic support, or help in addressing broad societal problems.

The codes include several directives pertaining to the duties of citizenship and their classic violations, such as breaking the law, freeloading, and bribing public officials. At the same time, the codes make clear that the corporation is no ordinary citizen. Rather than being full participants in the political and public policy–making processes, companies are directed to avoid "improper" involvement in political activities and to recognize the government's obligation and jurisdiction concerning society at large.

The Responsiveness Principle. Unlike the previously discussed principles, this one may have its origins in the modern corporate context as a corrective to the indifference that often characterizes bureaucratic systems. It implies a readiness to engage with other parties that may be affected by a company's activities or may have a justifiable claim (even if not an entitlement) to attention. Although the multisector codes typically call for greater responsiveness than the business codes, the CRT Principles strike something of a middle ground, with precepts on engaging with suppliers and responding to complaints and suggestions from customers, employees, and investors.

• • •

Some of the provisions found in our source codes – avoid fraud, for instance, and ensure a safe working environment – arise from only one main principle. Others, like guidelines on gifts and entertainment, have links to several. For example, much of what passes for business entertainment may be more aptly described as personal entertainment at corporate expense. Such diversions of corporate property to personal use are not only breaches of fiduciary obligation, but they are also a form of waste that violates the property principle. And in some cases, excessive gifts are simply a means to secure an unfair competitive advantage.

Although the principles have ancient roots, the precepts found in the codes are tailored to the modern business con-

text and recognize the corporate entity as an actor in its own right. In these respects, the codes reveal their contemporary origins, for the modern corporation is a relatively recent invention, and the idea that businesses should observe a set of ethical standards is even more recent. In early-twentieth-century legal circles, the corporation's capacity for moral judgment and responsibility was hotly contested. The idea continues to be debated by a few theorists, though by now it is widely accepted – as evidenced by the sheer number of corporate codes of ethics.

By emphasizing the common threads running through these codes and connecting them to enduring themes in ethical and legal thought, we do not mean to deny important differences in how the precepts are understood and applied around the world. Nor do we suggest that they are consistently observed. But we do see an emerging core of global standards of conduct.

The core precepts articulated in these codes reflect ethical principles that have arisen to address problems and concerns in virtually all societies – problems of trust, cooperation, fairness, safety, security, and so on. Given the central role of business in society today, it is not surprising that these same principles should be applied to corporate behavior. We urge business leaders to heed the rising chorus and to take steps now to ensure that their companies' practices are, in fact, up to code.

Creating the Codex

The Global Business Standards Codex reflects our findings on standards of conduct as well as our conclusions about the ethical principles informing them. At its core is the body of standards around which we found wide agreement. This group includes not only regulatory requirements and items that appeared with some consistency across the various codes but also ones that occurred with high frequency in either business sector *or* multisector codes. For example, we included provisions on conflicts of interest, the use of company resources, and employee privacy – topics that appear in half or more of the company codes but in few of the multisector codes. By the same reasoning, we included provisions on forced and child labor and employees' right to free association, both listed in all the multisector codes but in only a handful of the business sector codes.

In a few instances, we included provisions that we judged to be important and required by the underlying principles of the codex even though they appeared infrequently. Fair treatment of minority share owners and responsiveness to share owners' concerns, for example, were mentioned in only one company code and absent from most of the multisector codes.

We organized the codex by principle to reveal the ethical basis of the various standards. To facilitate implementation, the codex also displays the main constituency affected by each provision. Although further research will be required to determine the extent to which companies actually adhere to these standards, the codex may be taken as a first approximation of global best practice.

As we said at the beginning, we offer the codex not as a minimum code but as a reference that companies can use to assess their current code or to craft a new one. Some may adopt a minimalist approach, avoiding violations of the principles and standards articulated here. Others may focus on achieving excellence, enacting these principles in their most robust form. Many will want to take a position on issues outside the consensus area or include their own distinctive values and commitments alongside the basics found in the codex. But all will want to consider where they stand relative to this set of widely recognized standards of conduct for global business.

If our hypothesis is correct, companies will ultimately be judged – and their very license to operate may in some cases depend – on their responsiveness to this emerging global consensus.

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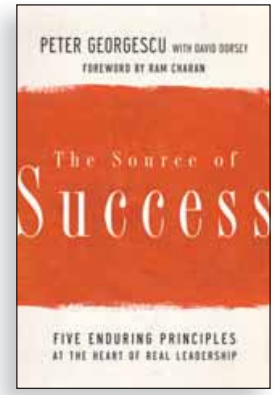

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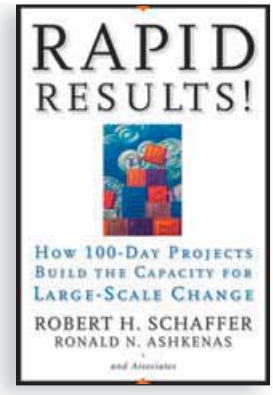

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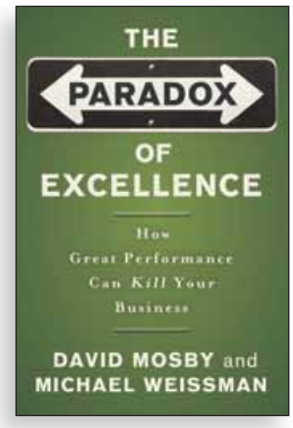

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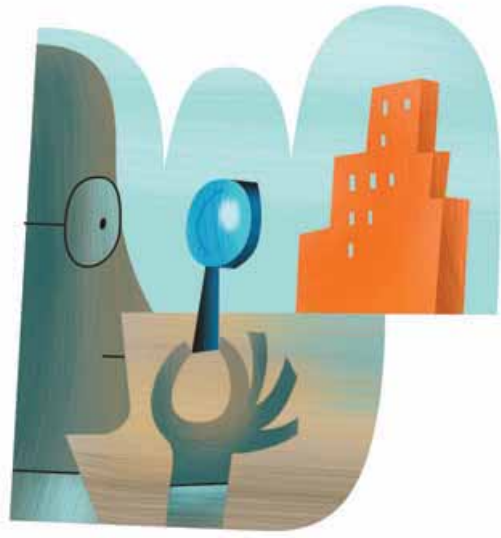

DOUG ROSS

It's not easy to make money by offshoring business processes, many CEOs are discovering. Companies benefit only when they pick the right processes, calculate both the operational and structural risks, and match organizational forms to needs.

Getting Offshoring Right

by Ravi Aron and Jitendra V. Singh

In 2003, Alpha Corp., a well-known U.S.-based organization, offshored and outsourced several customer-retention processes. When the company found that some of its customers seemed likely to switch to rivals, it provided data on them to an outsourcing firm in India. The service provider called those customers and, on Alpha Corp.'s behalf, offered them fee waivers, upgrades, and free financial products as incentives to remain with Alpha Corp.

A common, but rarely discussed, offshoring scenario then played out.

The vendor's employees were enthusiastic, but they didn't have much experience selling sophisticated financial products such as disability and loss-of-income insurance. As a result, they didn't know how to interpret customers' responses to the incentives they were offering and found it difficult to decide what to do when customers asked them for other incentives. In fact, the provider's employees often placed people on hold in order to contact Alpha Corp.'s supervisors and ask whether to give customers what they wanted.[1] As the demands on Alpha Corp.'s marketing managers rose and the vendor was unable to retain as many customers as it had hoped, Alpha Corp.'s executives began to wonder, "What have we done?"

They aren't the only executives asking that question today. Cut through the hype, and you'll find that, like Alpha Corp., many companies are waking up and smelling the harsh realities of offshoring. Sure, the prospect of offshoring and outsourcing business processes has captured the imagination of CEOs everywhere. In the last five years, many companies in North America and Europe have experimented with this strategy, hoping to reduce costs, become more efficient, and gain a little strategic

advantage. However, contrary to popular perception, many businesses have had, at best, mixed results. According to several studies, half the organizations that shifted processes offshore failed to generate the financial benefits they expected to. Many also faced resistance from employees as well as consumer dissatisfaction. In early 2005, both the Boston Consulting Group and Gartner predicted that 50% of the offshoring contracts that companies in North America had signed between 2001 and 2004 would fail to meet expectations. No wonder the "I" words, inshoring and insourcing, have become almost as popular in business circles as the two "O" words.

As academics who have studied the subject in several countries, industries, and companies for more than four years, we can't say we're shocked. Most companies believe it's easy to offshore business processes – easier than it was in the 1980s to procure components from global suppliers or to set up manufacturing plants overseas. Businesses therefore don't make decisions about offshoring systematically enough. As a result, they commit at least one of three fundamental mistakes.

First, most companies focus their efforts on choosing countries, cities, and vendors, as well as on negotiating prices, but they don't spend time evaluating which processes they should offshore and which they shouldn't. Without a standard methodology for differentiating processes, most executives find it tough to distinguish among *core* processes that they must control, *critical* processes that they might buy from best-in-class vendors, and *commodity* processes that they can outsource. They endlessly debate the differences between the core and critical ones, and after political tussles break out, diktats from the top mandate that some processes be sent offshore. Companies inevitably make the wrong choices and, after offshoring or outsourcing processes that they think aren't strategic, have to bring some back in-house.

Second, most organizations don't take into account all the risks that accompany offshoring. Executives use simple cost/benefit analyses to make decisions without realizing, for instance, that after they transfer processes, their vendors will gain the upper hand. Providers can hold companies to ransom; it's almost impossible for organizations to reabsorb business processes on short notice. Most organizations naively ignore these latent risks and are shocked when vendors demand price hikes that erode the savings from outsourcing.

Finally, most companies don't realize that outsourcing is no longer an all-or-nothing choice – that they have a continuum of options. At one end, there's executing processes in-house; at the other, there's outsourcing them to service providers. Along that continuum, companies can buy services from local providers (a lot of outsourcing is local), enter into joint ventures, or set up captive centers overseas. Most businesses don't consider all the available options and end up using organizational forms that are inappropriate for their purposes. They also analyze processes too narrowly, looking only at direct costs and failing to examine interdependencies that might tip the cost/benefit analysis in favor of keeping services in-house. Making the right governance choices is critical; our research shows that both location and organizational form decide the fate of offshoring strategies.

Clearly, companies have to rethink the manner in which they formulate their offshoring strategies if they wish to succeed. In the following pages, we'll outline tools that will help companies choose the right processes to offshore, and discuss the associated risks. We will also describe a new kind of organizational structure and show how companies can use it to benefit from offshoring. Don't misunderstand; smart companies have gained strategic advantage by offshoring processes. Your company can also harness the power of the services revolution by taking three steps, one at a time.

Rank Processes by Value

Executives can distinguish, at the outset, between business processes they should and shouldn't offshore by figuring out how each process helps them to create value for customers and to capture some of that value. The relative importance of a process along those two dimensions indicates the risks and rewards associated with moving its execution outside the organization or country. Executives instinctively know the importance of these criteria but usually don't know how to factor them into decisions about offshoring.

There's a simple way executives can do that. They should answer the question, How crucial is each process (or subprocess) compared with others in creating value for my company's customers? The answers will differ from business to business and, often, by industry. In the consumer goods industry, for instance, executives usually rate product-development processes higher than customer-service processes, while in the hotel industry, the opposite is true. Next, managers must ask, In relative terms, to what degree does each process enable my company to capture some of the value that it has created for customers? They must rank each process along these two dimensions, then add the two rankings together to arrive at

According to several studies, half the organizations that shift processes offshore fail to generate the expected financial benefits.

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a total ranking for each process. Sometimes, executives may feel that one of the two dimensions is more important in the industry or for their company. In that case, they must calculate the total rankings after assigning greater weight to the more important aspect. For instance, retail banks believe that making money is tougher than developing new consumer finance products. They tend to rate the value-capture aspect of their processes higher than they do the value-creation dimension.

By ranking all the company's processes, executives can create a value hierarchy. The higher a process's rank in the hierarchy, the more crucial it is to the company's strategy, and the less the organization should think about moving it offshore or outsourcing it. The hierarchy tells companies where the fault lines between processes are and lays out an offshore migration path. For example, at one U.S.-based computer and communications equipment manufacturer we worked with, senior executives unanimously agreed that of six processes in the finance function, managing the float for suppliers and dealers had the highest relative importance (see the exhibit "Creating a Value Hierarchy of Processes"). That alerted managers that it would be risky to offshore or outsource the process; even if the service provider made only a few errors, it would hurt the firm's dealers and suppliers financially and tarnish the company's reputation. The executives also felt that managing the company's working capital was too important to offshore. At the same time, the group decided that three other processes – invoice verification, payment authorization, and revenue and expense reporting – were less valuable and that the company could think about offshoring or even outsourcing them. Some of the executives also believed that at a later date, the business could offshore the cash-flow forecasting operation. This analysis became the basis of the company's offshoring strategy, which so far has been successful.

When executives, usually from the same department, sit around a table and draw up a value hierarchy, it serves several purposes. The ranking provides a standard basis for comparing processes across the company, which makes discussions about offshoring more constructive. Executives often rank the same business process differently; drawing up the hierarchy highlights these differences. That helps surface tensions around offshoring decisions. Above all, the value hierarchy allows managers to think systematically about the importance of processes without getting into interminable debates about what the company's core processes are or how critical its critical processes are.

Creating a Value Hierarchy of Processes

Executives in a company's finance department, charged with identifying business processes to offshore, ranked six processes on their ability to create value for customers and on their ability to capture value for the business. They then added the value-creation ranking and the value-capture ranking together to arrive at a total for each process. When they studied the final rankings, or hierarchy, the executives agreed that they could offshore the three lowest-ranking processes; the two highest-ranking processes, they decided, were too strategically valuable to offshore.

Process	Value-creation ranking*	Value-capture ranking*	Total ranking	
Float management for suppliers and dealers	1	1	**2**	Processes the company shouldn't offshore
Working capital management	2	3	**5**	
Cash-flow forecasting	4	2	**6**	
Revenue and expense reporting	3	4	**7**	Processes the company might offshore
Payment authorization	5	5	**10**	
Invoice verification	6	6	**12**	

*Determined by executive consensus

Identify and Manage Risk

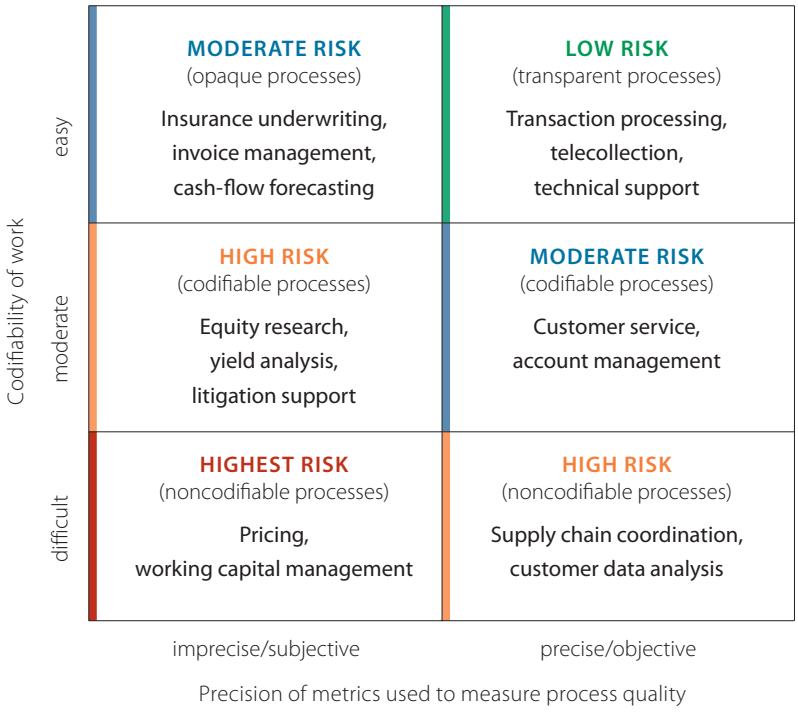
Once a company has established that some of its processes can be offshored or outsourced, it must tackle all the risks that could affect their migration. Companies face two very different kinds of risk: operational and structural. The former may be more critical in the initial stages of offshoring and outsourcing, but over time, the latter swells in importance.

Operational Risk. Smart companies start off assuming that service providers won't be able to execute business processes as well as their employees perform them in-house – at least, not for a long time. Unlike the manufacture of components, firms can't provide vendors with specifications and expect them to carry out tasks perfectly. Until service providers move up the learning curve, they will make more errors and execute tasks more slowly than companies' employees do. That often results in lower customer satisfaction.

Businesses can try to lower operational risk by tackling its twin causes, the first of which is an organization's ability to codify work. When companies document the work that employees

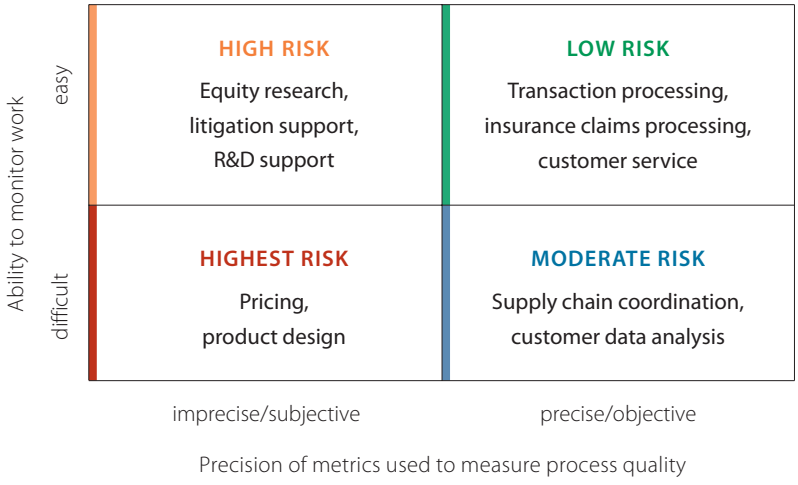
Evaluating Operational Risk

To evaluate operational risk (the risk that processes won't operate smoothly after being offshored), companies should classify processes by how precise their metrics for quality are, as well as the extent to which work can be codified. We've listed some processes that, our research shows, fall into each category.



Evaluating Structural Risk

To ascertain structural risk (the risk that relationships with service providers may not work as expected), companies should look at how precise their quality metrics are, as well as the extent to which the execution of processes can be monitered. Most processes fall into one of four categories.



do, describe the different situations they face, and stipulate what employees' responses should be in each scenario, people anywhere in the world can do the job for them. For instance, if a European retail bank has drawn up rules about when it will give customers loans, has stipulated the procedures for resolving exceptions to accounting norms, and has laid down when it will hold financial instruments in suspense accounts, managers on any continent can perform those tasks for the bank with minimal supervision. Investment banks can outsource even complex tasks like equity research as long as they codify the tasks involved. However, if a service provider's employees require a great deal of domain experience – information about the client's customers, a deep understanding of how its product and geographic markets function, and knowledge that the client's managers carry in their heads – to execute processes, they are unlikely to get those processes right for a long time. (For more on codifying knowledge in the workplace, see Dorothy Leonard and Walter Swap's article "Deep Smarts," HBR September 2004.)

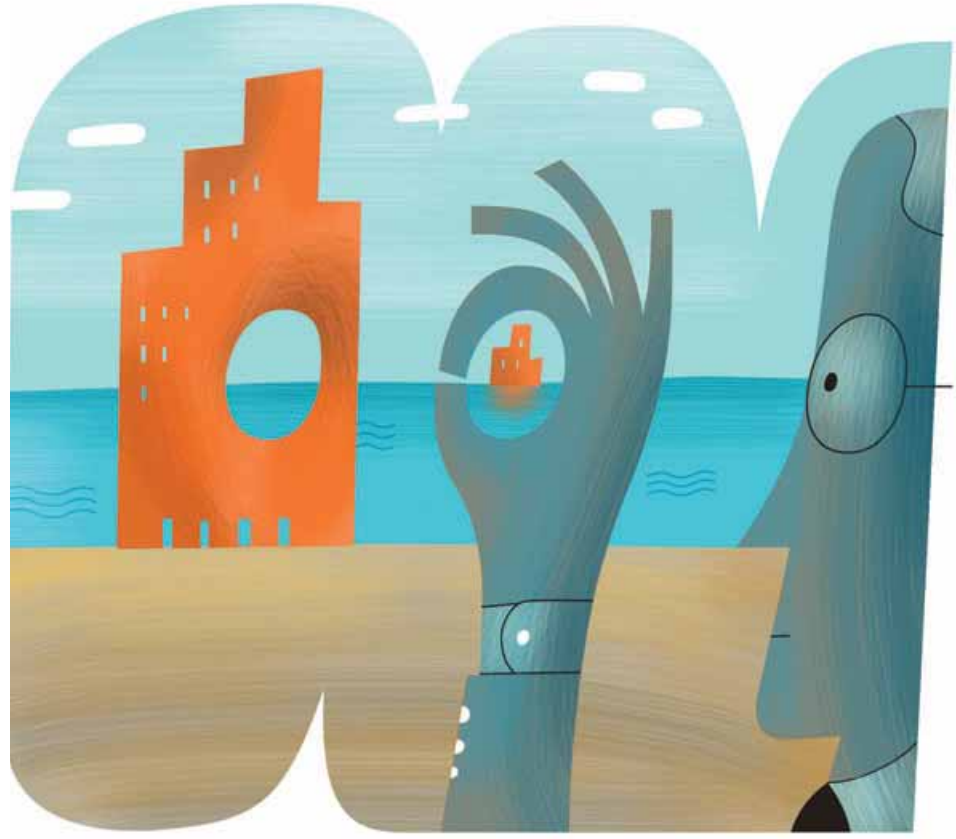
The second cause of operational risk is a company's use of metrics to measure the quality of processes. Many businesses, we find, haven't developed effective metrics, or they formulate metrics for the first time when they outsource processes. Both increase operational risk because, when such companies offshore or outsource processes, they have no way of knowing if providers have executed those processes better or worse than their employees did. Businesses would do better to create metrics, measure the quality of processes for a while, and improve their quality in-house before deciding to offshore or outsource them.

We cannot stress enough the importance of drawing up metrics; what a firm doesn't measure, it can't offshore well. According to our research, companies that define metrics subjectively usually end up with costly errors and long gestation periods before their providers execute processes effectively. Only firms that set tolerance limits for errors, draw

up completion times and productivity norms, and continuously measure employees' performance are able to move processes offshore. In 2002, when Lehman Brothers decided to offshore the development of some information technology–related processes, it identified lower costs, higher quality, and faster deployment of new systems as its goals. The investment bank drew up several metrics that allowed it to measure its service providers' performance along each of those dimensions. Lehman Brothers measured vendors' performance every month and, after a year, found that its providers had exceeded the cost-savings targets while delivering the same quality of execution as the bank's in-house operations. However, the time the vendors took to develop new systems was below expectations. Not only was Lehman Brothers able to take corrective action, but its focus on continuous measurement also allowed it to quickly ramp up its offshore operations, both in terms of volume and complexity.

Interestingly, the belief that offshoring linear processes – where one person hands off work to another person – poses less operational risk than offshoring processes where work flows back and forth between people is dead wrong. Just because a process is linear doesn't mean that it's easy to outsource. We've seen several linear processes, such as inventory control in consumer goods industries and wealth management–related processes in financial services, that businesses couldn't offshore because they didn't have good metrics to measure process quality. Moreover, our studies show that the nature of information flows doesn't affect the quality of execution. If companies codify work and develop metrics to evaluate quality, they can contain operational risk even if work constantly moves between companies' employees and vendors' agents.

When companies look at the extent to which they codify work and use metrics to measure process quality, they'll see that their processes fall into four distinct categories (see the exhibit "Evaluating Operational Risk").



Transparent Processes. Companies have metrics to measure the quality of processes, and they can codify the work. The operational risk of offshoring and outsourcing these processes is very low.

Codifiable Processes. Companies have some ability to measure the quality of execution and can codify most of the work. Still, only people who have formally mastered a body of knowledge, such as accountants and lawyers, can execute these tasks. It's also inherently difficult to manage the quality of the work in real time. If firms can measure the quality of the end result, the risk of offshoring or outsourcing the processes becomes manageable. However, if measuring the results is difficult, the risk of offshoring becomes very high.

Opaque Processes. Companies can codify the work, but they cannot measure the quality of process outputs. When firms underwrite insurance policies, for instance, it's difficult for them to measure how well their employees have executed the task since the events that policy buyers are protecting themselves from may never occur. Although the risks of offshoring these processes are moderate, companies have to inspect samples to ensure that the output meets their quality standards. That's often cumbersome and expensive. If companies specify how the outsourcer's agents should do their work and offer them performance-based rewards and penalties, they can lower the risk of offshoring these processes.

Noncodifiable Processes. Companies cannot easily codify the work because the variation in business events and employees' responses are too great to permit standard responses. Although it's often tough, companies may be able to evaluate the quality of execution. For instance, if employees don't fulfill orders correctly, customers will cancel those orders or return products. These processes are prone to a high degree of operational risk. If organizations do outsource them, they should closely supervise the service provider's agents.

For example, in 2003, Ford Motor Company outsourced the task of handling supplier inquiries to India-based Allsec Technologies. Ford insisted that the Indian employees who handle those calls work under the supervision of Ford managers on the company's premises in Chennai. That allows the American giant to monitor the agents' work closely and to provide decision-making input in real time. Ford has compensated for the difficulty in codifying work by getting its managers to help the vendor's agents do that work.

Structural Risk. Most companies don't worry about the behavior of service providers when they enter into contracts with them. They assume vendors will always act in ways that maximize both groups' interests. That isn't a wise assumption to make, even when companies are buying services from captive centers that they have set up. Like all supply chain partners, service providers can, and do, have incentives to behave in ways that reduce buyers' financial benefits from outsourcing. (For more on the role of incentives in supply chains, see V.G. Narayanan and Ananth Raman's article "Aligning Incentives in Supply Chains," HBR November 2004.)

What a firm doesn't measure, it can't offshore well.

Some structural risk arises because vendors can stop investing in training or employ people who aren't as qualified as the agents they presented during negotiations. Take the case of one Asian vendor that designs surveys, analyzes data, and develops customer profiles to help clients segment their markets better. When it signed contracts, the firm said that it would hire people only with postgraduate degrees in statistics or marketing and with four to six years of experience. However, as the firm's business grew, it began staffing projects with managers who had master's degrees, but not necessarily in statistics or marketing, and with less than two years of relevant experience. The quality of its services fell, but clients couldn't stop using the provider because they had reduced their own capabilities to a bare minimum. They had no choice but to bear the costs of training and upgrading the provider's agents until they came up to speed. Another problem is that service providers sometimes put in less effort than they initially agreed to. For instance, an offshore transactions processor hired by a large American bank agreed to check at random 12% of all the transactions it would process. The bank later found that, once its representatives stopped monitoring the provider, the provider checked only 5% of transactions. That reduced the provider's costs, but the bank had to absorb larger costs because of a rise in the number of undetected errors.

When companies supervise providers' work, structural risk falls. Thanks to advances in information technology, businesses can track providers' efforts in real time. In fact, most successful outsourcers monitor their agents as they're working, and the best service providers encourage this practice. Structural risk also falls when companies have metrics to gauge the quality of providers' work (see the exhibit "Evaluating Structural Risk").

Companies face another kind of structural risk when service providers alter the terms of contracts after clients have turned over processes to them. That happens because, as outsourcing contracts mature, the power in relationships shifts from the buyers to the sellers. Once companies have transferred processes to providers and terminated the services of employees who performed the tasks, they cannot bring those processes back into the organization on short notice. Knowing that, providers can demand exorbitant price increases when contracts come up for renewal. For instance, one vendor that archives, documents, and analyzes insurance claims raised its price by 65% when a contract came up for renewal. The client couldn't cancel the contract with the vendor because it had virtually eliminated its processing capacity. It reluctantly paid the vendor the new price for a year and later shifted all its business to another provider.

Two factors amplify these latent risks. First, when firms outsource processes that require the transfer of a large amount of tacit knowledge, they have to invest time and effort in training providers' employees. Second, some processes take a long time to stabilize when companies offshore them. In both cases, the cost of switching from existing providers is very high. That accentuates the risk that over time, vendors will dictate terms to buyers.

Buyers are never powerless, and they can hedge structural risks in several ways. When a firm negotiates a contract with a provider, it should specify a period after the contract's expiry during which the provider must continue to offer the service at a certain price. As a rule of thumb, the buffer should specify 150% of the time that it took the provider to deliver output that matched the company's quality standards. If it took 12 months for the vendor to come up to speed, the vendor must continue to provide the service for 18 months after the contract has expired. Lehman Brothers, for instance, has insisted on adding this clause to all its contracts with providers.

Although it may be difficult, companies should also split business between two providers. In the event a company wants to discontinue doing business with one of them, it can then transfer a process to the other vendor that is already executing the same process, however small the volumes may be. It will take the company less time to do that than to train a new provider from scratch. Having a second provider may also lower costs since the junior provider will bid low for contracts in exchange for greater volumes. That will put pressure on the senior provider. For example, Bank of America has developed relationships with two offshore providers of IT services. The vendors are comparable in many ways, and both realize that the bank can transfer work from one to the other if it wants to. When companies transfer complex

processes, like equity research, cash-flow management, and forecasting, they should also retain some residual capacity so that they can bring processes back into the company if they have to. In the case of relatively vital processes, firms must retain enough in-house expertise to train new providers. Otherwise, businesses will have to ask incumbent providers to train potential rivals, which, in our experience, never works well.

Finally, companies face the risk that rivals may steal their intellectual property and proprietary processes if they transfer processes offshore, especially to emerging markets. There's no surefire way organizations can protect themselves against this risk unless they set up dedicated facilities offshore. Companies should decide they want to do that only after evaluating all their organizational options, and in the next section of this article, we will explore that process of evaluation.

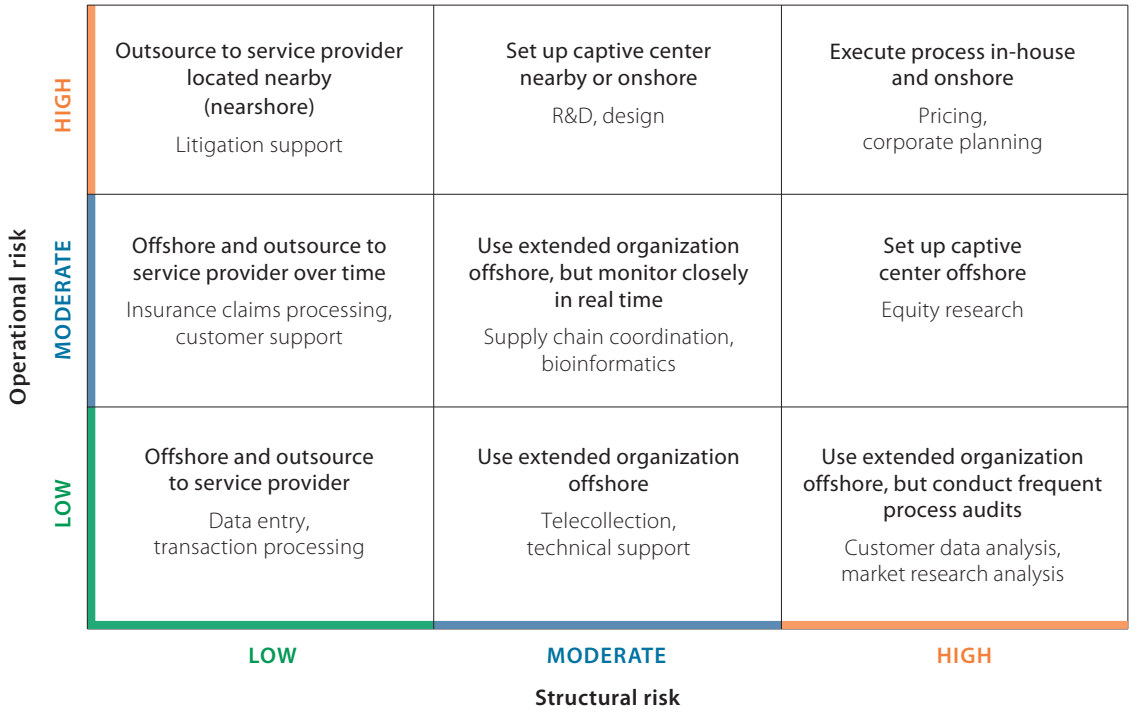
Choose the Right Organizational Form

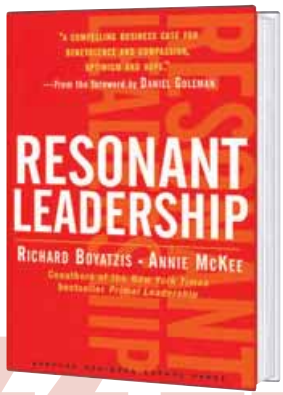
Most companies believe that they must either perform processes in-house or outsource them. That was true in the 1990s; today, however, companies can enter into joint ventures with other companies in the same industry or in other industries to generate services or, like GE, use the build-operate-transfer mechanism to create ventures that evolve from being part of the company into independent service providers.

Companies should match organizational structures to needs by considering both the structural and operational risks of offshoring processes. In general, they can use location – onshore, nearshore, or offshore – to combat operational risk, and organizational structures – such as captive centers and joint ventures – to respond to structural risk (see the exhibit "Choosing the Right Location and Organizational Form"). When both the operational and structural risks of offshoring processes are low, companies can outsource them to overseas service providers. As the operational risk of offshoring processes rises, locating them offshore becomes more dangerous. Companies should transfer processes that possess high levels of operational risk to nearby countries rather than to distant overseas locations. When the operational risk is very high, setting up captive centers locally is often the best solution. Outsourcing is less attractive in the case of processes with moderate or high structural risk; here, other forms of governance, such as joint ventures and captive centers, become better options. In the case of processes that have very high levels of structural risk, outsourcing isn't feasible. Companies must set up captive centers to execute those processes. Finally, when both operational and structural risks are very high,

Choosing the Right Location and Organizational Form

Once a company has determined the operational and structural risks of outsourcing its processes, it can use this grid to choose the best locations and organizational forms for those tasks. The nine cells in this table show the optimal offshoring responses to different levels of risk.





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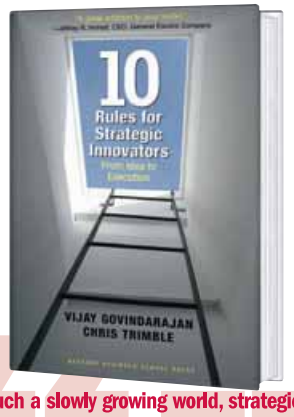

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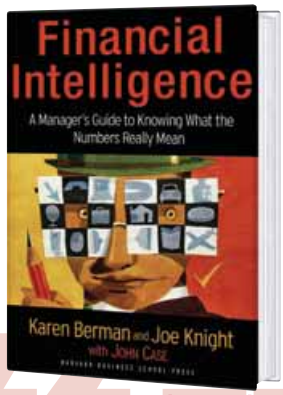

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offshoring and outsourcing are out of the question. Companies must execute those processes onshore and in-house.

When choosing organizational forms, companies have to trade off the control and quality they bring to the table with the scale economies and gains from the specialization that providers offer. Interestingly, offshoring has led to a hybrid form of organization that allows companies to, in a sense, have their cake and eat it, too. We call this structure the *extended organization*. In this hybrid organizational form, companies specify the quality of services they want and work closely alongside providers to get that quality. They manage providers carefully and monitor the agents' work to ensure that things are done properly. Technology enables buyers and sellers of services to exchange information in real time and to embed themselves deeply in each other's companies. Firms can thus move away from command-and-control structures to sense-and-respond forms of collaboration.

Consider, by way of illustration, Chennai-based Office Tiger, which offers research support and real-time scenario analysis, and builds investment models for some leading investment banks in the United States and UK. The banks tolerate very few mistakes, so Office Tiger's employees can't learn through trial and error. Moreover, nearly a third of the company's deadlines must be met within an hour. To make the tie-ups work, the investment banks' managers and Office Tiger's executives jointly manage both long-term goals and day-to-day operations. Office Tiger has developed an information system, T-Track, to monitor the productivity and quality of groups of employees and, if required, the performance of each agent. Its clients use the system to ask for changes in agent assignments, to modify quality control mechanisms, and to alter project priorities. Crucially, Office Tiger's agents and the investment bankers they support work in tandem. Both can see, in real time, the models and scenarios their counterparts are creating. They work off the same files, the same spreadsheets and data feeds, and, when necessary, they work iteratively. Buyer and seller are separated by boundaries that are porous and constantly shifting; it's impossible to tell where one boundary ends and the other begins. Walk through Office Tiger's offices, and you will see how closely its agents work with clients. The provider has created different premises for each client, and agents working for one investment bank cannot enter the offices of agents working for another bank.

Similarly, Gecis – GE's erstwhile captive center and, in 2004, an independent $426 million service provider based in India – has created a version of the extended organization. Gecis (recently renamed Genpact) always configures project teams with two leaders, one of whom is an employee of the buyer's company. He or she, along with a Gecis manager, sets priorities, tracks progress, helps define quality standards, and monitors the team. Every year, the two leaders jointly decide team members' pay, bonuses, and promotions. Gecis encourages its employees to see themselves as extensions of their clients. In fact, if you visit the floor in the Gecis center that executes several processes for a leading U.S. retail chain, you'll think you're in the retailer's own offices because of the decor and the vision statements on the walls.

Service providers can, and do, have incentives to behave in ways that reduce companies' financial benefits from outsourcing.

Our studies suggest that the extended organization is the most effective way to manage offshoring. In a two-year study, we compared how a captive center, a provider, and an extended organization executed several moderately complex processes in the financial services sector. While the captive center produced the

highest quality throughout the period of our study, the extended organization showed the greatest improvement and, over time, produced almost the same quality as the captive center. Moreover, the extended organization delivered that level of quality more cheaply than the captive center did. When we studied processes that were more complex, the same results held: The extended organization started out relatively poorly but, after it reached a stable state, was the most cost-effective way to execute processes. Clearly, offshoring isn't just about companies moving across geographical boundaries; it's also about companies redrawing organizational boundaries to achieve collaborative supply chains of information, expertise, and knowledge.

• • •

It may sound like a cliché, but companies must treat offshoring as a strategic imperative if they wish to capture all its benefits. Offshoring initiatives that have cost savings as their raison d'être, our studies show, don't allow companies to capture greater revenues from the market. That's because such companies don't commit themselves to the organizational changes that are necessary for offshoring to help them, say, customize products or services, lock in buyers, compress new product-development cycles, or enhance profit margins. Besides, when offshoring is only about cutting costs, businesses are reluctant to outsource complex processes, even though doing so will have a bigger impact on their bottom lines. However, when corporations begin with the desire to create strategic advantage through offshoring, they commit themselves to transferring complex processes relatively early. Companies would do well to remember that the manner in which they start their offshoring initiatives often determines how they will end.

1. "Alpha Corp." is a pseudonym. For more details on the offshoring problems faced by this company, see Ravi Aron, Eric K. Clemons, and Sashi Reddi, "Just Right Outsourcing: Understanding and Managing Risk," *Journal of Management Information Systems*, Fall 2005.

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Harvard Business Review

All Strategy Is Local

In "All Strategy Is Local" (September 2005), Bruce Greenwald and Judd Kahn make three main arguments. I agree with the first argument that companies do better if they have a larger share of a tightly defined market space. But I disagree with the second argument, which derives from the first; namely that companies should try to avoid expanding their markets across geographic borders. Most of the authors' examples

come from industries where there are significant barriers to the global transfer of competitive advantage. For instance, the article cites the problems of Wal-Mart's international expansion. But retailing is an industry in which companies need extensive local expertise, and home advantage does not transfer easily overseas. Even so, niche retailers, such as IKEA, have been highly successful on a global basis.

The article also cites problems stemming from the international expansion of telecom and media companies, but these problems are primarily due to cyclical and structural factors within those industries. Furthermore, both telecom and media companies – again not very global industries – are highly regulated and rely on local content. Indeed, in this era of globalization, it is easier for companies to expand within a line of business across borders than to expand across lines of business within one country. It is now easier to deal with the decreasing differences between countries than the continuing great differences between industries. Many new companies are even "born global," especially those in high technology businesses from smaller economies. Perhaps the most famous example is India's Infosys Technologies, which has depended on overseas customers for more than 90% of its business since its start in 1981.

The article's third argument is that most companies should avoid pursuing strategy unless they dominate a market space. I would accept that a company in a highly competitive industry, one that also lacks significant insulating advantages, should not pursue ambitious, transforming strategies, unless they have a real chance of moving the company into a better position. But the authors use an overly narrow definition of strategy. Strategy can and should be defined as a planned sequence of moves to achieve an important objective. So companies need many strategies.

Finally, I worry about the advice, drawn from the experiences of Apple Computer, that companies stick to a narrow range of products or services. Apple could never have gotten started had it

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not combined hardware and software. And it thrives today by continually expanding the scope of its offerings with successful new products, such as the iPod, serving new markets. Nor did Nokia, the world's leading maker of cellular phones, stick to its original business of making rubber boots!

George S. Yip
Professor
London Business School
Lead Fellow
Advanced Institute of Management Research
London

It is about time that senior executives recognize that global strategy is a myth. "All Strategy Is Local" is a brilliant demonstration of the need for success in a core home region. Greenwald and Kahn show correctly that penetration of foreign regional markets is extremely difficult and unprofitable. In my recent research, I have generalized this point to show that globalization does not exist and that a global strategy is inferior to a regional strategy. Indeed these findings now apply to virtually all of the world's largest *Fortune* 500 firms. From that set, I could identify only nine as global, defined as having at least 20% of their sales in each of the three broad regional markets of Asia, Europe, and North America. In contrast, for 320 of the 380 firms providing segmented geographical data, an average of 72% of their sales comes from their home region.

For example, 90% of Wal-Mart's sales come from North America, and, indeed, the retailer has found expansion into Europe and Asia to be difficult. In Europe, it faces well-established rivals such as Carrefour, which has 81% of its sales in Europe. Of the 49 large multinational retail companies in the *Fortune* 500, only LVMH, a luxury goods firm, is global.

Nor are all regions created equal. While no U.S. business goes outside its core home region, this is not the case for European and Asian businesses. For example, half of GlaxoSmithKline and AstraZeneca's sales come from North America. The same is true for Toyota and Nissan. These are truly biregional firms that have become insiders in the large U.S. market in terms of R&D, production, and marketing. Still, the overall number of global (9) and biregional (36) firms out of the 380 companies is tiny compared to the 320 home region–based firms identified in my new book *The Regional Multinationals* (Cambridge University Press, 2005).

I have found little evidence of the "globalization of manufacturing" that Greenwald and Kahn refer to. In related research, my colleague Simon Collinson and I find that in Japanese firms, intraregional foreign assets are even more localized (at 83%) than their intraregional foreign sales (at 81%). Why is this? Because upstream production assets are more immobile than downstream sales.

Greenwald and Kahn are correct in explaining that economies of scale are likely to be exhausted within the home region. These data are telling us that large firms are not global but operate predominately in their home region. So why do we continue to read in the annual reports of these firms that their strategic intent is to be global, that their managers have a global mind-set, and that their supply chains are global? Executives need to drop their mindless pursuit of global strategy and take up a new home region strategy.

Alan M. Rugman
L. Leslie Waters Chair in International Business
Kelley School of Business
Indiana University
Bloomington, Indiana

Greenwald and Kahn respond: Without addressing the issue of whether George Yip has correctly identified the three main arguments of our article, we agree that there are barriers to international mobility beyond those associated with local geographic competitive advantages. Adapting to different consumer cultures and managing the complexities of cross-border operations are two. However, the fact that other difficulties exist does not make the geographic competitive advantages enjoyed by national incumbents disappear. These geographic advantages are clearly present within national markets, as indicated in the data presented by Alan Rugman, and they have to be taken into account as companies formulate plans to expand internationally.

As to Yip's point that companies ought to develop strategies – defined as "sequences of moves" – in markets without barriers to entry, and hence without a well-defined set of competitors to respond to those moves, our disagreement is one of emphasis. We think that concentrating in a focused way on efficiency in these instances without the diversion of thinking of sequences of moves is generally the best allocation of scarce managerial attention. In some cases this may not be true, but the overwhelming evidence, again including the welcome supporting data from Rugman, suggests that such narrowly focused strategies have historically enjoyed greater success than broader approaches.

Steve Jobs is a rare genius. Strategies whose success depends on that kind of genius are not, it seems to us, good bets to make. Someone always wins the lottery, but buying lottery tickets is not a sound business strategy.

Editor's note: For more on regional strategy, see "Regional Strategies for Global Leadership" by Pankaj Ghemawat in this issue.

Using VoIP to Compete

Executives would be wise to heed Kevin Werbach's call in "Using VoIP to Compete" (September 2005). VoIP will indeed become a source of competitive advantage as a platform for virtualization, customization, and intelligent communications. However, these benefits will require more than the deployment of a new VoIP-based infrastructure. A fundamental shift in mind-set is required.

An analogous shift occurred at the start of the quality revolution. When W. Edwards Deming arrived in Japan 60 years ago, quality meant inspecting for and removing defects in built products.

The quality revolution took hold when managers recognized that they should build quality into the product from the start. Embedding quality into the business process ushered in the quality revolution.

The mind-set in communications today is also one of removing defects. We notice communications only when something fails–we can't get a dial tone, our e-mails bounce, we lose our cellular signal. But communications is much more than a utility that connects devices. The business transformations that preoccupy today's boardrooms, whether integrating global supply chains, accelerating innovation, ensuring business continuity, or delivering a holistic customer experience, have communications at their core.

For the communications revolution to truly take hold, communications, like quality, must be designed into the business model from the start and embedded into every business process. It is this convergence–not of voice and data, but of communications with business process–that will usher in a true communications revolution.

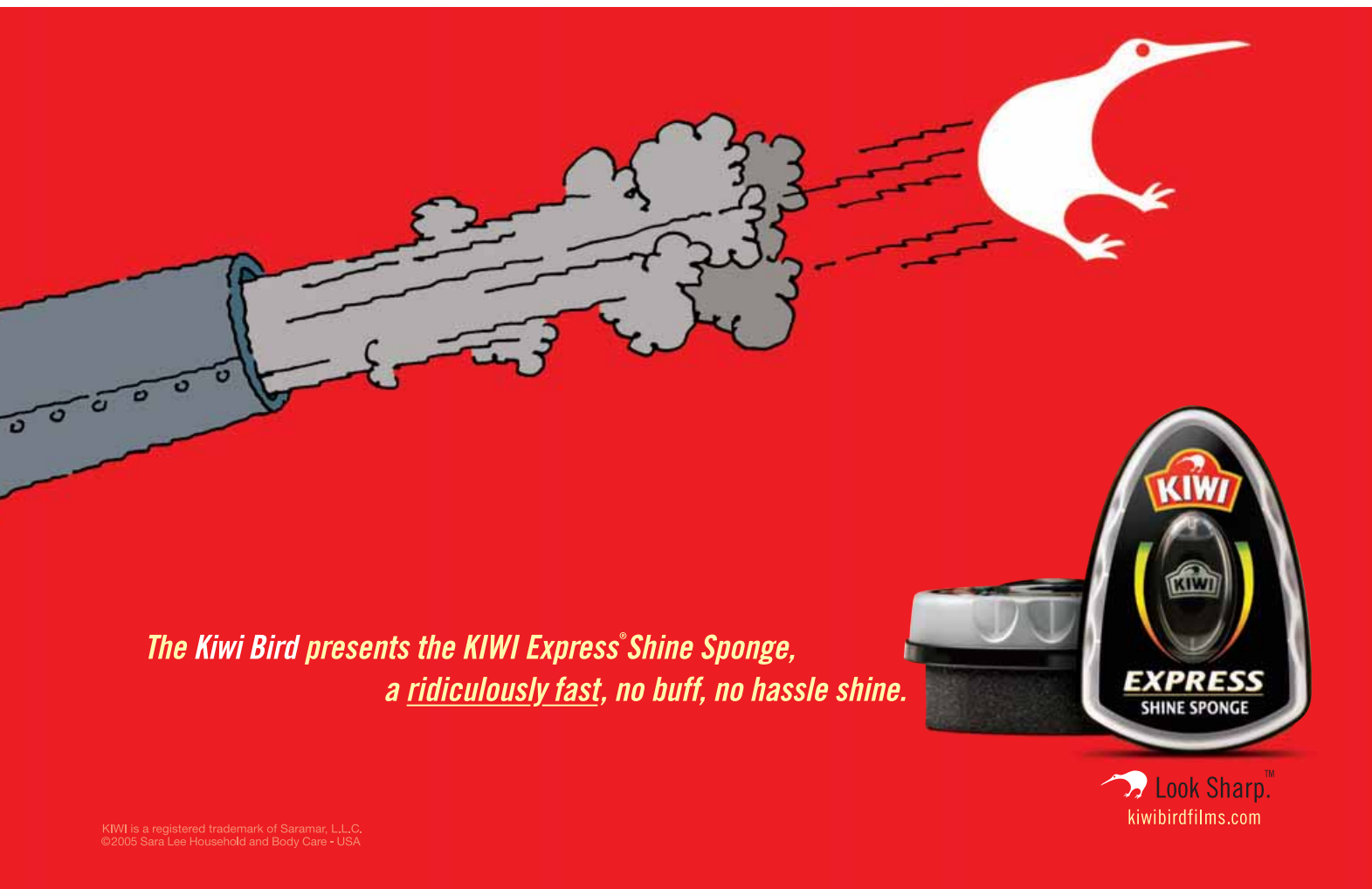
Donald Peterson
Chairman and CEO
Ayava
Basking Ridge, New Jersey

Werbach responds: Donald Peterson helpfully reinforces the points I made in my article. The important aspect of VoIP for businesses isn't the equipment or the technology; it's the way newly flexible, intelligent communications platforms can transform business processes and, ultimately, entire firms. Communication – whether through phone, fax, e-mail, videoconferencing, or shouting across the room, is already at the core of virtually every significant business activity. VoIP presents those links as strategic opportunities rather than as mechanical functions or points of friction.

EBay's recent decision to acquire VoIP start-up Skype for more than $2.5 billion shows how valuable a platform VoIP can be. There are terrific synergies between eBay's radically efficient, extensible, user-driven (and highly profitable) commerce engine and Skype's radically efficient, extensible, user-driven communications engine. Google, Yahoo, and Microsoft are all investing actively in VoIP capabilities as well. They are heeding Peterson's admonition to integrate communications with business processes. Every company should begin to think about how it can do the same.

Strategy as Active Waiting

In his article "Strategy as Active Waiting" (September 2005), Donald Sull draws on concepts of maneuver warfare to illuminate several aspects of a highly flexible and adaptive corporate strategy. A number of activities particular to the military environment enable its strategic flexibility, and, as Sull suggests, corporate managers must be aware of these



to draw an accurate analogy between their businesses and the military.

For example, consider the "OODA" loop: observation, orientation, decision, action. The U.S. Marines and Navy (of which we are, respectively, veterans) use the OODA loop as a decision-making cycle. The rate at which an organization goes through the loop sets the tempo of operations: The faster player has already acted and can observe the effect of that action, orienting himself for the next decision, while the slower player is still deciding what to do based on a now-obsolete view of the world.

One of the keys to accelerating this cycle is to foster a culture of decentralized decision-making that allows junior leaders to use their judgment to carry out their commanders' intent as the situation dictates. By itself, however, this diffuse decision-making authority is insufficient to deliver the benefits Sull describes. The entirety of a military unit's culture and activities must be aligned to enable the rapid tempo that drives success on the battlefield. To provide a commander with maximum flexibility to respond to a broad spectrum of unpredictable settings, a unit must recruit reliable people with sound judgment across functional roles; train them in a range of ambiguous scenarios; deploy modular systems that can be quickly and easily adapted; and field dynamic logistical systems and a host of other internal activities. Without these cultural, organizational, and system enablers, the authority to decide and act could never be delegated so deep in the organization.

Rapid and flexible decision-making can disrupt one's opponent, but it also can make it extremely difficult to coordinate with one's partners. For example, the militaries of NATO are better trained and equipped than their counterparts in much of the rest of the world, but, with the exception of the British military and the Dutch Air Force, they are increasingly incapable of integrating their operation with the complex systems and rapid tempo of American combat. This growing imbalance has profound strategic implications for all NATO members.

Managers and strategists seeking to borrow from the deep pool of military analogies would be well advised to consider the range of internal activities that drive success on the battlefield before pursuing strategies their organizations cannot execute.

John Brown
Cofounder
Verical
Alexandria, Virginia

Carl V. Petty
Consultant
Bain & Company
Johannesburg, South Africa

Sull responds: In their thoughtful letter, John Brown and Carl Petty note that a company's culture and systems must support the active waiting approach, and they cite examples including recruitment, training, and logistics. I could not agree more. Many companies anticipate emerging shifts in the environment but stumble when it comes to seizing opportunities or managing

STRATEGY
AS ACTIVE WAITING

threats. The essence of strategic agility lies less in anticipation and more in the ability to execute novel initiatives consistently.

My current research focuses on how managers build and maintain an execution culture in which effective promises are consistently honored up and down the hierarchy and across units. In this approach, a firm is viewed as a fluid network of commitments rather than as a bundle of standardized processes. An execution culture combines the flexibility to tackle novel opportunities with the discipline to get new things done faster and more effectively than rivals. Companies that have successfully built an execution culture – including Mittal Steel, AmBev, the Royal Bank of Scotland, Danone, Cemex, and Haier – have made remarkable gains in market share and valuation by seizing opportunities beyond the reach of less nimble rivals.

In recent decades, business strategists have refined a number of tools for making decisions under uncertain conditions, including real-option theory, scenario planning, and game theory. Our understanding of how to execute in an unpredictable world, however, lags behind. Here, as Brown and Petty rightly observe, we can learn much from the hard-won lessons of military thinkers.

Fixing Health Care from the Inside, Today

I thoroughly enjoyed Steven Spear's article "Fixing Health Care from the Inside, Today" (September 2005). When I was the director of pharmaceutical services at the University of Pittsburgh Medical Center (UPMC), South Side, my staff and I were immersed in applying the principles of the Toyota Production System to improve our provision of care. I continue to find the problem-solving process to be particularly valuable in helping to identify the true root cause of an unexpected outcome.

I would like to offer a point of clarification regarding Spear's representation of the "12 to 24 hours that elapsed between the writing and the filling of an order…." As a new physician's order was processed, a double supply of medications was prepared – some for immediate delivery (within an hour) and some for the following day's batch. It is this following day's batch, delivered 12 to 24 hours after preparation, that often required rework due to changes in the patient's needs. I would not want to leave the reader with the impression that a patient's needs were unmet for that period of time.

Kelley A. Wasicek
Manager, Pharmacy Operations
University of Pittsburgh Medical Center, Presbyterian Campus
Pittsburgh

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EXECUTIVE SUMMARIES

December 2005

> **"The best strategic moves for a company...[say] 'stick to your knitting.'"**
> – page 62

COVER STORY

62 | Strategy and Your Stronger Hand

Geoffrey A. Moore

There are two kinds of businesses in the world, says the author. Knowing what they are – and which one your company is – will guide you to the right strategic moves.

One kind includes businesses that compete on a complex-systems model. These companies have large enterprises as their primary customers. They seek to grow a customer base in the thousands, with no more than a handful of transactions per customer per year (indeed, in some years there may be none), and the average price per transaction ranges from six to seven figures. In this model, 1,000 enterprises each paying $1 million per year would generate $1 billion in annual revenue.

The other kind of business competes on a volume-operations model. Here, vendors seek to acquire millions of customers, with tens or even hundreds of transactions per customer per year, at an average price of relatively few dollars per transaction. Under this model, it would take 10 million customers each spending $8 per month to generate nearly $1 billion in revenue.

An examination of both models shows that they could not be further apart in their approach to every step along the classic value chain. The problem, though, is that companies in one camp often attempt to create new value by venturing into the other. In doing so, they fail to realize how their managerial habits have been shaped by the model they've grown up with. By analogy, they have a "handedness" – the equivalent of a person's right- or left-hand dominance – that makes them as adroit in one mode as they are awkward in the other. Unless you are in an industry whose structure forces you to attempt ambidexterity (in which case, special efforts are required to manage the inevitable dropped balls), you'll be far more successful making moves that favor your stronger hand.

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FORETHOUGHT

18 | No Monopoly on Innovation
Many economists argue that monopolies stifle innovation. But before the breakup, AT&T and its R&D units constituted probably the most potent innovation engine the world has known. **Reprint F0512A**

Those Who Can't, Don't Know It
Incompetent people don't perform up to speed, don't recognize their lack of competence, and don't recognize the competence of others. **Reprint F0512B**

How Not to Extend Your Luxury Brand Don't extend your premium brands into other product categories – unless they are adjacent to your core categories. **Reprint F0512C**

The Cost-Benefit of Well Employees
As major purchasers of health care, corporations have almost as much of a stake in maintaining employees' health as employees themselves do. **Reprint F0512D**

Heartless Bosses? If you're in the C-suite, your subordinates are probably more emotionally intelligent than you are. **Reprint F0512E**

Revaluing Writing Good writers who are consulted early enough can improve the product development process and, potentially, the products themselves. **Reprint F0512F**

Play to Win Henry Jenkins, the director of comparative media studies at MIT, talks about the influence of video games in and on the workplace. **Reprint F0512G**

The Changing Face of the Chinese Executive Researchers have identified four cultural tensions that will influence how Chinese leaders develop over the next 15 years. **Reprint F0512H**

Bringing the College Inside As part of its R&D efforts, Porsche taps the resources and expertise of nearly 600 graduate students – saving innovation costs in the process. **Reprint F0512J**

When Stability Breeds Instability
Low turnover – typically a sign of organizational health – seems to increase a company's vulnerability to the effects of losing social capital. **Reprint F0512K**

Book Reviews HBR reviews four business books.

HBR CASE STUDY

39 | Just in Time for the Holidays
Eric McNulty
It's the busiest time of year for North Pole Workshops. Production is in high gear, and the elves are on overtime in the sprint toward Christmas. But an unexpected spike in demand for one toy may leave children around the world disappointed on Christmas morning, whether they've been naughty or nice. At the same time, another toy's popularity threatens to plummet, leaving Santa and his elves faced with the prospect of millions of unloved playthings left in the warehouse.

This is the third time in three years that Santa's elves have been caught off guard by a toy's sudden surge in popularity. Earlier in the season, even just a month ago, it would have been possible to find capacity, but now every line is running full tilt. "Oh, it used to be so simple," Santa ruminates. "Wooden blocks, a train set, a doll…Now we have more than a million SKUs…. Trends jump across the oceans in an instant. I've asked the elves in the field to go beyond reporting on kids' behavior and start trend spotting. I've invested in software. But still I can't help thinking that one of these days we're not going to be able to do it."

Santa and his staff are determined not to disappoint the children, but North Pole Workshops must find a way to improve its response to shifts in demand. Should Santa invest in better forecasting? Or does the answer lie in a more flexible supply chain?

Commenting on this fictional case study are M. Eric Johnson, the director of the Glassmeyer/McNamee Center for Digital Strategies at Dartmouth's Tuck School of Business; Horst Brandstätter, the owner of Playmobil; Warren Hausman, a professor of operations management at Stanford University; and Anne Omrod, the CEO of the consulting firm John Galt Solutions. **Reprint R0512A**

53 | How to Build Your Network
Brian Uzzi and Shannon Dunlap
Many sensational ideas have faded away into obscurity because they failed to reach the right people. A strong personal network, however, can launch a burgeoning plan into the limelight by delivering private information, access to diverse skill sets, and power. Most executives know that they need to learn about the best ideas and that, in turn, their best ideas must be heard by the rest of the world. But strong personal networks don't just happen around a watercooler or at reunions with old college friends. As Brian Uzzi and Shannon Dunlap explain, networks have to be carefully constructed through relatively high-stakes activities that bring you into contact with a diverse group of people.

Most personal networks are highly clustered – that is, your friends are likely to be friends with one another as well. And, if you made those friends by introducing yourself to them, the chances are high that their experiences and perspectives echo your own. Because ideas generated within this type of network circulate among the same people with shared views, though, a potential winner can wither away and die if no one in the group has what it takes to bring that idea to fruition. But what if someone within that cluster knows someone else who belongs to a whole different group? That connection, formed by an *information broker,* can expose your idea to a new world, filled with fresh opportunities for success. Diversity makes the difference.

Uzzi and Dunlap show you how to assess what kind of network you currently have, helping you to identify your *superconnectors* and demonstrating how you act as an information broker for others. They then explain how to diversify your contacts through shared activities and how to manage your new, more potent, network. **Reprint R0512B**

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ADRIENNE M. SPELKER, BUSINESS MANAGER

MARKETING

74 | Marketing Malpractice: The Cause and the Cure

Clayton M. Christensen, Scott Cook, and Taddy Hall

Ted Levitt used to tell his Harvard Business School students, "People don't want a quarter-inch drill – they want a quarter-inch hole." But 35 years later, marketers are still thinking in terms of products and ever-finer demographic segments.

The structure of a market, as seen from customers' point of view, is very simple. When people need to get a job done, they hire a product or service to do it for them. The marketer's task is to understand what jobs periodically arise in customers' lives for which they might hire products the company could make.

One job, the "I-need-to-send-this-from-here-to-there-with-perfect-certainty-as-fast-as-possible" job, has existed practically forever. Federal Express designed a service to do precisely that – and do it wonderfully again and again. The FedEx brand began popping into people's minds whenever they needed to get that job done. Most of today's great brands – Crest, Starbucks, Kleenex, eBay, and Kodak, to name a few – started out as just this kind of *purpose* brand.

When a purpose brand is extended to products that target different jobs, it becomes an *endorser* brand. But, over time, the power of an endorser brand will surely erode unless the company creates a new purpose brand for each new job, even as it leverages the endorser brand as an overall marker of quality. Different jobs demand different purpose brands.

New growth markets are created when an innovating company designs a product and then positions its brand on a job for which no optimal product yet exists. In fact, companies that historically have segmented and measured markets by product categories generally find that when they instead segment by job, their market is much larger (and their current share much smaller) than they had thought. This is great news for smart companies hungry for growth.

Reprint R0512D; HBR OnPoint 2386; OnPoint collection "Make Sure *All* Your Products Are Profitable" 2432

86 | Managing Authenticity: The Paradox of Great Leadership

Rob Goffee and Gareth Jones

Leaders and followers both associate authenticity with sincerity, honesty, and integrity. It's the real thing—the attribute that uniquely defines great managers. But while the expression of a genuine self is necessary for great leadership, the concept of authenticity is often misunderstood, not least by leaders themselves. They often assume that authenticity is an innate quality—that a person is either genuine or not. In fact, the authors say, authenticity is largely defined by what other people see in you and, as such, can to a great extent be controlled by you.

In this article, the authors explore the qualities of authentic leadership. To illustrate their points, they recount the experiences of some of the authentic leaders they have known and studied, including the BBC's Greg Dyke, Nestlé's Peter Brabeck-Letmathe, and Marks & Spencer's Jean Tomlin.

Establishing your authenticity as a leader is a two-part challenge. You have to consistently match your words and deeds; otherwise, followers will never accept you as authentic. But it is not enough just to practice what you preach. To get people to follow you, you also have to get them to relate to you. This means presenting different faces to different audiences—a requirement that many people find hard to square with authenticity. But authenticity is not the product of manipulation. It accurately reflects aspects of the leader's inner self, so it can't be an act.

Authentic leaders seem to know which personality traits they should reveal to whom, and when. Highly attuned to their environments, authentic leaders rely on an intuition born of formative, sometimes harsh experiences to understand the expectations and concerns of the people they seek to influence. They retain their distinctiveness as individuals, yet they know how to win acceptance in strong corporate and social cultures and how to use elements of those cultures as a basis for radical change.

Reprint R0512E

98 | Regional Strategies for Global Leadership

Pankaj Ghemawat

The leaders of such global powerhouses as GE, Wal-Mart, and Toyota seem to have grasped two crucial truths: First, far from becoming submerged by the rising tide of globalization, geographic and other regional distinctions may in fact be increasing in importance. Second, regionally focused strategies, used in conjunction with local and global initiatives, can significantly boost a company's performance.

The business and economic data reveal a highly regionalized world. For example, trade within regions, rather than across them, drove the surge of international commerce in the second half of the twentieth century. Regionalization is also apparent in foreign direct investment, companies' international sales, and competition among the world's largest multinationals.

Harvard Business School professor Pankaj Ghemawat says that the most successful companies employ five types of regional strategies in addition to—or even instead of—global ones: home base, portfolio, hub, platform, and mandate. Some companies adopt the strategies in sequence, but the most nimble switch from one to another and combine approaches as their markets and businesses evolve. At Toyota, for example, exports from the home base continue to be substantial even as the company builds up an international manufacturing presence. And as Toyota achieves economies of scale and scope with a strong network of hubs, the company also pursues economies of specialization through interregional mandates.

Embracing regional strategies requires flexibility and creativity. A company must decide what constitutes a region, choose the most appropriate strategies, and mesh those strategies with the organization's existing structures. In a world that is neither truly global nor truly local, finding ways of coordinating within and across regions can deliver a powerful competitive advantage.

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110 | "A Players" or "A Positions"? The Strategic Logic of Workforce Management

Mark A. Huselid, Richard W. Beatty, and Brian E. Becker

Companies simply can't afford to have "A players" in all positions. Rather, businesses need to adopt a portfolio approach to workforce management, systematically identifying their strategically important A positions, supporting B positions, and surplus C positions, then focusing disproportionate resources on making sure A players hold A positions.

This is not as obvious as it may seem, because the three types of positions do not reflect corporate hierarchy, pay scales, or the level of difficulty in filling them. A positions are those that directly further company strategy and, less obviously, exhibit wide variation in the quality of the work done by the people who occupy them. Why variability? Because raising the average performance of individuals in these critical roles will pay huge dividends in corporate value. If a company like Nordstrom, for example, whose strategy depends on personalized service, were to improve the performance of its frontline sales associates, it could reap huge revenue benefits.

B positions are those that support A positions or maintain company value. Inattention to them could represent a significant downside risk. (Think how damaging it would be to an airline, for example, if the quality of its pilots were to drop.) Yet investing in them to the same degree as A positions is ill-advised because B positions don't offer an upside potential. (Pilots are already highly trained, so channeling resources into improving their performance would probably not create much competitive advantage.) And C positions? Companies should consider outsourcing them – or eliminating them.

We all know that effective business strategy requires differentiating a firm's products and services in ways that create value for customers. Accomplishing this requires a differentiated workforce strategy, as well.

Reprint R0512G; HBR OnPoint 2424; OnPoint collection "Shape Your Workforce for Strategic Success" 2769

122 | Up to Code: Does Your Company's Conduct Meet World-Class Standards?

Lynn Paine, Rohit Deshpandé, Joshua D. Margolis, and Kim Eric Bettcher

Codes of conduct have long been a feature of corporate life. Today, they are arguably a legal necessity – at least for public companies with a presence in the United States. But the issue goes beyond U.S. legal and regulatory requirements. Sparked by corruption and excess of various types, dozens of industry, government, investor, and multisector groups worldwide have proposed codes and guidelines to govern corporate behavior. These initiatives reflect an increasingly global debate on the nature of corporate legitimacy.

Given the legal, organizational, reputational, and strategic considerations, few companies will want to be without a code. But what should it say? Apart from a handful of essentials spelled out in Sarbanes-Oxley regulations and NYSE rules, authoritative guidance is sorely lacking.

In search of some reference points for managers, the authors undertook a systematic analysis of a select group of codes. In this article, they present their findings in the form of a "codex," a reference source on code content. The Global Business Standards Codex contains a set of overarching principles as well as a set of conduct standards for putting those principles into practice.

The GBS Codex is not intended to be adopted as is, but is meant to be used as a benchmark by those wishing to create their own world-class code. The provisions of the codex must be customized to a company's specific business and situation; individual companies' codes will include their own distinctive elements as well. What the codex provides is a starting point grounded in ethical fundamentals and aligned with an emerging global consensus on basic standards of corporate behavior.

Reprint R0512H

135 | Getting Offshoring Right

Ravi Aron and Jitendra V. Singh

The prospect of offshoring and outsourcing business processes has captured the imagination of CEOs everywhere. In the past five years, a rising number of companies in North America and Europe have experimented with this strategy, hoping to reduce costs and gain strategic advantage.

But many businesses have had mixed results. According to several studies, half the organizations that have shifted processes offshore have failed to generate the expected financial benefits. What's more, many of them have faced employee resistance and consumer dissatisfaction.

Clearly, companies have to rethink how they formulate their offshoring strategies. A three-part methodology can help. First, companies need to prioritize their processes, ranking each based on two criteria: the value it creates for customers and the degree to which the company can capture some of that value. Companies will want to keep their core (highest-priority) processes in-house and consider outsourcing their commodity (low-priority) processes; critical (moderate-priority) processes are up for debate and must be considered carefully.

Second, businesses should analyze all the risks that accompany offshoring and look systematically at their critical and commodity processes in terms of operational risk (the risk that processes won't operate smoothly after being offshored) and structural risk (the risk that relationships with service providers may not work as expected).

Finally, companies should determine possible locations for their offshore efforts, as well as the organizational forms – such as captive centers and joint ventures – that those efforts might take. They can do so by examining each process's operational and structural risks side by side.

This article outlines the tools that will help companies choose the right processes to offshore. It also describes a new organizational structure called the *extended organization,* in which companies specify the quality of services they want and work alongside providers to get that quality.

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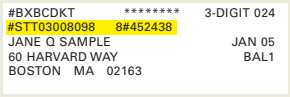
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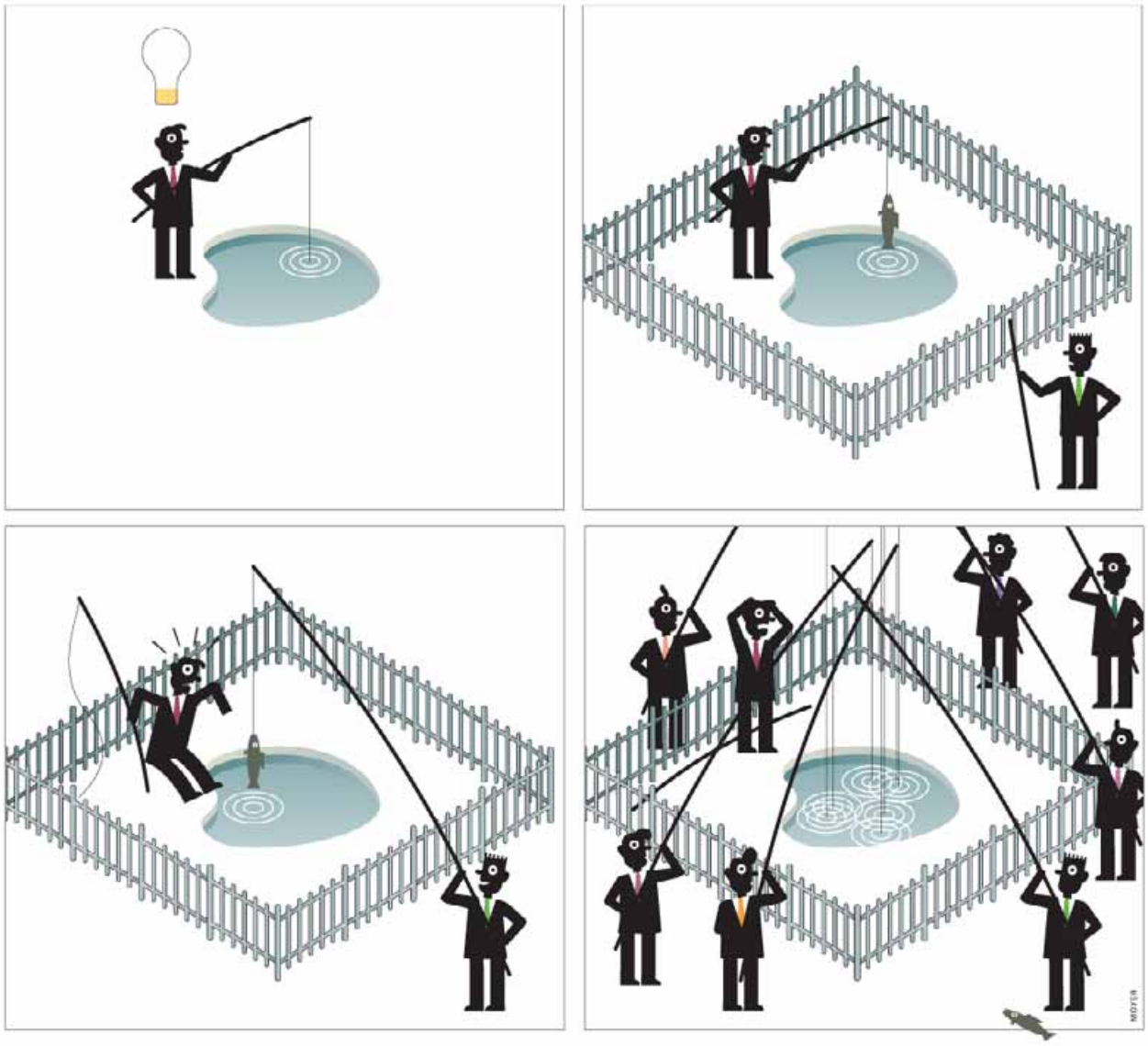
Volume 83, Number 12

by Don Moyer



Don't Fence It In

"Something there is that doesn't love a wall," observed Robert Frost. But company leaders do love walls, particularly those that protect their cherished products and business ideas from trespassing competitors. The term "barrier to entry," however, overstates such walls' effectiveness. If a market is sufficiently tempting, companies can erect nothing more formidable than a ledge to slow the pace of incursion.

Fortunately, competition is good for the economy. It is good for consumers. And ultimately, it is good for the company whose defenses are breached. Entrepreneurial fish nibbling at your toes make it impossible to stand still – so you innovate. Ideally, your worthy adversaries will abet your innovation efforts with something more than just motivation. "Most of PepsiCo's major strategic successes are ideas we borrowed from the marketplace – often from small regional or local competitors," wrote Andrall E. Pearson in "Tough-Minded Ways to Get Innovative" (HBR August 2002).

So don't worry so much about being a first mover. Concentrate, instead, on being a perennial shaker.

Don Moyer can be reached at dmoyer@thoughtformdesign.com.

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READER'S 2005 GUIDE

A guide to the year's articles by author and subject. Includes Executive Summaries.

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More and more executives are using their mail

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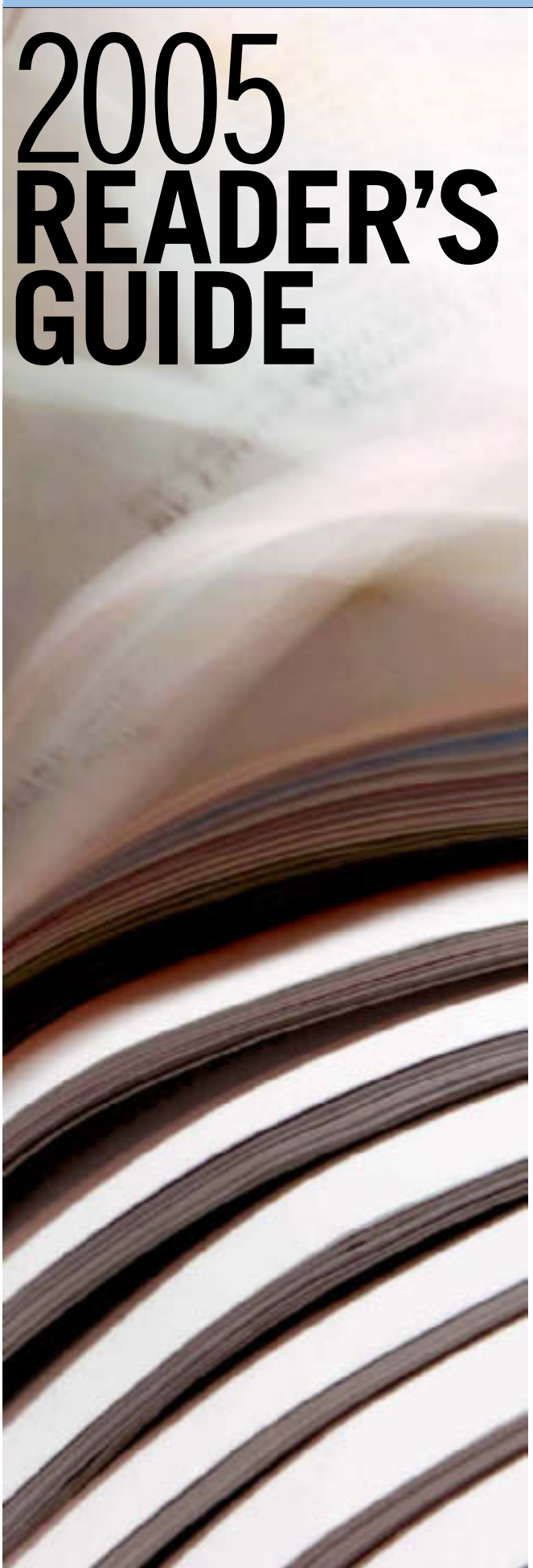

From the Editors

The 2005 *Harvard Business Review* Reader's Guide stuffs an entire year's worth of potent, disruptive, and sometimes explosive business ideas into a package small enough to roll up and – well, use as a megaphone, perhaps? Or peer into the future with? Here are the distillations, in the form of HBR's signature Executive Summaries, of ideas from today's leading thinkers on topics ranging from change management to teams. The articles are also indexed by author and by subject.

This is the second year HBR has published a stand-alone Reader's Guide. What's new this year is a section focusing on five popular topics that haven't been included among past HBR index headings. We have highlighted a handful of important articles on these subjects – China, health care, manufacturing, the nonprofit sector, and gender issues – from recent years. They include such agenda-setting pieces as Michael E. Porter and Elizabeth Olmsted Teisberg's "Redefining Competition in Health Care" from June 2004; Steven Spear and H. Kent Bowen's "Decoding the DNA of the Toyota Production System" from September–October 1999; and Sylvia Ann Hewlett and Carolyn Buck Luce's "Off-Ramps and On-Ramps: Keeping Talented Women on the Road to Success" from March 2005.

As this year's Reader's Guide demonstrates, HBR articles cover a surprising amount of territory and draw from multiple disciplines. They touch on psychology, virtue, race, obesity, creativity, and dozens more topics not often within the purview of business publications. We include these articles in our pages because they challenge the traditional assumptions about what business leaders need to know. HBR, like a good business leader, has both depth and breadth.

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Contents

4 INDEX OF ARTICLES, BY AUTHOR

11 INDEX OF ARTICLES, BY SUBJECT

16 EDITORS' PICKS

20 EXECUTIVE SUMMARIES

- 20 JANUARY
- 24 FEBRUARY
- 27 MARCH
- 31 APRIL
- 35 MAY
- 38 JUNE
- 42 JULY–AUGUST
- 48 SEPTEMBER
- 52 OCTOBER
- 56 NOVEMBER
- 60 DECEMBER

11 CHANGE MANAGEMENT

CORPORATE SOCIAL RESPONSIBILITY

DIVERSITY

ENTREPRENEURSHIP

ETHICS AND SOCIETY

FINANCE AND ACCOUNTING

GENERAL MANAGEMENT

GLOBALIZATION

GOVERNANCE

GOVERNMENT AND LAW

HUMAN RESOURCES

12 INFORMATION TECHNOLOGY

INNOVATION AND CREATIVITY

KNOWLEDGE MANAGEMENT

LEADERSHIP

MANAGEMENT DEVELOPMENT

MANAGING TECHNOLOGY

MARKETING

13 MERGERS AND ACQUISITIONS

NONPROFIT MANAGEMENT

OPERATIONS

ORGANIZATION AND CULTURE

14 PERFORMANCE MEASUREMENT

RESEARCH AND DEVELOPMENT

RISK MANAGEMENT

SELF-MANAGEMENT

STRATEGY AND COMPETITION

15 TEAMS

A

Abrahams, Marc
(a conversation with)
Save That Thought
Forethought, September
Reprint F0509F

Those Who Can't, Don't Know It
Forethought, December
Reprint F0512B

Abrami, Regina M.
The New Tools of Trade
Forethought, May
Reprint F0505J

Albert, Terri C.
Capturing Customers' Spare Change
Forethought, May
Reprint F0505K

Allmendinger, Glen
Four Strategies for the Age of Smart Services
October
Reprint R0510J

Aron, Ravi
Getting Offshoring Right
December
Reprint R0512J

Aspinall, Keith
Innovation Versus Complexity: What Is Too Much of a Good Thing?
November
Reprint R0511C ♦ OnPoint 222X

B

Bamford, James
Your Alliances Are Too Stable
June
Reprint R0506J

Barber, Felix
The Surprising Economics of a "People Business"
June
Reprint R0506D

Barker, Brianna
How to Play to Your Strengths
January
Reprint R0501G

Beale, Nicholas
Oil and Troubled Waters
Forethought, November
Reprint F0511F

Beatty, Richard W.
"A Players" or "A Positions"? The Strategic Logic of Workforce Management
December
Reprint R0512G ♦ OnPoint 2424 OnPoint collection "Shape Your Workforce for Strategic Success" 2769

Becker, Brian E.
"A Players" or "A Positions"? The Strategic Logic of Workforce Management
December
Reprint R0512G ♦ OnPoint 2424 OnPoint collection "Shape Your Workforce for Strategic Success" 2769

Beebe, Bruce
HBR Case Study: Springboard to a Swan Dive?
February
Reprint R0502B

Bendapudi, Neeli
Creating the Living Brand
May
Reprint R0505G

Bendapudi, Venkat
Creating the Living Brand
May
Reprint R0505G

Bennis, Warren G.
How Business Schools Lost Their Way
May
Reprint R0505F

Benson, Herbert
(a conversation with)
Are You Working Too Hard?
November
Reprint R0511B

Bettcher, Kim Eric
Up to Code: Does Your Company's Conduct Meet World-Class Standards?
December
Reprint R0512H

Bierman, Leonard
The New Tools of Trade
Forethought, May
Reprint F0505J

Bodrock, Phil
HBR Case Study: The Shakedown
March
Reprint R0503A

Boudreau, John W.
Where's Your Pivotal Talent?
Forethought, April
Reprint F0504K

Boynton, Andy
Virtuoso Teams
July–August
Reprint R0507K

Bradach, Jeffrey
Should Nonprofits Seek Profits?
February
Reprint R0502E

Bradberry, Travis
Heartless Bosses?
Forethought, December
Reprint F0512E

Bremmer, Ian
Managing Risk in an Unstable World
June
Reprint R0506B ♦ OnPoint 1126

Brown, John Seely
Productive Friction: How Difficult Business Partnerships Can Accelerate Innovation
February
Reprint R0502D

Buchanan, Leigh
The Beauty of an Open Calendar
A conversation with James Goodnight
Forethought, April
Reprint F0504L

Been There, Read That
A conversation with Robert Morris
Forethought, October
Reprint F0510G

Knowing What to Listen For
A conversation with Herb Greenberg
Forethought, June
Reprint F0506G

New Laws of the Jingle
Forethought, June
Reprint F0506C

No More Metaphors
Forethought, March
Reprint F0503E

Play to Win
A conversation with Henry Jenkins
Forethought, December
Reprint F0512G

Save That Thought
A conversation with Marc Abrahams
Forethought, September
Reprint F0509F

Sweat the Small Stuff
Forethought, April
Reprint F0504G

Those Fertile HR Fields
Forethought, April
Reprint F0504B

Bucheli, Marcelo
Banana War Maneuvers
Forethought, November
Reprint F0511E

Buckingham, Marcus
What Great Managers Do
March
Reprint R0503D

Buck Luce, Carolyn
Leadership in Your Midst: Tapping the Hidden Strengths of Minority Executives
November
Reprint R0511D ♦ OnPoint 2211 OnPoint collection "Required Reading for White Executives, 2nd Edition" 2203

Off-Ramps and On-Ramps: Keeping Talented Women on the Road to Success
March
Reprint R0503B ♦ OnPoint 9416 OnPoint collection "Required Reading for Executive Women–and the Companies Who Need Them" 9394

Butman, John
Lessons from the Egg Master
Forethought, May
Reprint F0505H

C

Callioni, Gianpaolo
Inventory-Driven Costs
March
Reprint R0503J

Cappelli, Peter
The New Road to the Top
January
Reprint R0501B

Carrott, Gregory T.
Culture Matters Most
Forethought, May
Reprint F0505D

Casciaro, Tiziana
Competent Jerks, Lovable Fools, and the Formation of Social Networks
June
Reprint R0506E ♦ OnPoint 1118

Case, John
Every Employee an Owner. Really.
June
Reprint R0506H

Castronova, Edward
Real Products in Imaginary Worlds
Forethought, May
Reprint F0505C

Charan, Ram
Ending the CEO Succession Crisis
February
Reprint R0502C ♦ OnPoint 8851 OnPoint collection "Hire the Right CEO" 8843

Chen, Ann
Expanding in China
Forethought, March
Reprint F0503D

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Christensen, Clayton M.
Marketing Malpractice: The Cause and the Cure
December
Reprint R0512D ♦ OnPoint 2386
OnPoint collection "Make Sure *All* Your Products Are Profitable" 2432

Ciampa, Dan
Almost Ready: How Leaders Move Up
January
Reprint R0501D

Clancy, Kevin J.
Don't Blame the Metrics
Forethought, June
Reprint F0506J

Coffman, Curt
Manage Your Human Sigma
July–August
Reprint R0507J ♦ OnPoint 1533

Cohn, Jeffrey M.
Growing Talent as if Your Business Depended on It
October
Reprint R0510C ♦ OnPoint 1924

Collins, Jim
Level 5 Leadership: The Triumph of Humility and Fierce Resolve
July–August
Originally published in 2001
Reprint R0507M ♦ OnPoint 5831
OnPoint collection "What Great Leaders Do" 1479

Collis, David
Benchmarking Your Staff
Forethought, September
Reprint F0509H

Cook, Scott
Marketing Malpractice: The Cause and the Cure
December
Reprint R0512D ♦ OnPoint 2386
OnPoint collection "Make Sure *All* Your Products Are Profitable" 2432

Coutu, Diane L.
Strategic Intensity: A Conversation with World Chess Champion Garry Kasparov
April
Reprint R0504B

Critelli, Michael J.
Back Where We Belong
May
Reprint R0505B

Cross, Rob
A Practical Guide to Social Networks
March
Reprint R0503H

Cunningham, Cynthia R.
Two Executives, One Career
February
Reprint R0502H

D

Darling, Marilyn
Learning in the Thick of It
July–August
Reprint R0507G ♦ OnPoint 1525

Davenport, Thomas H.
The Coming Commoditization of Processes
June
Reprint R0506F

Day, George S.
Scanning the Periphery
November
Reprint R0511H

Dell, Michael
(an interview with)
The HBR Interview: Execution Without Excuses
March
Reprint R0503G

de Montgros, Xavier
Inventory-Driven Costs
March
Reprint R0503J

Denrell, Jerker
Selection Bias and the Perils of Benchmarking
April
Reprint R0504H

Derman, Emanuel
Beware of Economists Bearing Greek Symbols
Forethought, October
Reprint F0510A

Deshpandé, Rohit
Up to Code: Does Your Company's Conduct Meet World-Class Standards?
December
Reprint R0512H

Dholakia, Paul M.
The Hazards of Hounding
Forethought, October
Reprint F0510F

Downes, Larry
The Commerce Clause Wakes Up
Forethought, September
Reprint F0509A

Drucker, Peter F.
Managing Oneself
January
Originally published in 1999
Reprint R0501K ♦ OnPoint 4444
OnPoint collection "Managing Yourself" 8762

Looking for a profit reality check? It's in the mailstream

On a never-ending quest for profitability, today's businesses are analyzing every corner of their operations, looking to squeeze out a little more cost and squeeze in a little more revenue. They'd do well to check the "mailstream".

The word "mail" is no longer an apt description for what has become an undeniably profitable business-building tool. In fact, there's a new term that defines the technology, data and processes for managing today's more complex and dynamic communications. It's called the mailstream.

What is the mailstream?

The mailstream is the sum of all the mail and documents, both traditional and digital, as well as packages, that flow across your business and to customers and back. It's the entire matrix of people, processes and technology, from your database to document creation to delivery.

Why should you care?

In a word, profit. Companies of all sizes across the full range of industries have proven that optimizing your mailstream can result in significantly higher revenue and lower costs.

How can the mailstream grow profit?

Every document, package or piece of mail – whether it's an invoice, an activation kit or an owner's manual that arrives via DVD – is an opportunity to up-sell or cross-sell, to acquire new customers or strengthen existing relationships.

What's driving the mailstream revolution?

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Drzik, John
Countering the Biggest Risk of All
April
Reprint R0504E ♦ OnPoint 977X

Dunlap, Shannon
How to Build Your Network
December
Reprint R0512B

Dutton, Jane
How to Play to Your Strengths
January
Reprint R0501G

E

Elberse, Anita
How Markets Help Marketers
Forethought, September
Reprint F0509L

Ernst, David
Your Alliances Are Too Stable
June
Reprint R0506J

Evans, David
When Good Customers Are Bad
Forethought, September
Reprint F0509B

Evans, Harold
The Eureka Myth
Forethought, June
Reprint F0506A

Evans, Philip
Collaboration Rules
July–August
Reprint R0507H

F

Fischer, Bill
Virtuoso Teams
July–August
Reprint R0507K

Fleming, John H.
Manage Your Human Sigma
July–August
Reprint R0507J ♦ OnPoint 1533

Florida, Richard
Managing for Creativity
July–August
Reprint R0507L

Foster, William
Should Nonprofits Seek Profits?
February
Reprint R0502E

Fryer, Bronwyn
Are You Working Too Hard?
A Conversation with Mind/Body Researcher Herbert Benson
November
Reprint R0511B

HBR Case Study: Fat Chance
May
Reprint R0505A

Furedi, Frank
Treat Employees like Adults
Forethought, May
Reprint F0505E

G

Gabarro, John J.
Managing Your Boss
January
Originally published in 1980
Reprint R0501J

Garvin, David A.
Change Through Persuasion
February
Reprint R0502F

Gavetti, Giovanni
How Strategists Really Think: Tapping the Power of Analogy
April
Reprint R0504C ♦ OnPoint 9661
OnPoint collection "Why Bad Decisions Happen to Good Managers" 9653

Geissler, Cornelia
HBR Case Study: The Cane Mutiny: Managing a Graying Workforce
October
Reprint R0510A

Gentile, Mary
Get Aggressive About Passivity
Forethought, November
Reprint F0511A

Gerson, Ben
The Limits of Professional Behavior
Forethought, April
Reprint F0504A

Ghemawat, Pankaj
Regional Strategies for Global Leadership
December
Reprint R0512F

Gnamm, Joerg
Leading from the Factory Floor
Forethought, November
Reprint F0511D

Goffee, Rob
Managing Authenticity: The Paradox of Great Leadership
December
Reprint R0512E

Goodnight, Jim
(a conversation with)
The Beauty of an Open Calendar
Forethought, April
Reprint F0504L

Managing for Creativity
July–August
Reprint R0507L

Goold, Michael
Benchmarking Your Staff
Forethought, September
Reprint F0509H

When Lean Isn't Mean
Forethought, April
Reprint F0504D

Gottfredson, Mark
Innovation Versus Complexity: What Is Too Much of a Good Thing?
November
Reprint R0511C ♦ OnPoint 222X

Strategic Sourcing: From Periphery to the Core
February
Reprint R0502J ♦ OnPoint 8878

Gourville, John T.
HBR Case Study: Holding Fast
June
Reprint R0506A

Govindarajan, Vijay
Building Breakthrough Businesses Within Established Organizations
May
Reprint R0505C ♦ OnPoint 9955
OnPoint collection "Building Breakthrough Businesses in Emerging Companies" 9971

Greaves, Jean
Heartless Bosses?
Forethought, December
Reprint F0512E

Greenberg, Herb
(a conversation with)
Knowing What to Listen For
Forethought, June
Reprint F0506G

Greenwald, Bruce
All Strategy Is Local
September
Reprint R0509E

Gulati, Ranjay
The Quest for Customer Focus
April
Reprint R0504F ♦ OnPoint 9645
OnPoint collection "Customer Data–Use It or Lose 'Em" 9637

H

Hagel, John III
Productive Friction: How Difficult Business Partnerships Can Accelerate Innovation
February
Reprint R0502D

Hall, Taddy
Marketing Malpractice: The Cause and the Cure
December
Reprint R0512D ♦ OnPoint 2386
OnPoint collection "Make Sure *All* Your Products Are Profitable" 2432

Hallowell, Edward M.
Overloaded Circuits: Why Smart People Underperform
January
Reprint R0501E ♦ OnPoint 8789

Hamel, Gary
Strategic Intent
July–August
Originally published in 1989
Reprint R0507N ♦ OnPoint 6557

Hamori, Monika
The New Road to the Top
January
Reprint R0501B

Hanig, Robert
Developing First-Level Leaders
June
Reprint R0506G

Hannaford, Steve
Both Sides Now
Forethought, March
Reprint F0503B

Harryson, Sigvald
Bringing the College Inside
Forethought, December
Reprint F0512J

Harter, James K.
Manage Your Human Sigma
July–August
Reprint R0507J ♦ OnPoint 1533

Heaphy, Emily
How to Play to Your Strengths
January
Reprint R0501G

Henderson, Pamela W.
Just My Type
Forethought, April
Reprint F0504J

Heracleous, Loizos
Shareholder Votes for Sale
Forethought, June
Reprint F0506D

Hewlett, Sylvia Ann
Leadership in Your Midst: Tapping the Hidden Strengths of Minority Executives
November
Reprint R0511D ♦ OnPoint 2211
OnPoint collection "Required Reading for White Executives, 2nd Edition" 2203

Off-Ramps and On-Ramps: Keeping Talented Women on the Road to Success
March
Reprint R0503B ♦ OnPoint 9416
OnPoint collection "Required Reading for Executive Women–and the Companies Who Need Them" 9394

Houlder, Dominic
Do Your Commitments Match Your Convictions?
January
Reprint R0501H ♦ OnPoint 8770
OnPoint collection "Managing Yourself" 8762

Hughes, Jonathan
Want Collaboration? Accept–and Actively Manage–Conflict
March
Reprint R0503F

Huselid, Mark A.
"A Players" or "A Positions"? The Strategic Logic of Workforce Management
December
Reprint R0512G ♦ OnPoint 2424
OnPoint collection "Shape Your Workforce for Strategic Success" 2769

I

Ibarra, Herminia
What's Your Story?
January
Reprint R0501F

J

Jackson, Alan
The Hard Side of Change Management
October
Reprint R0510G ♦ OnPoint 1916
OnPoint collection "Lead Change–Successfully, 3rd Edition" 1908

Jacobson, Robert
Talk About Brand Strategy
Forethought, October
Reprint F0510J

Javidan, Mansour
The Changing Face of the Chinese Executive
Forethought, December
Reprint F0512H

Jenkins, Henry
(a conversation with)
Play to Win
Forethought, December
Reprint F0512G

Johansson, Frans
Masters of the Multicultural
Forethought, October
Reprint F0510D

Jones, Daniel T.
Lean Consumption
March
Reprint R0503C ♦ OnPoint 9432

Jones, Gareth
Managing Authenticity: The Paradox of Great Leadership
December
Reprint R0512E

K

Kahn, Judd
All Strategy Is Local
September
Reprint R0509E

Kalyanam, Kirthi
The Perfect Message at the Perfect Moment
November
Reprint R0511G ♦ OnPoint 219X
OnPoint collection "CRM–the Right Way, 3rd Edition" 2173

Kambil, Ajit
HBR Case Study: Springboard to a Swan Dive?
February
Reprint R0502B

Room at the Top Line
Forethought, October
Reprint F0510H

Kaplan, Robert S.
The Balanced Scorecard: Measures That Drive Performance
July–August
Originally published in 1992
Reprint R0507Q ♦ OnPoint 4096

The Office of Strategy Management
October
Reprint R0510D ♦ OnPoint 1894
OnPoint collection "Focus Your Organization on Strategy–with the Balanced Scorecard, 3rd Edition" 1886

Kasparov, Garry
(a conversation with)
Strategic Intensity
April
Reprint R0504B

Kastenholz, John
The Spielberg Variables
Forethought, April
Reprint F0504C

Katzenbach, Jon R.
The Discipline of Teams
July–August
Originally published in 1993
Reprint R0507P ♦ OnPoint 4428

Keenan, Perry
The Hard Side of Change Management
October
Reprint R0510G ♦ OnPoint 1916
OnPoint collection "Lead Change–Successfully, 3rd Edition" 1908

Kell, Thomas
Culture Matters Most
Forethought, May
Reprint F0505D

Kesner, Idalene F.
HBR Case Study: Class–or Mass?
April
Reprint R0504A

Kets de Vries, Manfred F.R.
The Dangers of Feeling like a Fake
September
Reprint R0509F

Khanna, Tarun
Strategies That Fit Emerging Markets
June
Reprint R0506C

Khurana, Rakesh
Growing Talent as if Your Business Depended on It
October
Reprint R0510C ♦ OnPoint 1924

Kirby, Julia
HBR Case Study: Fat Chance
May
Reprint R0505A

Toward a Theory of High Performance
July–August
Reprint R0507B

Koetzle, Laura
A United Defense
Forethought, September
Reprint F0509G

Kotter, John P.
Managing Your Boss
January
Originally published in 1980
Reprint R0501J

Koudal, Peter
Global Manufacturers at a Crossroads
Forethought, March
Reprint F0503F

Krishna, Aradhna
How Big Is "Tall"?
Forethought, April
Reprint F0504F

L

Lan, Luh Luh
Shareholder Votes for Sale
Forethought, June
Reprint F0506D

Lanzolla, Gianvito
The Half-Truth of First-Mover Advantage
April
Reprint R0504J

Leamer, Edward E.
The Rich (and Poor) Keep Getting Richer
Forethought, April
Reprint F0504H

Liedtka, Jeanne
A Practical Guide to Social Networks
March
Reprint R0503H

Linder, Jane C.
Outsourcing Integration
Forethought, June
Reprint F0506B

Lineback, Kent
What's Your Story?
January
Reprint R0501F

Lombreglia, Ralph
Four Strategies for the Age of Smart Services
October
Reprint R0510J

Longman, Phillip
Vanishing Jobs? Blame the Boomers
Forethought, March
Reprint F0503G

Lorange, Peter
Bringing the College Inside
Forethought, December
Reprint F0512J

Lynton, Nandani
The Changing Face of the Chinese Executive
Forethought, December
Reprint F0512H

M

MacMillan, Ian C.
MarketBusting: Strategies for Exceptional Business Growth
March
Reprint R0503E ♦ OnPoint 9408
OnPoint collection "Spur Market-Busting Growth" 9386

Mankins, Michael C.
Turning Great Strategy into Great Performance
July–August
Reprint R0507E ♦ OnPoint 1509
OnPoint collection "Great Strategy *and* Great Results" 1495

Margolis, Joshua D.
Up to Code: Does Your Company's Conduct Meet World-Class Standards?
December
Reprint R0512H

Martens, Martin L.
Hang On to Those Founders
Forethought, October
Reprint F0510E

Mass, Nathaniel J.
The Relative Value of Growth
April
Reprint R0504G

Mayo, Anthony J.
Zeitgeist Leadership
October
Reprint R0510B

McFarlan, F. Warren
Information Technology and the Board of Directors
October
Reprint R0510F

McGovern, Gail
Outsourcing Marketing
Forethought, March
Reprint F0503J

McGrath, Rita Gunther
MarketBusting: Strategies for Exceptional Business Growth
March
Reprint R0503E ♦ OnPoint 9408
OnPoint collection "Spur Market-Busting Growth" 9386

McNulty, Eric
HBR Case Study: Just in Time for the Holidays
December
Reprint R0512A

Melton, H. Keith
(a conversation with)
What? Me, Worry?
Forethought, November
Reprint F0511G

Menkes, Justin
Hiring for Smarts
November
Reprint R0511F

Merton, Robert C.
You Have More Capital than You Think
November
Reprint R0511E

Mizik, Natalie
Talk About Brand Strategy
Forethought, October
Reprint F0510J

Moon, Youngme
Break Free from the Product Life Cycle
May
Reprint R0505E ♦ OnPoint 9963

Moore, Geoffrey A.
Strategy and Your Stronger Hand
December
Reprint R0512C ♦ OnPoint 2394

Moore, Joseph
Learning in the Thick of It
July–August
Reprint R0507G ♦ OnPoint 1525

Morris, Robert
(a conversation with)
Been There, Read That
Forethought, October
Reprint F0510G

Morse, Gardiner
Crap Circles
Forethought, November
Reprint F0511C

Hidden Harassment
Forethought, June
Reprint F0506K

Innovate at Your Own Risk
A conversation with Deborah Wince-Smith
Forethought, May
Reprint F0505G

Trust, but Verify
Forethought, May
Reprint F0505B

What? Me, Worry?
A conversation with H. Keith Melton
Forethought, November
Reprint F0511G

When Stability Breeds Instability
Forethought, December
Reprint F0512K

Murray, Shelley S.
Two Executives, One Career
February
Reprint R0502H

N

Nadler, David A.
Confessions of a Trusted Counselor
September
Reprint R0509C ♦ OnPoint 1770

Narayandas, Das
Building Loyalty in Business Markets
September
Reprint R0509H

Neeleman, David
(a conversation with)
Lessons from the Slums of Brazil
Forethought, March
Reprint F0503K

Neilson, Gary L.
The Passive-Aggressive Organization
October
Reprint R0510E

Neuhaus, Klaus
Leading from the Factory Floor
Forethought, November
Reprint F0511D

Nohria, Nitin
HBR Case Study: Feed R&D–or Farm It Out?
July–August
Reprint R0507A

Zeitgeist Leadership
October
Reprint R0510B

Nolan, Richard
Information Technology and the Board of Directors
October
Reprint R0510F

Norton, David P.
The Balanced Scorecard: Measures That Drive Performance
July–August
Originally published in 1992
Reprint R0507Q ♦ OnPoint 4096

The Office of Strategy Management
October
Reprint R0510D ♦ OnPoint 1894
OnPoint collection "Focus Your Organization on Strategy–with the Balanced Scorecard, 3rd Edition" 1886

O

O'Brien, Anne Lim
The Hardest Hire
Forethought, October
Reprint F0510K

O'Brien, Louise
The HBR Interview: Execution Without Excuses
An interview with Michael Dell and Kevin Rollins
March
Reprint R0503G

The HBR Interview: Transforming an Industrial Giant
An interview with Heinrich von Pierer
February
Reprint R0502G

Okada, Erica Mina
Denying the Urge to Splurge
Forethought, September
Reprint F0509K

Oldroyd, James B.
The Quest for Customer Focus
April
Reprint R0504F ♦ OnPoint 9645
OnPoint collection "Customer Data–Use It or Lose 'Em" 9637

O'Toole, James
How Business Schools Lost Their Way
May
Reprint R0505F

P

Paine, Lynn
Up to Code: Does Your Company's Conduct Meet World-Class Standards?
December
Reprint R0512H

Palepu, Krishna G.
Strategies That Fit Emerging Markets
June
Reprint R0506C

Paoni, Anthony J.
Every Product's a Platform
Forethought, October
Reprint F0510C

Parry, Charles
Learning in the Thick of It
July–August
Reprint R0507G ♦ OnPoint 1525

Pascale, Richard Tanner
Your Company's Secret Change Agents
May
Reprint R0505D

Pasternack, Bruce A.
The Passive-Aggressive Organization
October
Reprint R0510E

Peebles, M. Ellen
HBR Case Study: Into the Fray
January
Reprint R0501A

Phillips, Stephen
Strategic Sourcing: From Periphery to the Core
February
Reprint R0502J ♦ OnPoint 8878

Prahalad, C.K.
Strategic Intent
July–August
Originally published in 1989
Reprint R0507N ♦ OnPoint 6557

Priestland, Andreas
Developing First-Level Leaders
June
Reprint R0506G

Prusak, Laurence
The Madness of Individuals
Forethought, June
Reprint F0506E

Puryear, Rudy
Strategic Sourcing: From Periphery to the Core
February
Reprint R0502J ♦ OnPoint 8878

Q

Quelch, John
Outsourcing Marketing
Forethought, March
Reprint F0503J

Quinn, Robert E.
How to Play to Your Strengths
January
Reprint R0501G

Moments of Greatness: Entering the Fundamental State of Leadership
July–August
Reprint R0507F ♦ OnPoint 1460
OnPoint collection "What Great Leaders Do" 1479

R

Ramstad, Peter M.
Where's Your Pivotal Talent?
Forethought, April
Reprint F0504K

Reddy, Mergen
How Not to Extend Your Luxury Brand
Forethought, December
Reprint F0512C

Reeves, Laura
Growing Talent as if Your Business Depended on It
October
Reprint R0510C ♦ OnPoint 1924

Reich, Robert B.
Plenty of Knowledge Work to Go Around
Forethought, April
Reprint F0504E

Reichheld, Frederick F.
Motivating Through Metrics
Forethought, September
Reprint F0509C

Reisenberg, Kurt
The Trouble with CFOs
Forethought, November
Reprint F0511B

Riordan, Michael
No Monopoly on Innovation
Forethought, December
Reprint F0512A

Rivkin, Jan W.
How Strategists Really Think: Tapping the Power of Analogy
April
Reprint R0504C ♦ OnPoint 9661
OnPoint collection "Why Bad Decisions Happen to Good Managers" 9653

Roberto, Michael A.
Change Through Persuasion
February
Reprint R0502F

Roberts, John H.
Defensive Marketing: How a Strong Incumbent Can Protect Its Position
November
Reprint R0511J

Roberts, Laura Morgan
How to Play to Your Strengths
January
Reprint R0501G

Roche, Eileen
HBR Case Study: Riding the Celtic Tiger
November
Reprint R0511A

Rogers, Paul
Motivating Through Metrics
Forethought, September
Reprint F0509C

Rohde, Frank
Little Decisions Add Up
Forethought, June
Reprint F0506F

Rollins, Kevin
(an interview with)
The HBR Interview: Execution Without Excuses
March
Reprint R0503G

Rooke, David
Seven Transformations of Leadership
April
Reprint R0504D

Rosen, Corey
Every Employee an Owner. Really.
June
Reprint R0506H

Runzheimer, Rex
The Department of Mobility
Forethought, November
Reprint F0511H

S

Salzhauer, Amy
Coal Cleans Up Its Act
Forethought, June
Reprint F0506L

Is There a Patient in the House?
Forethought, November
Reprint F0511K

Way Faster than a Speeding Bullet
Forethought, April
Reprint F0504M

Sampath, Rekha
Room at the Top Line
Forethought, October
Reprint F0510H

Sams, Steven
Emerging Expertise
Forethought, May
Reprint F0505F

Samuelson, Judith
Get Aggressive About Passivity
Forethought, November
Reprint F0511A

Schoemaker, Paul J.H.
Scanning the Periphery
November
Reprint R0511H

Schott, Peter K.
The Rich (and Poor) Keep Getting Richer
Forethought, April
Reprint F0504H

Schwartz, Jonathan
If You Want to Lead, Blog
Forethought, November
Reprint F0511J

Sheffi, Yossi
HBR Case Study: The Tug-of-War
September
Reprint R0509A

Shulman, Jack
Revaluing Writing
Forethought, December
Reprint F0512F

Simons, Robert
Designing High-Performance Jobs
July–August
Reprint R0507D ♦ OnPoint 1517

Singh, Jitendra V.
Getting Offshoring Right
December
Reprint R0512J

Sinha, Jayant
Strategies That Fit Emerging Markets
June
Reprint R0506C

Sirkin, Harold L.
The Hard Side of Change Management
October
Reprint R0510G ♦ OnPoint 1916
OnPoint collection "Lead Change–Successfully, 3rd Edition" 1908

Slagmulder, Regine
Inventory-Driven Costs
March
Reprint R0503J

Slywotzky, Adrian J.
Countering the Biggest Risk of All
April
Reprint R0504E ♦ OnPoint 977X

Smith, Douglas K.
The Discipline of Teams
July–August
Originally published in 1993
Reprint R0507P ♦ OnPoint 4428

Sodhi, ManMohan S.
Six Sigma Pricing
May
Reprint R0505H

Sodhi, Navdeep S.
Six Sigma Pricing
May
Reprint R0505H

Sousa Lobo, Miguel
Competent Jerks, Lovable Fools, and the Formation of Social Networks
June
Reprint R0506E ♦ OnPoint 1118

Spear, Steven J.
Fixing Health Care from the Inside, Today
September
Reprint R0509D ♦ OnPoint 1738
OnPoint collection "Curing U.S. Healthcare, 2nd Edition" 172X

Spreitzer, Gretchen
How to Play to Your Strengths
January
Reprint R0501G

Stalk, George, Jr.
Rotate the Core
Forethought, March
Reprint F0503C

Starbuck, William H.
"Bureaucracy" Becomes a Four-Letter Word
Forethought, October
Reprint F0510B

Staubus, Martin
Every Employee an Owner. Really.
June
Reprint R0506H

Steele, Richard
Turning Great Strategy into Great Performance
July–August
Reprint R0507E ♦ OnPoint 1509
OnPoint collection "Great Strategy *and* Great Results" 1495

Sternin, Jerry
Your Company's Secret Change Agents
May
Reprint R0505D

Stewart, Thomas A.
The HBR Interview: Execution Without Excuses
An interview with Michael Dell and Kevin Rollins
March
Reprint R0503G

The HBR Interview: Transforming an Industrial Giant
An interview with Heinrich von Pierer
February
Reprint R0502G

Stone, Randy L.
Don't Blame the Metrics
Forethought, June
Reprint F0506J

Strack, Rainer
The Surprising Economics of a "People Business"
June
Reprint R0506D

Suarez, Fernando
The Half-Truth of First-Mover Advantage
April
Reprint R0504J

Sull, Donald N.
Do Your Commitments Match Your Convictions?
January
Reprint R0501H ♦ OnPoint 8770
OnPoint collection "Managing Yourself" 8762

Strategy as Active Waiting
September
Reprint R0509G ♦ OnPoint 1754
OnPoint collection "Strategy Despite Uncertainty: Cutting Through the Fog" 1746

Sullivan, Chris T.
A Stake in the Business
September
Reprint R0509B

Sviokla, John
Every Product's a Platform
Forethought, October
Reprint F0510C

T

Terblanche, Nic
How Not to Extend Your Luxury Brand
Forethought, December
Reprint F0512C

Thompson, Caroline
The Faster They Fall
Forethought, March
Reprint F0503H

Thurm, David
Master of the House: Why a Company Should Take Control of Its Building Projects
October
Reprint R0510H

Torbert, William R.
Seven Transformations of Leadership
April
Reprint R0504D

Trimble, Chris
Building Breakthrough Businesses Within Established Organizations
May
Reprint R0505C ♦ OnPoint 9955
OnPoint collection "Building Breakthrough Businesses in Emerging Companies" 9971

Trout, Jack
Schizophrenia at GM
Forethought, September
Reprint F0509D

U

Uzzi, Brian
How to Build Your Network
December
Reprint R0512B

V

Van Alstyne, Marshall W.
Create Colleagues, Not Competitors
Forethought, September
Reprint F0509E

Van Hoek, Remko
When Good Customers Are Bad
Forethought, September
Reprint F0509B

Van Nuys, Karen E.
The Passive-Aggressive Organization
October
Reprint R0510E

Van Wassenhove, Luk N.
Inventory-Driven Costs
March
Reprint R0503J

Viguerie, S. Patrick
The Faster They Fall
Forethought, March
Reprint F0503H

Vishwanath, Vijay
Expanding in China
Forethought, March
Reprint F0503D

Vogel, David
The Low Value of Virtue
Forethought, June
Reprint F0506H

von Pierer, Heinrich
(an interview with)
The HBR Interview: Transforming an Industrial Giant
February
Reprint R0502G

W

Wademan, Daisy
The Best Advice I Ever Got
January
Reprint R0501C

Lessons from the Slums of Brazil
A conversation with David Neeleman
Forethought, March
Reprint F0503K

Walden, Eric
Give a Little, Get a Little
Forethought, September
Reprint F0509J

Walters, Rockney
HBR Case Study: Class–or Mass?
April
Reprint R0504A

Weinberger, David
Sorting Data to Suit Yourself
Forethought, March
Reprint F0503A

Weiss, Jeff
Want Collaboration? Accept–and Actively Manage–Conflict
March
Reprint R0503F

Weiss, Leigh
A Practical Guide to Social Networks
March
Reprint R0503H

Werbach, Kevin
Using VoIP to Compete
September
Reprint R0509J

West, Cornel
Leadership in Your Midst: Tapping the Hidden Strengths of Minority Executives
November
Reprint R0511D ♦ OnPoint 2211
OnPoint collection "Required Reading for White Executives, 2nd Edition" 2203

Wetherbe, James
Give a Little, Get a Little
Forethought, September
Reprint F0509J

White, Miles
The Cost-Benefit of Well Employees
Forethought, December
Reprint F0512D

Wince-Smith, Deborah
(a conversation with)
Innovate at Your Own Risk
Forethought, May
Reprint F0505G

Winer, Russell S.
Capturing Customers' Spare Change
Forethought, May
Reprint F0505K

Wolf, Bob
Collaboration Rules
July–August
Reprint R0507H

Womack, James P.
Lean Consumption
March
Reprint R0503C ♦ OnPoint 9432

Wright, Linda
Inventory-Driven Costs
March
Reprint R0503J

Y

Young, David
When Lean Isn't Mean
Forethought, April
Reprint F0504D

Z

Zittrain, Jonathan
In Praise of Uncertainty
Forethought, May
Reprint F0505A

Zweben, Monte
The Perfect Message at the Perfect Moment
November
Reprint R0511G ♦ OnPoint 219X
OnPoint collection "CRM – the Right Way, 3rd Edition" 2173

Other Contributors

The Best Advice I Ever Got
Daisy Wademan with Shelly Lazarus, Daniel Vasella, Liz Lange, Henry M. Paulson, Jr., Earl G. Graves, Barry S. Sternlicht
January
Reprint R0501C

The HBR List: Breakthrough Ideas for 2005
Roderick M. Kramer, Julia Kirby, Joseph L. Bower, Jeffrey F. Rayport, Eric Bonabeau, Roger L. Martin, Kirthi Kalyanam, Monte Zweben, Robert C. Merton, Thomas A. Stewart, Mohanbir Sawhney, Denise Caruso, Thomas H. Davenport, Leigh Buchanan, Henry W. Chesbrough, Kenneth Lieberthal, Jochen Wirtz, Loizos Heracleous, Mary Catherine Bateson, Jeffrey Rosen, Tihamér von Ghyczy, Janis Antonovics, Jeffrey Pfeffer
February
Reprint R0502A

When Failure Isn't an Option
Michael R. Hillmann, Philippe Dongier, Robert P. Murgallis, Mary Khosh, Elizabeth K. Allen, Ray Evernham
July–August
Reprint R0507C

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David A. Garvin and Michael A. Roberto
February
Reprint R0502F

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Harold L. Sirkin, Perry Keenan, and Alan Jackson
October
Reprint R0510G ♦ OnPoint 1916
OnPoint collection "Lead Change – Successfully, 3rd Edition" 1908

HBR Case Study: The Tug-of-War
Yossi Sheffi
September
Reprint R0509A

The HBR Interview: Execution Without Excuses
Michael Dell and Kevin Rollins
Interviewed by Thomas A. Stewart and Louise O'Brien
March
Reprint R0503G

Your Company's Secret Change Agents
Richard Tanner Pascale and Jerry Sternin
May
Reprint R0505D

Corporate Social Responsibility

The Low Value of Virtue
David Vogel
Forethought, June
Reprint F0506H

Diversity

Leadership in Your Midst: Tapping the Hidden Strengths of Minority Executives
Sylvia Ann Hewlett, Carolyn Buck Luce, and Cornel West
November
Reprint R0511D ♦ OnPoint 2211
OnPoint collection "Required Reading for White Executives, 2nd Edition" 2203

Entrepreneurship

Hang On to Those Founders
Martin L. Martens
Forethought, October
Reprint F0510E

Ethics and Society

Coal Cleans Up Its Act
Amy Salzhauer
Forethought, June
Reprint F0506L

Get Aggressive About Passivity
Judith Samuelson and Mary Gentile
Forethought, November
Reprint F0511A

HBR Case Study: The Shakedown
Phil Bodrock
March
Reprint R0503A

Up to Code: Does Your Company's Conduct Meet World-Class Standards?
Lynn Paine, Rohit Deshpandé, Joshua D. Margolis, and Kim Eric Bettcher
December
Reprint R0512H

Finance and Accounting

Beware of Economists Bearing Greek Symbols
Emanuel Derman
Forethought, October
Reprint F0510A

You Have More Capital than You Think
Robert C. Merton
November
Reprint R0511E

General Management

Been There, Read That
A conversation with Robert Morris
Leigh Buchanan
Forethought, October
Reprint F0510G

The HBR List: Breakthrough Ideas for 2005
February
Reprint R0502A

How Business Schools Lost Their Way
Warren G. Bennis and James O'Toole
May
Reprint R0505F

No More Metaphors
Leigh Buchanan
Forethought, March
Reprint F0503E

Selection Bias and the Perils of Benchmarking
Jerker Denrell
April
Reprint R0504H

Globalization

The Changing Face of the Chinese Executive
Mansour Javidan and Nandani Lynton
Forethought, December
Reprint F0512H

Expanding in China
Ann Chen and Vijay Vishwanath
Forethought, March
Reprint F0503D

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Peter Koudal
Forethought, March
Reprint F0503F

Managing Risk in an Unstable World
Ian Bremmer
June
Reprint R0506B ♦ OnPoint 1126

The New Tools of Trade
Regina M. Abrami and Leonard Bierman
Forethought, May
Reprint F0505J

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Robert B. Reich
Forethought, April
Reprint F0504E

The Rich (and Poor) Keep Getting Richer
Edward E. Leamer and Peter K. Schott
Forethought, April
Reprint F0504H

Governance

Oil and Troubled Waters
Nicholas Beale
Forethought, November
Reprint F0511F

Shareholder Votes for Sale
Luh Luh Lan and Loizos Heracleous
Forethought, June
Reprint F0506D

Government and Law

The Commerce Clause Wakes Up
Larry Downes
Forethought, September
Reprint F0509A

Human Resources

"A Players" or "A Positions"? The Strategic Logic of Workforce Management
Mark A. Huselid, Richard W. Beatty, and Brian E. Becker
December
Reprint R0512G ♦ OnPoint 2424
OnPoint collection "Shape Your Workforce for Strategic Success" 2769

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Miles White
Forethought, December
Reprint F0512D

HBR Case Study: Fat Chance
Bronwyn Fryer and Julia Kirby
May
Reprint R0505A

HBR Case Study: The Cane Mutiny: Managing a Graying Workforce
Cornelia Geissler
October
Reprint R0510A

Heartless Bosses?
Travis Bradberry and Jean Greaves
Forethought, December
Reprint F0512E

Knowing What to Listen For
A conversation with Herb Greenberg
Leigh Buchanan
Forethought, June
Reprint F0506G

Managing for Creativity
Richard Florida and Jim Goodnight
July–August
Reprint R0507L

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Sylvia Ann Hewlett and Carolyn Buck Luce
March
Reprint R0503B ♦ OnPoint 9416
OnPoint collection "Required Reading for Executive Women – and the Companies Who Need Them" 9394

Play to Win
A conversation with Henry Jenkins
Leigh Buchanan
Forethought, December
Reprint F0512G

Those Fertile HR Fields
Leigh Buchanan
Forethought, April
Reprint F0504B

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Those Who Can't, Don't Know It
Marc Abrahams
Forethought, December
Reprint F0512B

Treat Employees like Adults
Frank Furedi
Forethought, May
Reprint F0505E

Vanishing Jobs? Blame the Boomers
Phillip Longman
Forethought, March
Reprint F0503G

Where's Your Pivotal Talent?
John W. Boudreau and Peter M. Ramstad
Forethought, April
Reprint F0504K

Information Technology

In Praise of Uncertainty
Jonathan Zittrain
Forethought, May
Reprint F0505A

Is There a Patient in the House?
Amy Salzhauer
Forethought, November
Reprint F0511K

Innovation and Creativity

The Eureka Myth
Harold Evans
Forethought, June
Reprint F0506A

Every Product's a Platform
John Sviokla and Anthony J. Paoni
Forethought, October
Reprint F0510C

Innovate at Your Own Risk
A conversation with Deborah Wince-Smith
Gardiner Morse
Forethought, May
Reprint F0505G

Lessons from the Egg Master
John Butman
Forethought, May
Reprint F0505H

Masters of the Multicultural
Frans Johansson
Forethought, October
Reprint F0510D

No Monopoly on Innovation
Michael Riordan
Forethought, December
Reprint F0512A

Save That Thought
A conversation with Marc Abrahams
Leigh Buchanan
Forethought, September
Reprint F0509F

Knowledge Management

Create Colleagues, Not Competitors
Marshall W. Van Alstyne
Forethought, September
Reprint F0509E

The Madness of Individuals
Laurence Prusak
Forethought, June
Reprint F0506E

Sorting Data to Suit Yourself
David Weinberger
Forethought, March
Reprint F0503A

Leadership

Almost Ready: How Leaders Move Up
Dan Ciampa
January
Reprint R0501D

Confessions of a Trusted Counselor
David A. Nadler
September
Reprint R0509C ♦ OnPoint 1770

The Dangers of Feeling like a Fake
Manfred F.R. Kets de Vries
September
Reprint R0509F

Ending the CEO Succession Crisis
Ram Charan
February
Reprint R0502C ♦ OnPoint 8851
OnPoint collection "Hire the Right CEO" 8843

Growing Talent as if Your Business Depended on It
Jeffrey M. Cohn, Rakesh Khurana, and Laura Reeves
October
Reprint R0510C ♦ OnPoint 1924

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Heinrich von Pierer
Interviewed by Thomas A. Stewart and Louise O'Brien
February
Reprint R0502G

Hiring for Smarts
Justin Menkes
November
Reprint R0511F

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Jonathan Schwartz
Forethought, November
Reprint F0511J

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July–August
Originally published in 2001
Reprint R0507M ♦ OnPoint 5831
OnPoint collection "What Great Leaders Do" 1479

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Rob Goffee and Gareth Jones
December
Reprint R0512E

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Robert E. Quinn
July–August
Reprint R0507F ♦ OnPoint 1460
OnPoint collection "What Great Leaders Do" 1479

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David Rooke and William R. Torbert
April
Reprint R0504D

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Kurt Reisenberg
Forethought, November
Reprint F0511B

What Great Managers Do
Marcus Buckingham
March
Reprint R0503D

Zeitgeist Leadership
Anthony J. Mayo and Nitin Nohria
October
Reprint R0510B

Management Development

Developing First-Level Leaders
Andreas Priestland and Robert Hanig
June
Reprint R0506G

The Hardest Hire
Anne Lim O'Brien
Forethought, October
Reprint F0510K

Managing Technology

Information Technology and the Board of Directors
Richard Nolan and F. Warren McFarlan
October
Reprint R0510F

Using VoIP to Compete
Kevin Werbach
September
Reprint R0509J

Marketing

Break Free from the Product Life Cycle
Youngme Moon
May
Reprint R0505E ♦ OnPoint 9963

Building Loyalty in Business Markets
Das Narayandas
September
Reprint R0509H

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Terri C. Albert and Russell S. Winer
Forethought, May
Reprint F0505K

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Gardiner Morse
Forethought, November
Reprint F0511C

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John H. Roberts
November
Reprint R0511J

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Erica Mina Okada
Forethought, September
Reprint F0509K

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Kevin J. Clancy and Randy L. Stone
Forethought, June
Reprint F0506J

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Paul M. Dholakia
Forethought, October
Reprint F0510F

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Idalene F. Kesner and Rockney Walters
April
Reprint R0504A

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John T. Gourville
June
Reprint R0506A

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Aradhna Krishna
Forethought, April
Reprint F0504F

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Anita Elberse
Forethought, September
Reprint F0509L

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Mergen Reddy and Nic Terblanche
Forethought, December
Reprint F0512C

Just My Type
Pamela W. Henderson
Forethought, April
Reprint F0504J

Marketing Malpractice: The Cause and the Cure
Clayton M. Christensen, Scott Cook, and Taddy Hall
December
Reprint R0512D ♦ OnPoint 2386
OnPoint collection "Make Sure *All* Your Products Are Profitable" 2432

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Leigh Buchanan
Forethought, June
Reprint F0506C

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Gail McGovern and John Quelch
Forethought, March
Reprint F0503J

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Kirthi Kalyanam and Monte Zweben
November
Reprint R0511G ♦ OnPoint 219X
OnPoint collection "CRM–the Right Way, 3rd Edition" 2173

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Reprint R0504F ♦ OnPoint 9645
OnPoint collection "Customer Data–Use It or Lose 'Em" 9637

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Edward Castronova
Forethought, May
Reprint F0505C

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Jack Trout
Forethought, September
Reprint F0509D

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John Kastenholz
Forethought, April
Reprint F0504C

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Natalie Mizik and Robert Jacobson
Forethought, October
Reprint F0510J

Mergers and Acquisitions

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Jane C. Linder
Forethought, June
Reprint F0506B

Nonprofit Management

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William Foster and Jeffrey Bradach
February
Reprint R0502E

Operations

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Thomas H. Davenport
June
Reprint R0506F

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Rex Runzheimer
Forethought, November
Reprint F0511H

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Steven J. Spear
September
Reprint R0509D ♦ OnPoint 1738
OnPoint collection "Curing U.S. Healthcare, 2nd Edition" 172X

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Ravi Aron and Jitendra V. Singh
December
Reprint R0512J

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Eric McNulty
December
Reprint R0512A

Inventory-Driven Costs
Gianpaolo Callioni, Xavier de Montgros, Regine Slagmulder, Luk N. Van Wassenhove, and Linda Wright
March
Reprint R0503J

Leading from the Factory Floor
Joerg Gnamm and Klaus Neuhaus
Forethought, November
Reprint F0511D

Lean Consumption
James P. Womack and Daniel T. Jones
March
Reprint R0503C ♦ OnPoint 9432

Six Sigma Pricing
ManMohan S. Sodhi and Navdeep S. Sodhi
May
Reprint R0505H

When Good Customers Are Bad
Remko Van Hoek and David Evans
Forethought, September
Reprint F0509B

Organization and Culture

The Beauty of an Open Calendar
A conversation with James Goodnight
Leigh Buchanan
Forethought, April
Reprint F0504L

Benchmarking Your Staff
Michael Goold and David Collis
Forethought, September
Reprint F0509H

"Bureaucracy" Becomes a Four-Letter Word
William H. Starbuck
Forethought, October
Reprint F0510B

Collaboration Rules
Philip Evans and Bob Wolf
July–August
Reprint R0507H

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Tiziana Casciaro and Miguel Sousa Lobo
June
Reprint R0506E ♦ OnPoint 1118

Creating the Living Brand
Neeli Bendapudi and Venkat Bendapudi
May
Reprint R0505G

Culture Matters Most
Thomas Kell and Gregory T. Carrott
Forethought, May
Reprint F0505D

Designing High-Performance Jobs
Robert Simons
July–August
Reprint R0507D ♦ OnPoint 1517

Every Employee an Owner. Really.
Corey Rosen, John Case, and Martin Staubus
June
Reprint R0506H

HBR Case Study: Into the Fray
M. Ellen Peebles
January
Reprint R0501A

Hidden Harassment
Gardiner Morse
Forethought, June
Reprint F0506K

Learning in the Thick of It
Marilyn Darling, Charles Parry, and Joseph Moore
July–August
Reprint R0507G ♦ OnPoint 1525

Lessons from the Slums of Brazil
A conversation with David Neeleman
Daisy Wademan
Forethought, March
Reprint F0503K

The Limits of Professional Behavior
Ben Gerson
Forethought, April
Reprint F0504A

Little Decisions Add Up
Frank Rohde
Forethought, June
Reprint F0506F

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David Thurm
October
Reprint R0510H

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Reprint R0510E

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February
Reprint R0502D

Rotate the Core
George Stalk, Jr.
Forethought, March
Reprint F0503C

A Stake in the Business
Chris T. Sullivan
September
Reprint R0509B

Strategy and Your Stronger Hand
Geoffrey A. Moore
December
Reprint R0512C ♦ OnPoint 2394

Sweat the Small Stuff
Leigh Buchanan
Forethought, April
Reprint F0504G

Want Collaboration? Accept – and Actively Manage – Conflict
Jeff Weiss and Jonathan Hughes
March
Reprint R0503F

When Lean Isn't Mean
Michael Goold and David Young
Forethought, April
Reprint F0504D

When Stability Breeds Instability
Gardiner Morse
Forethought, December
Reprint F0512K

Performance Measurement

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Reprint R0507J ♦ OnPoint 1533

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Forethought, September
Reprint F0509C

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Felix Barber and Rainer Strack
June
Reprint R0506D

Research and Development

Bringing the College Inside
Sigvald Harryson and Peter Lorange
Forethought, December
Reprint F0512J

HBR Case Study: Feed R&D – or Farm It Out?
Nitin Nohria
July–August
Reprint R0507A

Revaluing Writing
Jack Shulman
Forethought, December
Reprint F0512F

Way Faster than a Speeding Bullet
Amy Salzhauer
Forethought, April
Reprint F0504M

Risk Management

A United Defense
Laura Koetzle
Forethought, September
Reprint F0509G

Self-Management

Are You Working Too Hard? A Conversation with Mind/Body Researcher Herbert Benson
Bronwyn Fryer
November
Reprint R0511B

The Best Advice I Ever Got
Daisy Wademan
January
Reprint R0501C

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Donald N. Sull and Dominic Houlder
January
Reprint R0501H ♦ OnPoint 8770
OnPoint collection "Managing Yourself" 8762

HBR Case Study: Riding the Celtic Tiger
Eileen Roche
November
Reprint R0511A

HBR Case Study: Springboard to a Swan Dive?
Ajit Kambil and Bruce Beebe
February
Reprint R0502B

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Brian Uzzi and Shannon Dunlap
December
Reprint R0512B

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January
Reprint R0501G

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Peter F. Drucker
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Reprint R0501K ♦ OnPoint 4444
OnPoint collection "Managing Yourself" 8762

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Cynthia R. Cunningham and Shelley S. Murray
February
Reprint R0502H

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Herminia Ibarra and Kent Lineback
January
Reprint R0501F

Strategy and Competition

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Bruce Greenwald and Judd Kahn
September
Reprint R0509E

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Michael J. Critelli
May
Reprint R0505B

Banana War Maneuvers
Marcelo Bucheli
Forethought, November
Reprint F0511E

Both Sides Now
Steve Hannaford
Forethought, March
Reprint F0503B

Building Breakthrough Businesses Within Established Organizations
Vijay Govindarajan and Chris Trimble
May
Reprint R0505C ♦ OnPoint 9955
OnPoint collection "Building Breakthrough Businesses in Emerging Companies" 9971

Countering the Biggest Risk of All
Adrian J. Slywotzky and John Drzik
April
Reprint R0504E ♦ OnPoint 977x

Emerging Expertise
Steven Sams
Forethought, May
Reprint F0505F

The Faster They Fall
S. Patrick Viguerie and Caroline Thompson
Forethought, March
Reprint F0503H

Four Strategies for the Age of Smart Services
Glen Allmendinger and Ralph Lombreglia
October
Reprint R0510J

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Eric Walden and James Wetherbe
Forethought, September
Reprint F0509J

The Half-Truth of First-Mover Advantage
Fernando Suarez and Gianvito Lanzolla
April
Reprint R0504J

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Giovanni Gavetti and Jan W. Rivkin
April
Reprint R0504C ♦ OnPoint 9661
OnPoint collection "Why Bad Decisions Happen to Good Managers" 9653

Innovation Versus Complexity: What Is Too Much of a Good Thing?
Mark Gottfredson and Keith Aspinall
November
Reprint R0511C ♦ OnPoint 222X

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Rita Gunther McGrath and Ian C. MacMillan
March
Reprint R0503E ♦ OnPoint 9408
OnPoint collection "Spur Market-Busting Growth" 9386

The Office of Strategy Management
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October
Reprint R0510D ♦ OnPoint 1894
OnPoint collection "Focus Your Organization on Strategy–with the Balanced Scorecard, 3rd Edition" 1886

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Pankaj Ghemawat
December
Reprint R0512F

The Relative Value of Growth
Nathaniel J. Mass
April
Reprint R0504G

Room at the Top Line
Rekha Sampath and Ajit Kambil
Forethought, October
Reprint F0510H

Scanning the Periphery
George S. Day and Paul J.H. Schoemaker
November
Reprint R0511H

Strategic Intensity: A Conversation with World Chess Champion Garry Kasparov
Diane L. Coutu
April
Reprint R0504B

Strategic Intent
Gary Hamel and C.K. Prahalad
July–August
Originally published in 1989
Reprint R0507N ♦ OnPoint 6557

Strategic Sourcing: From Periphery to the Core
Mark Gottfredson, Rudy Puryear, and Stephen Phillips
February
Reprint R0502J ♦ OnPoint 8878

Strategies That Fit Emerging Markets
Tarun Khanna, Krishna G. Palepu, and Jayant Sinha
June
Reprint R0506C

Strategy as Active Waiting
Donald N. Sull
September
Reprint R0509G ♦ OnPoint 1754
OnPoint collection "Strategy Despite Uncertainty: Cutting Through the Fog" 1746

Toward a Theory of High Performance
Julia Kirby
July–August
Reprint R0507B

Turning Great Strategy into Great Performance
Michael C. Mankins and Richard Steele
July–August
Reprint R0507E ♦ OnPoint 1509
OnPoint collection "Great Strategy *and* Great Results" 1495

What? Me, Worry?
A conversation with H. Keith Melton
Gardiner Morse
Forethought, November
Reprint F0511G

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June
Reprint R0506J

Teams

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Originally published in 1993
Reprint R0507P ♦ OnPoint 4428

Trust, but Verify
Gardiner Morse
Forethought, May
Reprint F0505B

Virtuoso Teams
Bill Fischer and Andy Boynton
July–August
Reprint R0507K

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July–August
Reprint R0507C

The
mailstream
is evolving at
blinding speeds.

Today, the flow of mail, documents and packages is increasingly diverse, containing everything from bills and e-statements to direct mail, catalogs and goods like DVDs and prescription drugs.

Simply put, the mailstream is the sum of all mail, documents and packages – both traditional and digital – that flow into and out of any organization or household via third-party carriers such as postal services, UPS, FedEx, daily messenger services, and on-site mail outsourcers like Pitney Bowes.

Aren't there less costly ways to effectively reach customers?

Actually, no. Mail is still the least expensive way to achieve impact and effectiveness.

Doesn't the Internet mean the end of mail?

It's a misguided prediction. The Internet and mail work in concert. Internet users receive more mail than non-users do, with mail volumes correlating directly to income and education.

Is there anything else working in the mailstream's favor?

Quite a bit, including Do-Not-Call lists, spam filters and Tivo. They're putting walls between you and your customer – walls that mail can get around.

Who can help you capitalize on this opportunity?

Pitney Bowes. We're the only company with in-depth knowledge of the entire mailstream. End-to-end. And we've been honing that knowledge for over 80 years.

For more information about how you can grow profit through the mailstream,
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Strategies That Fit Emerging Markets
Tarun Khanna, Krishna G. Palepu, and Jayant Sinha
June 2005 see executive summary on page 40
Reprint R0506C

Fast-growing economies often provide poor soil for profits. The cause? A lack of specialized intermediary firms and regulatory systems, on which multinational companies depend. Successful businesses look for those institutional voids and work around them.

The Chinese Negotiation
John L. Graham and N. Mark Lam
October 2003
Reprint R0310E ♦ OnPoint 5100
OnPoint collection "China Tomorrow: Prospects and Perils" 5097

You may think you know what it takes to negotiate business deals in China. But the old etiquette rules will bring you only so far. To take your dealings to the next level, you need to grasp the cultural context of Chinese business style.

The Great Transition
Kenneth Lieberthal and Geoffrey Lieberthal
October 2003
Reprint R0310D ♦ OnPoint 5089
OnPoint collection "China Tomorrow: Prospects and Perils" 5097

Multinational corporations' operations in China are entering a new phase in which old strategies will no longer work. Unraveling the complexities of trade in China can mean the difference between major opportunity and major disappointment.

The Hidden Dragons
Ming Zeng and Peter J. Williamson
October 2003
Reprint R0310F ♦ OnPoint 5119
OnPoint collection "China Tomorrow: Prospects and Perils" 5097

China is becoming more than just the world's workshop. Some Chinese companies are quietly – and successfully – challenging their larger competitors in foreign markets. If Chinese brands aren't on your radar yet, they should be.

HBR Case Study: Trouble in Paradise
Katherine Xin and Vladimir Pucik
August 2003
Reprint R0308A

The Chinese executives of a successful joint venture in Shanghai envision a beautiful future that includes the creation of hundreds of jobs and the launch of a new national brand. But the U.S. partner is fuming; by its standards, the JV's performance has been less than stellar. Can this venture be saved?

Health Care

Fixing Health Care from the Inside, Today
Steven J. Spear
September 2005 see executive summary on page 49
Reprint R0509D ♦ OnPoint 1738
OnPoint collection "Curing U.S. Healthcare, 2nd Edition" 172X

Right now, there are doctors, nurses, technicians, and managers who are radically improving patient care and lowering its cost by applying the same operations techniques that drive the famous Toyota Production System. If this approach were applied more widely, billions upon billions of dollars – and thousands upon thousands of lives – would be saved.

Change Through Persuasion
David A. Garvin and Michael A. Roberto
February 2005 see executive summary on page 26
Reprint R0502F

To make change stick, leaders must conduct an effective persuasion campaign – one that begins weeks or months before the turnaround plan is set in concrete. That's what guided the dramatic, successful turnaround at Boston's Beth Israel Deaconess Medical Center.

Presenteeism: At Work – But Out of It
Paul Hemp
October 2004
Reprint R0410B

Employers are beginning to realize that they face a nearly invisible but significant drain on productivity: presenteeism, the problem of workers being on the job but, because of illness or other medical conditions, not fully functioning. By some estimates, the phenomenon costs U.S. companies over $150 billion a year – much more than absenteeism does.

Redefining Competition in Health Care
Michael E. Porter and Elizabeth Olmsted Teisberg
June 2004
Reprint R0406D ♦ OnPoint 6964
OnPoint collection "Curing U.S. Health Care" 6956

For far too long, health plans, providers, payers, and others in the U.S. health care system have been competing on cost. It's time for all of them – employers, too – to start focusing on value. Stat.

Clueing In Customers
Leonard L. Berry and Neeli Bendapudi
February 2003
Reprint R0302H

When customers lack the expertise to judge a company's offerings, they turn detective. The Mayo Clinic's effectiveness at managing the evidence to convey a simple, consistent message offers an example that other service organizations would do well to follow.

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Manufacturing

Building Deep Supplier Relationships
Jeffrey K. Liker and Thomas Y. Choi
December 2004
Reprint R0412G

When it comes to building strong relationships with North American suppliers, automakers Toyota and Honda have the Big Three beat hands down. So how do they do it?

The Triple-A Supply Chain
Hau L. Lee
October 2004
Reprint R0410F ♦ OnPoint 8096

Companies that focus on making their supply chains faster or more cost-effective won't stay ahead of rivals. Building a supply chain that is agile, adaptable, and aligned is the key to gaining the upper hand.

Uncovering Hidden Value in a Midsize Manufacturing Company
James E. Ashton, Frank X. Cook, Jr., and Paul Schmitz
June 2003
Reprint R0306H ♦ OnPoint 404X

There's lots of potential in creating new products and entering new markets. But going after them shouldn't be the first priority. You can create tremendous value by focusing on the business you're in.

Read a Plant – Fast
R. Eugene Goodson
May 2002
Reprint R0205H

You can tell a lot about a factory in a short visit, if you know what to look for. Use the Rapid Plant Assessment tool, along with information gained from visual cues and employees' input during a plant tour, to rate your own plant, a competitor's, or an acquisition target's.

Decoding the DNA of the Toyota Production System
Steven Spear and H. Kent Bowen
September–October 1999
Reprint 99509

The Toyota story has been intensively researched and painstakingly documented, yet what really happens inside the company remains a mystery. Here's insight into the unspoken rules that give Toyota its competitive edge.

Nonprofit Sector

Should Nonprofits Seek Profits?
William Foster and Jeffrey Bradach
February 2005 see executive summary on page 25
Reprint R0502E

Nonprofits increasingly feel compelled to launch earned-income ventures – not only to appear more disciplined and businesslike to stakeholders but also to reduce their reliance on fund-raising. But unrealistic expectations are distorting managers' decisions, wasting precious resources, and leaving important social needs unmet.

Lofty Missions, Down-to-Earth Plans
V. Kasturi Rangan
March 2004
Reprint R0403J

For nonprofits to succeed, their altruistic ideals must be made of stronger stuff – namely, a systematic method for linking good ideas to great programs.

The Nonprofit Sector's $100 Billion Opportunity
Bill Bradley, Paul Jansen, and Les Silverman
May 2003
Reprint R0305G

A major new study reveals that charitable organizations could become far more productive by making five changes in the way they operate. That's good news for them – and even better news for society.

The Competitive Advantage of Corporate Philanthropy
Michael E. Porter and Mark R. Kramer
December 2002
Reprint R0212D ♦ OnPoint 242X

When it comes to philanthropy, executives increasingly see themselves as caught between critics demanding ever higher levels of "corporate social responsibility" and investors applying pressure to maximize short-term profits. There is a truly strategic way to think about philanthropy – but it requires fundamental changes in the way companies approach their contribution programs.

Working on Nonprofit Boards: Don't Assume the Shoe Fits
F. Warren McFarlan
November–December 1999
Reprint 99608

The governance of nonprofits can differ dramatically from the governance of business. Even the best intentions can prove disastrous when new board members fail to understand that their traditional business experience can carry them only so far.

Women/Gender

Off-Ramps and On-Ramps: Keeping Talented Women on the Road to Success
Sylvia Ann Hewlett and Carolyn Buck Luce
March 2005 see executive summary on page 28
Reprint R0503B ♦ OnPoint 9416
OnPoint collection "Required Reading for Executive Women – and the Companies Who Need Them" 9394

Most professional women step off the career fast track at some point. With children to raise, elderly parents to care for, and other pulls on their time, these women are confronted with one off-ramp after another. Just how widespread is the problem – and what are the implications for corporate America?

Two Executives, One Career
Cynthia R. Cunningham and Shelley S. Murray
February 2005 see executive summary on page 26
Reprint R0502H

For six years, Cynthia Cunningham and Shelley Murray shared an executive job at Fleet Bank: one desk, one computer, and one voice-mail account. To their clients and colleagues, they were effectively one person.

Do Women Lack Ambition?
Anna Fels
April 2004
Reprint R0404B

Everyone dreams big and hopes high, and everyone reevaluates those dreams in the cold light of day. But women, more than men, not only reconsider but also abandon their ambitions. Why's that? And what can be done about it?

Executive Women and the Myth of Having It All
Sylvia Ann Hewlett
April 2002
Reprint R0204E ♦ OnPoint 9616

When it comes to having a high-powered career and a family, the painful truth is that women in the United States don't "have it all." At least one-third of successful career women are childless, and most yearn for motherhood. Here's the most disturbing part: The next generation of women may be even worse off.

HBR Case Study: Mommy-Track Backlash
Alden M. Hayashi
March 2001
Reprint R0103A

Everybody at ClarityBase seemed to understand when one account manager – a working mother – got a special deal: Fridays off, limited travel, easy clients. But when other employees – namely, nonparents – started asking for similar treatment, the company found itself on the brink of a firestorm.

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January 2005

JANUARY | 46

COVER STORY

Almost Ready: How Leaders Move Up

Dan Ciampa

Most designated CEO successors are talented, hardworking, and smart enough to go all the way–yet fail to land the top job. What they don't realize is, the qualities that helped them in their climb to the number two position aren't enough to boost them to number one.

In addition to running their businesses well, the author explains, would-be CEOs must master the art of forming coalitions and winning support. They must also sharpen their self-awareness and their sensitivity to the needs of bosses and influential peers because they typically receive little performance feedback once they're on track to become CEO. Indeed, the ability to pick up on subtle cues is often an important part of the test.

When succession doesn't go well–or fails altogether–many people pay the price: employees depending on a smooth handoff at the top, investors expecting continuous leadership, and families uprooted when jobs don't pan out. Among those at fault are boards that do not keep a close watch on the succession process, human resource organizations that should have the capacity to help but are not up to the task, and CEOs who do a poor job coaching potential successors.

But the aspiring CEO also bears some responsibility. He can dramatically increase his chances of success by understanding his boss's point of view, knowing his own limitations, and managing what psychologist Gerry Egan has called the "shadow organization"–the political side of a company, characterized by unspoken relationships and alliances–without being labeled "political." Most of all, he must learn to conduct himself with a level of maturity and wisdom that signals he is ready–not almost ready–to be chief executive.

Reprint R0501D

JANUARY | 15

HBR CASE STUDY

Into the Fray

M. Ellen Peebles

"Psst, psst, psst." Talk of cost cutting and layoffs was already in the air in the New York offices of international beverage company Legrand SA. But now everyone is imagining the worst after the sudden and mysterious resignation of Lucien Beaumont, the company's president of U.S. operations. The rumors are flying fast and furious about what prompted his departure and, just as important, who will get Lucien's job.

Although Michael Feldstein is not one of the old guard at Paris-based Legrand – he joined the company as part of an acquisition two years ago – he's confident that he's a top contender for Lucien's job. Michael, the global category director for rums, believes his stellar brand results and strong track record might earn him the position.

Then, with a slight sense of paranoia, he notices Danielle Harcourt – the global category director for vodka and liqueurs and Michael's chief competitor for Lucien's job – networking with some of the Paris executives at a launch party for one of Michael's brands. She has also reached out to at least one of his direct reports. Before he can confront her, Michael gets a call from CEO Pierre Hoffman and a proposition – but not the one he's looking for.

In this fictional case study, Michael must weigh the advantages of taking an unexpected post in China against holding his ground in the politically charged New York offices of Legrand. Offering expert advice are Nancy Clifford Widmann, an executive coach, and Amy Dorn Kopelan, the CEO of Bedlam Entertainment, a conference management company; Fred Hassan, the chairman and CEO of Schering-Plough; Allan Cohen, the Edward A. Madden Distinguished Professor in Global Leadership at Babson College; and Gary B. Rhodes, a senior fellow at the Center for Creative Leadership.

Reprint R0501A

JANUARY | 25

The New Road to the Top

Peter Cappelli and Monika Hamori

By comparing the top executives of 1980's *Fortune* 100 companies with the top brass of firms in the 2001 list, the authors have quantified a transformation that until now has been largely anecdotal. A dramatic shift in executive careers, and in executives themselves, has occurred over the past two decades. Today's *Fortune* 100 executives are younger, more of them are female, and fewer were educated at elite institutions. They're also making their way to the top more quickly. They're taking fewer jobs along the way, and they increasingly move from one company to the next as their careers unfold.

In their wide-ranging analysis, the authors offer a number of insights. For one thing, it has become clear that there are huge advantages to working in a growing firm. For another, the firms that have been big for a long time still provide the most extensive training and development. They also offer relatively long promotion ladders – hence the common wisdom that these "academy companies" are great to have been *from*.

While women were disproportionately scarce among the most senior ranks of executives in 2001, those who arrived got there faster and at a younger age than their male colleagues. Perhaps the career hurdles that women face had blocked all but the most highly qualified female managers, who then proceeded to rise quickly.

In the future, a record of good P&L performance may become even more critical to getting hired and advancing in the largest companies. As a result, we may see a reversal of the usual flow of talent, which has been from the academy companies to smaller firms. It may be increasingly common for executives to develop records of performance in small companies, or even as entrepreneurs, and then seek positions in large corporations.

Reprint R0501B

JANUARY | 35

The Best Advice I Ever Got

Daisy Wademan

A young manager faces an impasse in his career. He goes to see his mentor at the company, who closes the office door, offers the young man a chair, recounts a few war stories, and serves up a few specific pointers about the problem at hand. Then, just as the young manager is getting up to leave, the elder executive adds one small kernel of avuncular wisdom – which the junior manager carries with him through the rest of his career.

Such is the nature of business advice. Or is it? The six essays in this article suggest otherwise. Few of the leaders who tell their stories here got their best advice in stereotypical form, as an aphorism or a platitude. For Ogilvy & Mather chief Shelly Lazarus, profound insight came from a remark aimed at relieving the tension of the moment. For Novartis CEO Daniel Vasella, it was an apt comment, made on a snowy day, back when he was a medical resident. For publishing magnate Earl Graves and Starwood Hotels' Barry Sternlicht, advice they received about trust from early bosses took on ever deeper and more practical meaning as their careers progressed. For Goldman Sachs chairman Henry Paulson, Jr., it was as much his father's example as it was a specific piece of advice his father handed down to him. And fashion designer Liz Lange rejects the very notion that there's inherent wisdom in accepting other people's advice.

As these stories demonstrate, people find wisdom when they least expect to, and they never really know what piece of advice will transcend the moment, profoundly affecting how they later make decisions, evaluate people, and examine – and reexamine – their own actions.

Reprint R0501C

JANUARY | 54

Overloaded Circuits: Why Smart People Underperform

Edward M. Hallowell

Frenzied executives who fidget through meetings, lose track of their appointments, and jab at the "door close" button on the elevator aren't crazy – just crazed. They suffer from a newly recognized neurological phenomenon that the author, a psychiatrist, calls attention deficit trait, or ADT. It isn't an illness; it's purely a response to the hyperkinetic environment in which we live. But it has become epidemic in today's organizations.

When a manager is desperately trying to deal with more input than he possibly can, the brain and body get locked into a reverberating circuit while the brain's frontal lobes lose their sophistication, as if vinegar were added to wine. The result is black-and-white thinking; perspective and shades of gray disappear. People with ADT have difficulty staying organized, setting priorities, and managing time, and they feel a constant low level of panic and guilt.

ADT can be controlled by engineering one's environment and one's emotional and physical health. Make time every few hours for a "human moment," a face-to-face exchange with a person you like. Get enough sleep, switch to a good diet, and get adequate exercise. Break down large tasks into smaller ones, and keep a section of your work space clear. Try keeping a portion of your day free of appointments and e-mail.

The author recommends that companies invest in amenities that contribute to a positive atmosphere. Leaders can also help prevent ADT by matching employees' skills to tasks. When managers assign goals that stretch people too far or ask workers to focus on what they're not good at, stress rises. ADT is a very real threat to all of us. If we don't manage it, it will manage us.

Reprint R0501E; HBR OnPoint 8789

JANUARY | 64

What's Your Story?

Herminia Ibarra and Kent Lineback

When you're in the midst of a major career change, telling stories about your professional self can inspire others' belief in your character and in your capacity to take a leap and land on your feet. It also can help you believe in yourself. A narrative thread will give meaning to your career history; it will assure you that, in moving on to something new, you are not discarding everything you've worked so hard to accomplish.

Unfortunately, the authors explain in this article, most of us fail to use the power of storytelling in pursuit of our professional goals, or we do it badly. Tales of transition are especially challenging. Not knowing how to reconcile the built-in discontinuities in our work lives, we often relay just the facts. We present ourselves as safe – and dull and unremarkable.

That's not a necessary compromise. A transition story has inherent dramatic appeal. The protagonist is you, of course, and what's at stake is your career. Perhaps you've come to an event or insight that represents a point of no return. It's this kind of break with the past that will force you to discover and reveal who you really are. Discontinuity and tension are part of the experience. If these elements are missing from your career story, the tale will fall flat.

With all these twists and turns, how do you demonstrate stability and earn listeners' trust? By emphasizing continuity and causality – in other words, by showing that your past is related to the present and, from that trajectory, conveying that a solid future is in sight. If you can make your story of transition cohere, you will have gone far in convincing the listener – and reassuring yourself – that the change makes sense for you and is likely to bring success.

Reprint R0501F

JANUARY | 74

How to Play to Your Strengths

Laura Morgan Roberts, Gretchen Spreitzer, Jane Dutton, Robert Quinn, Emily Heaphy, and Brianna Barker

Most feedback accentuates the negative. During formal employee evaluations, discussions invariably focus on "opportunities for improvement," even if the overall evaluation is laudatory. No wonder most executives – and their direct reports – dread them.

Traditional, corrective feedback has its place, of course; every organization must filter out failing employees and ensure that everyone performs at an expected level of competence. But too much emphasis on problem areas prevents companies from reaping the best from their people. After all, it's a rare baseball player who is equally good at every position. Why should a natural third baseman labor to develop his skills as a right fielder?

This article presents a tool to help you understand and leverage your strengths. Called the Reflected Best Self (RBS) exercise, it offers a unique feedback experience that counterbalances negative input. It allows you to tap into talents you may or may not be aware of and so increase your career potential.

To begin the RBS exercise, you first need to solicit comments from family, friends, colleagues, and teachers, asking them to give specific examples of times in which those strengths were particularly beneficial. Next, you need to search for common themes in the feedback, organizing them in a table to develop a clear picture of your strong suits. Third, you must write a self-portrait – a description of yourself that summarizes and distills the accumulated information. And finally, you need to redesign your personal job description to build on what you're good at.

The RBS exercise will help you discover who you are at the top of your game. Once you're aware of your best self, you can shape the positions you choose to play – both now and in the next phase of your career.

Reprint R0501G

JANUARY | 82
Do Your Commitments Match Your Convictions?

Donald N. Sull and *Dominic Houlder*

How many of us keep pace day to day, upholding our obligations to our bosses, families, and the community, even as our overall satisfaction with work and quality of life decline? And yet, our common response to the situation is: "I'm too busy to do anything about it now." Unfortunately, unless a personal or professional crisis strikes, very few of us step back, take stock of our day-to-day actions, and make a change.

In this article, London Business School strategy professors Donald Sull and Dominic Houlder examine the reasons why a gap often exists between the things we value most and the ways we actually spend our time, money, and attention. They also suggest a practical approach to managing the gap. The framework they propose is based on their study of *organizational* commitments – the investments, promises, and contracts made today that bind companies to a future course of action. Such commitments can prevent organizations from responding effectively to change.

A similar logic applies to *personal* commitments – the day-to-day decisions we make about how we allocate our precious resources. These decisions are individually small and, therefore, easy to lose sight of. When we do, a gap can develop between our commitments and our convictions.

Sull and Houlder make no value judgments about the *content* of personal commitments; they've devised a somewhat dispassionate tool to help you take a thorough inventory of what matters to you most. It involves listing your most important values and assigning to each a percentage of your annual salary, the hours out of your week, and the amount of energy you devote. Using this exercise, you should be able to identify big gaps – stated values that receive little or none of your scarce resources or a single value that sucks a disproportionate share of resources – and change your allocations accordingly.

Reprint R0501H; HBR OnPoint 8770; OnPoint collection "Managing Yourself" 8762

JANUARY | 92
Managing Your Boss

John J. Gabarro and *John P. Kotter*

In this classic HBR article, first published in 1980, Gabarro and Kotter advise readers to devote time and energy to managing their relationships with their bosses. The authors aren't talking about showering supervisors with flattery; rather, they ask readers to understand that the manager–boss relationship is one of mutual dependence. Bosses need cooperation, reliability, and honesty from their direct reports. Managers, for their part, rely on bosses for making connections with the rest of the company, for setting priorities, and for obtaining critical resources. It only makes sense to work at making the relationship operate as smoothly as possible.

Successfully managing your relationship with your boss requires that you have a good understanding of your supervisor and of yourself, particularly strengths, weaknesses, work styles, and needs. Once you are aware of what impedes or facilitates communication with your boss, you can take actions to improve your relationship. You can usually establish a way of working together that fits both of you, that is characterized by unambiguous mutual expectations, and that makes both of you more productive and effective.

No doubt, some managers will resent that on top of all their other duties, they must also take responsibility for their relationships with their bosses. But these managers fail to realize that by doing so, they can actually simplify their jobs, eliminating potentially severe problems and improving productivity.

Reprint R0501J

JANUARY | 100
Managing Oneself

Peter F. Drucker

Throughout history, people had little need to manage their careers – they were born into their stations in life or, in the recent past, they relied on their companies to chart their career paths. But times have drastically changed. Today we must all learn to manage ourselves.

What does that mean? As Peter Drucker tells us in this seminal article first published in 1999, it means we have to learn to develop ourselves. We have to place ourselves where we can make the greatest contribution to our organizations and communities. And we have to stay mentally alert and engaged during a 50-year working life, which means knowing how and when to change the work we do.

It may seem obvious that people achieve results by doing what they are good at and by working in ways that fit their abilities. But, Drucker says, very few people actually know – let alone take advantage of – their fundamental strengths.

He challenges each of us to ask ourselves: What are my strengths? How do I perform? What are my values? Where do I belong? What should my contribution be? Don't try to change yourself, Drucker cautions. Instead, concentrate on improving the skills you have and accepting assignments that are tailored to your individual way of working. If you do that, you can transform yourself from an ordinary worker into an outstanding performer.

Today's successful careers are not planned out in advance. They develop when people are prepared for opportunities because they have asked themselves those questions and have rigorously assessed their unique characteristics. This article challenges readers to take responsibility for managing their futures, both in and out of the office.

Reprint R0501K; HBR OnPoint 4444; OnPoint collection "Managing Yourself" 8762

February 2005

FEBRUARY | 72

COVER STORY

Ending the CEO Succession Crisis

Ram Charan

The CEO succession process is broken. Many companies have no meaningful succession plans, and few of the ones that do are happy with them. CEO tenure is shrinking; in fact, two out of five CEOs fail in their first 18 months.

It isn't just that more CEOs are being replaced; it's that they're being replaced *badly.* The problems extend to every aspect of CEO succession: internal development programs, board supervision, and outside recruitment.

While many organizations do a decent job of nurturing middle managers, few have set up the comprehensive programs needed to find the half-dozen true CEO candidates out of the thousands of leaders in their midst. Even more damaging is the failure of boards to devote enough attention to succession. Search committee members often have no experience hiring CEOs; lacking guidance, they supply either the narrowest or the most general of requirements and then fail to vet either the candidates or the recruiters.

The result is that too often new CEOs are plucked from the well-worn Rolodexes of a remarkably small number of recruiters. These candidates may be strong in charisma but may lack critical skills or otherwise be a bad fit with the company. The resulting high turnover is particularly damaging, since outside CEOs often bring in their own teams, can cause the company to lose focus, and are especially costly to be rid of.

Drawing on over 35 years of experience with CEO succession, the author explains how companies can create a deep pool of internal candidates, how boards can consistently align strategy and leadership development, and how directors can get their money's worth from recruiters. Choosing a CEO should be not one decision but an amalgam of thousands of decisions made by many people every day over years.

Reprint R0502C; HBR OnPoint 8851; OnPoint collection "Hire the Right CEO" 8843

FEBRUARY | 17

THE HBR LIST

Breakthrough Ideas for 2005

The List is HBR's annual attempt to capture ideas in the state of becoming—when they're teetering between what one person suspects and what everyone accepts.

Roderick M. Kramer says it isn't bad when leaders flip-flop. **Julia Kirby** describes new efforts to redefine the problem of organizational performance. **Joseph L. Bower** praises the "Velcro organization," where managerial responsibilities can be rearranged. **Jeffrey F. Rayport** argues that companies must refocus innovation on the "demand side."

Eric Bonabeau describes a future in which computer-generated sound can be used to transmit vast amounts of data. **Roger L. Martin** says corporate systems such as CRM that are highly reliable tend to have little validity. **Kirthi Kalyanam** and **Monte Zweben** report that marketers are learning to contact customers at just the right moment. **Robert C. Merton** explains how equity swaps could help developing countries avoid some of the risk of boom and bust.

Thomas A. Stewart says companies need champions of the status quo. **Mohanbir Sawhney** suggests marketing strategies for the blogosphere. **Denise Caruso** shows how to deal with risks that lack owners. **Thomas H. Davenport** says personal information management—how well we use our PDAs and PCs—is the next productivity frontier.

Leigh Buchanan explores workplace taboos. **Henry W. Chesbrough** argues that the time is ripe for services science to become an academic field. **Kenneth Lieberthal** says China may change everyone's approach to intellectual property. **Jochen Wirtz** and **Loizos Heracleous** describe customer service apps for biometrics.

Mary Catherine Bateson envisions a midlife sabbatical for workers. **Jeffrey Rosen** explains why one privacy policy won't fit everyone. **Tihamér von Ghyczy** and **Janis Antonovics** say firms should embrace parasites. And **Jeffrey Pfeffer** warns business-book buyers to beware.

Reprint R0502A

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FEBRUARY | 59

HBR CASE STUDY

Springboard to a Swan Dive?

Ajit Kambil and *Bruce Beebe*

John Clough, the CFO of NetRF, a tech firm in Salt Lake City, gets an offer he's not sure he wants to refuse. Benchmark, a *Fortune* 500 packaged-goods company, is looking for someone to join its board – specifically, to join the audit committee. "Would you be interested?" the executive recruiter asks.

John's experience with publicly held companies is limited, but he's highly regarded in the financial community for his acumen and probity. At NetRF, a maker of wireless communications equipment, John had championed expensing stock options at a time when it was uncommon for high-tech firms to do so; he'd received a lot of admiring press for that move. In mulling over the offer, the 39-year-old executive and flight enthusiast considers his situation. He loves his work, his Cessna timeshare, and the skiing in the Salt Lake area. Board membership would confer on him a certain amount of honor and prestige, but would he be spreading himself too thin?

One colleague, Gordon Telford, extols a few of the virtues of board membership – the opportunity to learn and the chance to expand your business network. But another colleague, Philip Tedeschi, chief outside counsel to NetRF, warns that the hours can be considerable and board members' responsibilities (post-Sarbanes-Oxley) substantial. Subsequent meetings with Benchmark's nominating committee, its CEO, and its audit committee leave John with more questions than answers. Should he join the board?

This fictional case study outlines the risks and rewards that come with board service. Offering expert advice are Peter Goodson, a strategic adviser to corporate boards; John F. Olson, chair of the ABA Business Law Section's Corporate Governance Committee; David J. Berger, a partner at the law firm Wilson Sonsini Goodrich & Rosati; and Charles H. King, managing director at Korn/Ferry International.

Reprint R0502B

FEBRUARY | 82

Productive Friction: How Difficult Business Partnerships Can Accelerate Innovation

John Hagel III and *John Seely Brown*

Companies are becoming more dependent on business partners, but coordinating with outsiders takes its toll. Negotiating terms, monitoring performance, and, if needs are not being met, switching from one partner to another require time and money. Such transaction costs, Ronald Coase explained in his 1937 essay "The Nature of the Firm," drove many organizations to bring their activities in-house.

But what if Coase placed too much emphasis on these costs? What if friction between companies can be productive? Indeed, as John Hagel and John Seely Brown point out, interactions between organizations can yield benefits beyond the goods or services contracted for. Companies get better at what they do – and improve faster than their competitors – by working with outsiders whose specialized capabilities complement their own. Different enterprises bring different perspectives and competencies. When these enterprises tackle a problem together, they dramatically increase the chances for innovative solutions.

Of course, misunderstandings often arise when people with different backgrounds and skill sets try to collaborate. Opposing sides may focus on the distance that separates them rather than the common challenges they face.

How can companies harness friction so that it builds capabilities? Start by articulating performance goals that everyone buys into. Then make sure people are using tangible prototypes to wrangle over. Finally, assemble teams with committed people who bring different perspectives to the table.

As individual problems are being addressed, take care that the underpinnings of shared meaning and trust are also being woven between the companies. Neither can be dictated – but they can be cultivated. Without them, the performance fabric quickly unravels, and business partnerships disintegrate into rivalrous competition.

Reprint R0502D

FEBRUARY | 92

Should Nonprofits Seek Profits?

William Foster and *Jeffrey Bradach*

Twenty years ago, it would have been shocking for a children's choir to sell singing telegrams or for an organization serving the homeless to dabble in property management. Today, it seems routine. Nonprofits increasingly feel compelled to launch earned-income ventures – not only to appear more disciplined and businesslike to stakeholders but also to reduce their reliance on fundraising.

There's plenty of hype about the value of earned-income ventures in the nonprofit world, but such projects account for only a small share of funding in most nonprofit domains, and few of the ventures make money. Moreover, when the authors examined how nonprofits evaluate potential enterprises, they discovered a pattern of unwarranted optimism. The potential financial returns are often exaggerated, and the challenges of running a successful business are routinely discounted. But the biggest downside of such ventures is that they can distract nonprofits' managers from their core social missions and, in some cases, even subvert those missions.

There are several reasons for the gap between the hype and the reality. One is that an organization's nonfinancial concerns – such as a desire to hire the disadvantaged – can hamper it in the commercial marketplace. Another is that nonprofits' executives tend to overlook the distinction between revenue and profit. For example, a youth services organization that had received funding to launch a food products enterprise hired young people and began making salad dressing. The nonprofit believed it spent $3.15 to produce each bottle of dressing that was sold for $3.50. But when expenses such as unused ingredients and managers' salaries were factored in, the cost per bottle reached a staggering $90.

Earned-income ventures do have a role in the nonprofit sector, the authors say, but unrealistic expectations are distorting managers' decisions, wasting precious resources, and leaving important social needs unmet.

Reprint R0502E

FEBRUARY | 104

Change Through Persuasion

David A. Garvin and *Michael A. Roberto*

Faced with the need for a massive change, most managers respond predictably. They revamp the organization's strategy, shift around staff, and root out inefficiencies. They then wait patiently for performance to improve–only to be bitterly disappointed because they've failed to adequately prepare employees for the change. In this article, the authors contend that to make change stick, leaders must conduct an effective persuasion campaign–one that begins weeks or months before the turnaround plan is set in concrete.

Like a political campaign, a persuasion campaign is largely one of differentiation from the past. Turnaround leaders must convince people that the organization is truly on its deathbed–or, at the very least, that radical changes are required if the organization is to survive and thrive. (This is a particularly difficult challenge when years of persistent problems have been accompanied by few changes in the status quo.) And they must demonstrate through word and deed that they are the right leaders with the right plan.

Accomplishing all this calls for a four-part communications strategy. Prior to announcing a turnaround plan, leaders need to set the stage for employees' acceptance of it. At the time of delivery, they must present a framework through which employees can interpret information and messages about the plan. As time passes, they must manage the mood so that employees' emotional states support implementation and follow-through. And at critical intervals, they must provide reinforcement to ensure that the desired changes take hold and that there's no backsliding.

Using the example of the dramatic turnaround at Boston's Beth Israel Deaconess Medical Center, the authors elucidate the inner workings of a successful change effort.

Reprint R0502F

FEBRUARY | 114

THE HBR INTERVIEW

Transforming an Industrial Giant

Heinrich von Pierer

Interviewed by Thomas A. Stewart and Louise O'Brien

In his 12 years at the helm of Siemens, CEO Heinrich von Pierer designed and directed a major transformation. Taking this German icon from a technically superb but slow-moving industrial giant to a disciplined yet nimble multinational has posed enormous challenges.

Since 1992, Siemens has revamped its portfolio of businesses, expanded its reach into 192 countries, and created a more local-market-driven culture, gaining recognition as one of the best-managed and most competitive companies in the world. In this edited interview with HBR editor Thomas A. Stewart and consulting editor Louise O'Brien, von Pierer describes the requirements for transformation and culture change and how he broke down historical barriers at Siemens. He shares his insights about portfolio restructuring, his lessons from competing with GE, and the pros and cons of being based in Europe versus America. He reflects on the true start of globalization after the fall of the Berlin wall and on how dramatically the company needed to change in order to counter the resulting pricing pressures across all of its businesses. He talks, too, about the biggest challenge on his successor's desk–"the particular challenge of China," he says.

Amid all these topics, von Pierer reiterates the importance of people: "We all talk about people as our most important resource, but as a matter of fact, who's really taking care of people?…We need [their] backing. We can't afford to run into a situation where people no longer accept what we do."

Reprint R0502G

FEBRUARY | 125

Two Executives, One Career

Cynthia R. Cunningham and Shelley S. Murray

For six years, Cynthia Cunningham and Shelley Murray shared an executive job at Fleet Bank. One desk, one chair, one computer, one telephone, and one voice-mail account. To their clients and colleagues, they were effectively one person, though one person with the strengths and ideas of two, seamlessly handing projects back and forth. Although their department was dissolved after the bank merged with Bank of America, the two continue to consider themselves a package–they have one résumé, and they are seeking their next opportunity together.

Their choice to share a job was not only a quality-of-life decision but one intended to keep their careers on course: "Taking two separate part-time jobs would have thrown us completely off track," they write in this first-person account. "We're both ambitious people, and neither of us wanted just a job. We wanted careers."

In this article, the two highly motivated women reveal their determination to manage the demands of both family and career. Flextime, telecommuting, and compressed workweeks are just some of the options open to executives seeking greater work/life balance, and the job share, as described by Cunningham and Murray, could well be the next solution for those wishing to avoid major trade-offs between their personal and professional lives.

Cunningham and Murray describe in vivid detail how they structured their unusual arrangement, how they sold themselves to management, and the hurdles they faced along the way. Theirs is a win-win story, for the company and for them.

Reprint R0502H

FEBRUARY | 132

Strategic Sourcing: From Periphery to the Core

Mark Gottfredson, Rudy Puryear, and Stephen Phillips

As globalization changes the basis of competition, sourcing is moving from the periphery of corporate functions to the core. Always important in terms of costs, sourcing is becoming a strategic opportunity. But few companies are ready for this shift.

Outsourcing has grown so sophisticated that even critical functions like engineering, R&D, manufacturing, and marketing can – and often should – be moved outside. And that, in turn, is changing the way companies think about their organizations, their value chains, and their competitive positions.

Already, a handful of vanguard companies are transforming what used to be purely internal corporate functions into entirely new industries. Companies like UPS, Solectron, and Hewitt have created new business models by concentrating scale and skill within a single function. As these and other function-based companies grow, so does the potential value of outsourcing to all companies.

Migrating from a vertically integrated company to a specialized provider of a single function is not a winning strategy for everyone. But all companies need to rigorously reassess each of their functions as possible outsourcing candidates. Presented in this article is a simple three-step process to identify which functions your company needs to own and protect, which can be best performed by what kinds of partners, and which could be turned into new business opportunities. The result of such an analysis will be a comprehensive capabilities-sourcing strategy.

As a detailed examination of 7-Eleven's experience shows, the success of the strategy often hinges on the creativity with which partnerships are organized and managed. But only by first taking a broad, strategic view of capabilities sourcing can your company gain the greatest benefit from all of its sourcing choices.

Reprint R0502J; HBR OnPoint 8878

March 2005

MARCH | 58

COVER STORY

Lean Consumption

James P. Womack and Daniel T. Jones

During the past 20 years, the real price of most consumer goods has fallen worldwide, the variety of goods and the range of sales channels offering them have continued to grow, and product quality has steadily improved. So why is consumption often so frustrating? It doesn't have to be – and shouldn't be – the authors say. They argue that it's time to apply lean thinking to the processes of consumption – to give consumers the full value they want from goods and services with the greatest efficiency and the least pain.

Companies may think they save time and money by off-loading work to the consumer but, in fact, the opposite is true. By streamlining their systems for providing goods and services, and by making it easier for customers to buy and use those products and services, a growing number of companies are actually lowering costs while saving everyone time. In the process, these businesses are learning more about their customers, strengthening consumer loyalty, and attracting new customers who are defecting from less user-friendly competitors.

The challenge lies with the retailers, service providers, manufacturers, and suppliers that are not used to looking at total cost from the standpoint of the consumer and even less accustomed to working with customers to optimize the consumption process.

Lean consumption requires a fundamental shift in the way companies think about the relationship between provision and consumption, and the role their customers play in these processes. It also requires consumers to change the nature of their relationships with the companies they patronize.

Lean production has clearly triumphed over similar obstacles in recent years to become the dominant global manufacturing model. Lean consumption, its logical companion, can't be far behind.

Reprint R0503C; HBR OnPoint 9432

MARCH | 16

FORETHOUGHT

Sorting Data to Suit Yourself Letting customers organize *your* information the way *they* want is a cool benefit today but will be a necessity tomorrow, says Harvard Law School Internet scholar David Weinberger. **Reprint F0503A**

Both Sides Now What's an oligonomy? A market with few sellers *and* few buyers, says market watchdog Steve Hannaford. **Reprint F0503B**

Rotate the Core By rotating key executives through headquarters, companies can keep corporate lean but still hold sway over the units, says BCG senior VP George Stalk, Jr. **Reprint F0503C**

Expanding in China Bain consultants Ann Chen and Vijay Vishwanath offer three key strategies multinationals can use to expand from China's premium segment into the broader market. **Reprint F0503D**

No More Metaphors Truly new ideas spawn original language, but where new management ideas should be, there are too many clichés borrowed from other fields. We deserve better, argues HBR senior editor Leigh Buchanan. **Reprint F0503E**

Global Manufacturers at a Crossroads As multinationals decrease their direct investment in low-wage markets, they're opening the door to competitors, says Deloitte consultant Peter Koudal. **Reprint F0503F**

Vanishing Jobs? Blame the Boomers Baby busters won't get the jobs the boomers leave behind, warns demographer Phillip Longman. **Reprint F0503G**

The Faster They Fall The likelihood that an industry leader will lose its top position within five years has doubled since 1972, say McKinsey consultants S. Patrick Viguerie and Caroline Thompson. **Reprint F0503H**

Outsourcing Marketing Marketing is becoming more analytic and less creative. That's why, HBS professors Gail McGovern and John Quelch assert, more companies are finding it makes sense to outsource many marketing functions. **Reprint F0503J**

Lessons from the Slums of Brazil JetBlue's David Neeleman talks about how his lessons from working with the poor have informed his company's culture. **Reprint F0503K**

MARCH | 31

HBR CASE STUDY

The Shakedown

Phil Bodrock

Customer Strategy Solutions, a California-based developer of order-fulfillment systems, is facing a shakedown. Six months after the firm's CEO, Pavlo Zhuk, set up a software development center in Kiev, local bureaucrats say the company hasn't filed all the tax schedules it should have. Moreover, Ukrainian tax officials claim that the company owes the government tax arrears. Zhuk is shocked; he and his colleagues have done everything by the book.

This isn't the first time Zhuk has encountered trouble in Ukraine. In the process of getting the development center up and running, a state-owned telecommunications utility had made it difficult for Zhuk to get the phone lines his company needed. Senior telecom manager Vasyl Feodorovych Mylofienko had told Zhuk it would take three years to install the lines in his office – but for a certain price, Mylofienko had added, the lines could be functioning the following week.

Even as the picture of rampant bribery and corruption in Ukraine becomes clear, Zhuk still doesn't want to pull out of the country. Of Ukrainian descent, he has dreams of helping to modernize the country. By paying his programmers more than they could make at any local company, he hopes to raise their standard of living so they can afford three meals a day without having to barter, stand in queues for hours, or moonlight. And yet, he isn't sure he can keep compromising his principles for the sake of the greater good.

Should Customer Strategy Solutions pay off the Ukrainian tax officials? Commenting on this fictional case study are Alan L. Boeckmann, the chairman and CEO of Fluor Corporation; Rafael Di Tella, a professor at Harvard Business School; Thomas W. Dunfee, the Kolodny Professor of Social Responsibility and a professor of legal studies at Wharton; and Bozidar Djelic, the former finance and economy minister of Serbia. **Reprint R0503A**

MARCH | 43

Off-Ramps and On-Ramps: Keeping Talented Women on the Road to Success

Sylvia Ann Hewlett and Carolyn Buck Luce

Most professional women step off the career fast track at some point. With children to raise, elderly parents to care for, and other pulls on their time, these women are confronted with one off-ramp after another. When they feel pushed at the same time by long hours and unsatisfying work, the decision to leave becomes even easier. But woe to the woman who intends for that exit to be temporary. The on-ramps for professional women to get back on track are few and far between, the authors confirm. Their new survey research reveals for the first time the extent of the problem – what percentage of highly qualified women leave work and for how long, what obstacles they face coming back, and what price they pay for their time-outs.

And what are the implications for corporate America? One thing at least seems clear: As market and economic factors align in ways guaranteed to make talent constraints and skill shortages huge issues again, employers must learn to reverse this brain drain. Like it or not, large numbers of highly qualified, committed women need to take time out of the workplace. The trick is to help them maintain connections that will allow them to reenter the workforce without being marginalized for the rest of their lives.

Strategies for building such connections include creating reduced-hour jobs, providing flexibility in the workday and in the arc of a career, removing the stigma of taking time off, refusing to burn bridges, offering outlets for altruism, and nurturing women's ambition. An HBR Special Report, available online at www.womenscareersreport.hbr.org, presents detailed findings of the survey. **Reprint R0503B; HBR OnPoint 9416; OnPoint collection "Required Reading for Executive Women – and the Companies Who Need Them" 9394**

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MARCH | 70

What Great Managers Do

Marcus Buckingham

Much has been written about the qualities that make a great manager, but most of the literature overlooks a fundamental question: What does a great manager actually *do?* While there are countless management styles, one thing underpins the behavior of all great managers. Above all, an exceptional manager comes to know and value the particular quirks and abilities of her employees. She figures out how to capitalize on her staffers' strengths and tweaks her environment to meet her larger goals.

Such a specialized approach may seem like a lot of work. But in fact, capitalizing on each person's uniqueness can save time. Rather than encourage employees to conform to strict job descriptions that may include tasks they don't enjoy and aren't good at, a manager who develops positions for his staff members based on their unique abilities will be rewarded with behaviors that are far more efficient and effective than they would be otherwise.

This focus on individuals also makes employees more accountable. Because staffers are evaluated on their particular strengths and weaknesses, they are challenged to take responsibility for their abilities and to hone them.

Capitalizing on a person's uniqueness also builds a stronger sense of team. By taking the time to understand what makes each employee tick, a great manager shows that he sees his people for who they are. This personal investment not only motivates individuals but also galvanizes the entire team.

Finally, this approach shakes up existing hierarchies, which leads to more creative thinking.

To take great managing from theory to practice, the author says, you must know three things about a person: her strengths, the triggers that activate those strengths, and how she learns. By asking the right questions, squeezing the right triggers, and becoming aware of your employees' learning styles, you will discover what motivates each person to excel.

Reprint R0503D

MARCH | 80

MarketBusting: Strategies for Exceptional Business Growth

Rita Gunther McGrath and Ian C. MacMillan

If company leaders were granted a single wish, it would surely be for a reliable way to create new growth businesses. Business practitioners' overwhelming interest in this subject prompted the authors to conduct a three-year study of organizational growth – specifically, to find out which growth strategies were most successful.

They discovered, somewhat to their surprise, that even companies in mature industries found rich new sources of growth when they reconfigured their *unit of business* (what they bill customers for) or their *key metrics* (how they measure success). In this article, the authors outline these and other moves companies can make to redefine their profit drivers and realize low-risk growth. They offer plenty of real-world examples. For instance:

Changing Your Unit of Business. Once a conventional printing house, Madden Communications not only prints promotional materials for customers but also manages the distribution and installation of those materials on-site. Its revenues grew from $10 million in 1990 to $133 million in 2004, in an industry that many had come to regard as hopelessly mature.

Improving Your Key Metrics – Particularly Productivity. Lamons Gasket, with $80 million in revenues, built a Web site that radically improved its customers' ability to find, order, and pay for goods. The firm's market share rose along with its customer retention rate.

The authors also suggest ways to identify your unit of business and associated key metrics and recognize the obstacles to changing them; review the key customer segments you serve; assess the need for new capabilities and the potential for internal resistance to change; and communicate to internal and external constituencies the changes you wish to make in your unit of business or key metrics.

Reprint R0503E; HBR OnPoint 9408; OnPoint collection "Spur Market-Busting Growth" 9386

What is the mailstream (and why should you care)?

The mailstream is the sum of all the mail and documents, both traditional and digital, as well as packages, that flow across your business and to customers and back. It's the entire matrix of people, processes and technology, from your database to document creation to delivery.

The mailstream process begins with creation of messages, then winds its way through a myriad of technologies and procedures, including data mining, printing, preparation and finishing, distribution, receipt, archiving, retrieval, response and database updating.

Of course, the mailstream would be merely a gee-whiz, conceptual exercise in semantics, if not for one overriding fact: **Deftly managing the mailstream can translate directly to increased profits.** Hundreds of business examples have proven that optimizing the mailstream yields significantly higher revenue and lower costs.

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MARCH | 92

Want Collaboration? Accept – and Actively Manage – Conflict

Jeff Weiss and *Jonathan Hughes*

Companies try all kinds of ways to improve collaboration among different parts of the organization: cross-unit incentive systems, organizational restructuring, teamwork training. While these initiatives produce occasional success stories, most have only limited impact in dismantling organizational silos and fostering collaboration.

The problem? Most companies focus on the symptoms ("Sales and delivery do not work together as closely as they should") rather than on the root cause of failures in cooperation: conflict. The fact is, you can't improve collaboration until you've addressed the issue of conflict. The authors offer six strategies for effectively managing conflict:

- Devise and implement a common method for resolving conflict.
- Provide people with criteria for making trade-offs.
- Use the escalation of conflict as an opportunity for coaching.
- Establish and enforce a requirement of joint escalation.
- Ensure that managers resolve escalated conflicts directly with their counterparts.
- Make the process for escalated conflict-resolution transparent.

The first three strategies focus on the point of conflict; the second three focus on escalation of conflict up the management chain. Together they constitute a framework for effectively managing discord, one that integrates conflict resolution into day-to-day decision-making processes, thereby removing a barrier to cross-organizational collaboration.

Reprint R0503F

MARCH | 102

THE HBR INTERVIEW

Execution Without Excuses

Michael Dell and *Kevin Rollins*

Interviewed by Thomas A. Stewart and Louise O'Brien

The success of Dell – it provides extraordinary rewards to shareholders, it can turn on a dime, and it has demonstrated impeccable timing in entering new markets – is based on more than its famous business model. High expectations and disciplined, consistent execution are embedded in the company's DNA.

"We don't tolerate businesses that don't make money," founder Michael Dell tells HBR. "We used to hear all sorts of excuses for why a business didn't make money, but to us they all sounded like 'The dog ate my homework.' We just don't accept that."

In order to double its revenues in a five-year period, the company had to adapt its execution-obsessed culture to new demands. In fact, Michael Dell and CEO Kevin Rollins realized they had a crisis on their hands. "We had a very visible group of employees who'd gotten rich from stock options," Rollins says. "You can't build a great company on employees who say, 'If you pay me enough, I'll stay.'" Dell and Rollins knew they had to reignite the spirit of the company.

They implemented an employee survey, whose results led to the creation of the Winning Culture initiative, now a top operating priority at Dell. They also defined the Soul of Dell: Focus on the customer, be open and direct in communications, be a good global citizen, have fun in winning. It turned out to be a huge motivator. And they increased the focus on developing people within the company.

"We've changed as individuals and as an organization," Rollins says. "We want the world to see not just a great financial record and operational performance but a great company. We want to have leaders that other companies covet. We want a culture that makes people stick around for reasons other than money."

Reprint R0503G

MARCH | 124

A Practical Guide to Social Networks

Rob Cross, *Jeanne Liedtka*, and *Leigh Weiss*

Saying that networks are important is stating the obvious. But harnessing the power of these seemingly invisible groups to achieve organizational goals is an elusive undertaking. Most efforts to promote collaboration are haphazard and built on the implicit philosophy that more connectivity is better. In truth, networks create relational demands that sap people's time and energy and can bog down entire organizations. It's crucial for executives to learn how to promote connectivity only where it benefits an organization or individual and to decrease unnecessary connections.

In this article, the authors introduce three types of social networks, each of which delivers unique value. The *customized response network* excels at framing the ambiguous problems involved in innovation. Strategy consulting firms and new-product development groups rely on this format. By contrast, surgical teams and law firms rely mostly on the *modular response network,* which works best when components of the problem are known but the sequence of those components in the solution is unknown. And the *routine response network* is best suited for organizations like call centers, where the problems and solutions are fairly predictable but collaboration is still needed.

Executives shouldn't simply hope that collaboration will spontaneously occur in the right places at the right times in their organization. They need to develop a strategic, nuanced view of collaboration, and they must take steps to ensure that their companies support the types of social networks that best fit their goals.

Drawing on examples from Novartis, the FAA, and Sallie Mae, the authors offer managers the tools they need to determine which network will deliver the best results for their organizations and which strategic investments will nurture the right degree of connectivity.

Reprint R0503H

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MARCH | 135

Inventory-Driven Costs

Gianpaolo Callioni, Xavier de Montgros, Regine Slagmulder, Luk N. Van Wassenhove, and Linda Wright

In the 1990s, Hewlett-Packard's PC business was struggling to turn a dollar, despite the company's success in winning market share. By 1997, margins on its PCs were as thin as a silicon wafer, and some product lines hadn't turned a profit since 1993.

The problem had everything to do with the PC industry's notoriously short product cycles and brutal product and component price deflation. A common rule of thumb was that the value of a fully assembled PC decreased 1% a week. In such an environment, inventory costs become critical. But not just the inventory costs companies traditionally track, HP found, after a thorough review of the problem. The standard "holding cost of inventory"—the capital and physical costs of inventory—accounted for only about 10% of HP's inventory costs. The greater risks, it turned out, resided in four other, essentially hidden costs, which stemmed from mismatches between demand and supply:

Component devaluation costs for components still held in production;

Price protection costs incurred when product prices drop on the goods distributors still have on their shelves;

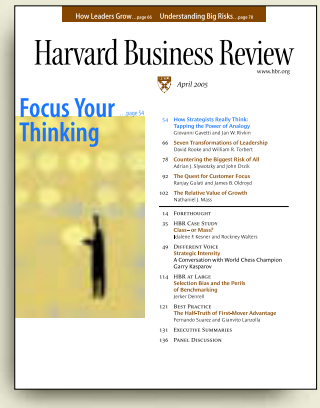
Product return costs that have to be absorbed when distributors return and receive refunds on overstock items, and;

Obsolescence costs for products still unsold when new models are introduced.

By developing metrics to track those costs in a consistent way throughout the PC division, HP has found it can manage its supply chains with much more sophistication. Gone are the days of across-the-board measures such as, "Everyone must cut inventories by 20% by the end of the year," which usually resulted in a flurry of cookie-cutter lean production and just-in-time initiatives. Now, each product group is free to choose the supply chain configuration that best suits its needs. Other companies can follow HP's example.

Reprint R0503J

April 2005



APRIL | 54

COVER STORY

How Strategists Really Think: Tapping the Power of Analogy

Giovanni Gavetti and Jan W. Rivkin

Leaders tend to be so immersed in the specifics of strategy that they rarely stop to think how much of their reasoning is done by analogy. As a result, they miss useful insights that psychologists and other scientists have generated about analogies' pitfalls. Managers who pay attention to their own analogical thinking will make better strategic decisions and fewer mistakes.

Charles Lazarus was inspired by the supermarket when he founded Toys R Us; Intel promoted its low-end chips to avoid becoming like U.S. Steel; and Circuit City created CarMax because it saw the used-car market as analogous to the consumer-electronics market. Each example displays the core elements of analogical reasoning: a novel problem or a new opportunity, a specific prior context that managers deem to be similar in its essentials, and a solution that managers can transfer from its original setting to the new one.

Analogical reasoning is a powerful tool for sparking breakthrough ideas. But dangers arise when analogies are built on surface similarities (headlong diversification based on loose analogies played a role in Enron's collapse, for instance). Psychologists have discovered that it's all too easy to overlook the superficiality of analogies. The situation is further complicated by people's tendency to hang on to beliefs even after contrary evidence comes along (a phenomenon known as anchoring) and their tendency to seek only the data that confirm their beliefs (an effect known as the confirmation bias).

Four straightforward steps can improve a management team's odds of using an analogy well: Recognize the analogy and identify its purpose; thoroughly understand its source; determine whether the resemblance is more than superficial; and decide whether the original strategy, properly translated, will work in the target industry.

Reprint R0504C; HBR OnPoint 9661; OnPoint collection "Why Bad Decisions Happen to Good Managers" 9653

APRIL | 14
FORETHOUGHT

The Limits of Professional Behavior Professional service firms were once great models for corporations – until they started to resemble them. **Reprint** F0504A

Those Fertile HR Fields In the United States, HR management is perceived as a narrow specialty. In Japan, it's a place to go to get ahead. **Reprint** F0504B

The Spielberg Variables Unilever applies the principles of feature film directing and editing to turn so-so commercials into winners. **Reprint** F0504C

When Lean Isn't Mean The trend is to downsize corporate headquarters – but sometimes a bigger HQ is better. **Reprint** F0504D

Plenty of Knowledge Work to Go Around The furor over offshoring knowledge work is a tempest in a teapot. **Reprint** F0504E

How Big Is "Tall"? Consumers make clear and consistent distinctions among sizes. **Reprint** F0504F

Sweat the Small Stuff The "broken windows" theory of crime prevention – pay attention to the details – pertains to companies, too. **Reprint** F0504G

The Rich (and Poor) Keep Getting Richer Earnings have stagnated for people in the world's middle-wage countries. **Reprint** F0504H

Just My Type Your choice of typeface tells customers whether your brand is attractive, innovative, dishonest, or unpleasant. **Reprint** F0504J

Where's Your Pivotal Talent? Decisions about talent should be made with the same rigor and logic as decisions about money, customers, and technology. **Reprint** F0504K

The Beauty of an Open Calendar Companies want to be flexible, but they're not flexible about people's time. **Reprint** F0504L

Way Faster than a Speeding Bullet Femtosecond lasers will revolutionize processes in a variety of industries. **Reprint** F0504M

APRIL | 35
HBR CASE STUDY

Class – or Mass?

Idalene F. Kesner and Rockney Walters

Jim Hargrove, the marketing director of $820 million Neptune Gourmet Seafood, is having a bad week. Neptune is the most upmarket player in the $20 billion industry, and the company is doing everything it can to preserve its premium image among customers. But Neptune's recent investment in state-of-the-art freezer trawlers, along with new fishing regulations, is resulting in catches that are bigger than ever. Though demand is at an all-time high, the company is saddled with excess inventory – and there's no relief in sight.

Neptune's sales head, Rita Sanchez, has come up with two strategies that Hargrove feels would destroy the company's premium image: cut prices or launch a new mass-market brand. Not many executives in the company are in favor of cutting prices, but it's clear that Sanchez is gaining ground in her bid to launch a low-priced brand. Reputation worries aside, Hargrove fears that an inexpensive brand would cannibalize the company's premium line and antagonize the powerful association of seafood processors. How can he get others to see the danger, too?

The commentators for this fictional case study are Dan Schulman, the CEO of Virgin Mobile USA, a wireless voice and data services provider; Dipak C. Jain, a professor of marketing and the dean of the Kellogg School of Management at Northwestern University; Oscar de la Renta, chairman, and Alexander L. Bolen, CEO, of Oscar de la Renta Limited, the New York–based luxury goods manufacturer; and Thomas T. Nagle, the chairman of the Strategic Pricing Group, a Massachusetts-based management consultancy that specializes in pricing.
Reprint R0504A

APRIL | 49

Strategic Intensity: A Conversation with World Chess Champion Garry Kasparov

It's hard to find a better exemplar for competition than chess. The image of two brilliant minds locked in a battle of skill and will – in which chance plays little or no apparent role – is compelling. Even people who have scant knowledge of the game instinctively recognize that chess is unusual in terms of its intellectual complexity and the strategic demands it places on players.

Can strategists learn anything from chess players about what it takes to win? To find out, HBR senior editor Diane L. Coutu talked with Garry Kasparov, the world's number one player since 1984. Kasparov believes that success in both chess and business is very much a question of psychological advantage; the complexity of the game demands that players rely heavily on their instincts and on gamesmanship.

In this wide-ranging interview, Kasparov explores the power of chess as a model for business competition; the balance that chess players strike between intuition and analysis; the significance of his loss to IBM's chess-playing computer, Deep Blue; and how his legendary rivalry with Anatoly Karpov, Kasparov's predecessor as World Chess Champion, affected his own success.

Kasparov also shares his solution to what he calls the champion's dilemma, a question for all world masters, whether they are in business, sports, or chess: Where *does* a virtuoso go after he has accomplished everything he's ever wanted to, even beyond his wildest imagination? If you are lucky, says Kasparov, your enemies will push you to be passionate about staying at the top.
Reprint R0504B

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APRIL | 66

Seven Transformations of Leadership

David Rooke and William R. Torbert

Most developmental psychologists agree that what differentiates one leader from another is not so much philosophy of leadership, personality, or style of management. Rather, it's internal "action logic"—how a leader interprets the surroundings and reacts when his or her power or safety is challenged. Relatively few leaders, however, try to understand their action logic, and fewer still have explored the possibility of changing it. They should, because leaders who undertake this voyage of personal understanding and development can transform not only their own capabilities but also those of their companies.

The authors draw on 25 years of consulting experience and collaboration with psychologist Susanne Cook-Greuter to present a typology of leadership based on the way managers personally make sense of the world around them. Rooke and Torbert classify leaders into seven distinct action-logic categories: Opportunists, Diplomats, Experts, Achievers, Individualists, Strategists, and Alchemists—the first three associated with below-average performance, the latter four with medium to high performance. These leadership styles are not fixed, the authors say, and executives who are willing to work at developing themselves and becoming more self-aware can almost certainly move toward one of the more effective action logics. A Diplomat, for instance, can succeed through hard work and self-reflection at transforming himself into a Strategist.

Few people may become Alchemists, but many will have the desire and potential to become Individualists and Strategists. Corporations that help their executives and leadership teams to examine their action logics can reap rich rewards.

Reprint R0504D

APRIL | 78

Countering the Biggest Risk of All

Adrian J. Slywotzky and John Drzik

Corporate treasurers and chief financial officers have become adept at quantifying and managing a wide variety of risks: financial (for example, currency fluctuations), hazard (chemical spills), and operational (computer system failures). To defend themselves, they use tried-and-true tools such as hedging, insurance, and backup systems. Some companies have even adopted the concept of enterprise risk management, integrating available risk management techniques in a comprehensive, organization-wide approach. But most managers have not addressed in a systematic way the greatest threat of all—*strategic risks,* the array of external events and trends that can devastate a company's growth trajectory and shareholder value.

Strategic risks go beyond such familiar challenges as the possible failure of an acquisition or a product launch. A new technology may overtake your product. Gradual shifts in the market may slowly erode one of your brands beyond the point of viability. Or rapidly shifting customer priorities may suddenly change your industry. The key to surviving these strategic risks, the authors say, is knowing how to assess and respond to them.

In this article, they lay out a method for identifying and responding to strategic threats. They categorize the risks into seven major classes (industry, technology, brand, competitor, customer, project, and stagnation) and describe a particularly dangerous example within each category. The authors also offer countermeasures to take against these risks and describe how individual companies (American Express, Coach, and Air Liquide, among them) have deployed them to neutralize a threat and, in many cases, capitalize on it.

Besides limiting the downside of risk, strategic-risk management forces executives to think more systematically about the future, thus helping them identify opportunities for growth.

Reprint R0504E; HBR OnPoint 977X

APRIL | 92

The Quest for Customer Focus

Ranjay Gulati and James B. Oldroyd

Companies have poured enormous amounts of money into customer relationship management, but in many cases the investment hasn't really paid off. That's because getting closer to customers isn't about building an information technology system. It's a learning journey—one that unfolds over four stages, requiring people and business units to coordinate in progressively more sophisticated ways.

The journey begins with the creation of a companywide repository containing each interaction a customer has with the company, organized not by product, purchase, or location, but by customer. *Communal coordination* is what's called for at this stage, as each group contributes its information to the data pool separately from the others and then taps into it as needed.

In the second stage, one-way *serial coordination* from centralized IT through analytical units and out to the operating units allows companies to go beyond just assembling data to drawing inferences.

In stage three, companies shift their focus from past relationships to future behavior. Through *symbiotic coordination,* information flows back and forth between central analytic units and various organizational units like marketing, sales, and operations, as together they seek answers to questions like "How can we prevent customers from switching to a competitor?" and "Who would be most likely to buy a new product in the future?"

In stage four, firms begin to move past discrete, formal initiatives and, through *integral coordination,* bring an increasingly sophisticated understanding of their customers to bear in all day-to-day operations.

Skipping stages denies organizations the sure foundation they need to build a lasting customer-focused mind-set. Those that recognize this will invest their customer relationship dollars much more wisely—and will see their customer-focusing efforts pay off on the bottom line.

Reprint R0504F; HBR OnPoint 9645; OnPoint collection "Customer Data—Use It or Lose 'Em" 9637

APRIL | 102
The Relative Value of Growth
Nathaniel J. Mass

Most executives would say that adding a point of growth and gaining a point of operating-profit margin contribute about equally to shareholder value. Margin improvements hit the bottom line immediately, while growth compounds value over time. But the reality is that the two are rarely equivalent. Growth often is far more valuable than managers think. For some companies, convincing the market that they can grow by just one additional percentage point can be worth six, seven, or even ten points of margin improvement.

This article presents a new strategic metric, called the relative value of growth (RVG), which gives managers a clear picture of how growth projects and margin improvement initiatives affect shareholder value. Using basic balance sheet and income sheet data, managers can determine their companies' RVGs, as well as those of their competitors. Calculating RVGs gives managers insights into which corporate strategies are working to deliver value and whether their companies are pulling the most powerful value-creation levers.

The author examines a number of well-known companies and explains what their RVG numbers say about their strategies. He reviews the unspoken assumption that growth and profits are incompatible over the long term and shows that a fair number of companies are effective at delivering both. Finally, he explains how managers can use the RVG framework to help them define strategies that balance growth and profitability at both the corporate and business unit levels.

Reprint R0504G

APRIL | 114
Selection Bias and the Perils of Benchmarking
Jerker Denrell

To find the secrets of business success, what could be more natural than studying successful businesses?

In fact, nothing could be more dangerous, warns this Stanford professor. Generalizing from the examples of successful companies is like generalizing about New England weather from data taken only in the summer. That's essentially what businesspeople do when they learn from good examples and what consultants, authors, and researchers do when they study only existing companies or – worse yet – only high-performing companies. They reach conclusions from unrepresentative data samples, falling into the classic statistical trap of selection bias.

Drawing on a wealth of case studies, for instance, one researcher concluded that great leaders share two key traits: They persist, often despite initial failures, and they are able to persuade others to join them. But those traits are also the hallmarks of spectacularly unsuccessful entrepreneurs, who must persist in the face of failure to incur large losses and must be able to persuade others to pour their money down the drain.

To discover what makes a business successful, then, managers should look at both successes and failures. Otherwise, they will overvalue risky business practices, seeing only those companies that won big and not the ones that lost dismally. They will not be able to tell if their current good fortune stems from smart business practices or if they are actually coasting on past accomplishments or good luck.

Fortunately, economists have developed relatively simple tools that can correct for selection bias even when data about failed companies are hard to come by. Success may be inspirational, but managers are more likely to find the secrets of high performance if they give the stories of their competitors' failures as full a hearing as they do the stories of dazzling successes.

Reprint R0504H

APRIL | 121
The Half-Truth of First-Mover Advantage
Fernando Suarez and Gianvito Lanzolla

Many executives take for granted that the first company in a new product category gets an unbeatable head start and reaps long-lasting benefits. But that doesn't always happen. The authors of this article discovered that much depends on the pace at which the category's technology is changing and the speed at which the market is evolving. By analyzing these two factors, companies can improve their odds of succeeding as first movers with the resources they possess.

Gradual evolution in both the technology and the market provides a first mover with the best conditions for creating a dominant position that is long lasting (Hoover in the vacuum cleaner industry is a good example). In such calm waters, a company can defend its advantages even without exceptional skills or extensive financial resources.

When the market is changing rapidly and the product isn't, a first entrant with extensive resources can obtain a long-lasting advantage (as Sony did with its Walkman personal stereo); a company with only limited resources probably must settle for a short-term benefit. When the market is static but the product is changing constantly, first-mover advantages of either kind – durable or short-lived – are unlikely. Only companies with very deep pockets can survive (think of Sony and the digital cameras it pioneered).

Rapid churn in both the technology and the market creates the worst conditions. But if companies have an acute sense of when to exit – as Netscape demonstrated when it agreed to be acquired by AOL – a worthwhile short-term gain is possible.

Before venturing into a newly forming market, you need to analyze the environment, assess your resources, then determine which type of first-mover advantage is most achievable. Once you've gone into the water, you have no choice but to swim.

Reprint R0504J

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May 2005

MAY | 58

COVER STORY

Building Breakthrough Businesses Within Established Organizations

Vijay Govindarajan and Chris Trimble

Many companies assume that once they've launched a major innovation, growth will soon follow. It's not that simple. High-potential new businesses within established companies face stiff headwinds well after their inception. That's why a company's emphasis must shift: from ideas to execution and from leadership excellence to organizational excellence.

The authors spent five years chronicling new businesses at the New York Times Company, Analog Devices, Corning, Hasbro, and other organizations. They found that a breakthrough new business (referred to as NewCo) rarely coexists gracefully with the established business in the company (called CoreCo). The unnatural combination creates three specific challenges – *forgetting, borrowing,* and *learning* – that NewCo must meet in order to survive and grow.

NewCo must first forget some of what made CoreCo successful. NewCo and CoreCo have elemental differences, so NewCo must leave behind CoreCo's notions about what skills and competencies are most valuable.

NewCo must also borrow some of CoreCo's assets – usually in one or two key areas that will give NewCo a crucial competitive advantage. Incremental cost reductions, for example, are never a sufficient justification for borrowing.

Finally, NewCo must be prepared to learn some things from scratch. It will face several critical unknowns. The more rapidly it can resolve those unknowns – that is, the faster it can learn – the sooner it will zero in on a winning business model or exit a hopeless situation. Managers can accelerate this learning by planning more simply and more often and by comparing predicted and actual trends.

Reprint R0505C; HBR OnPoint 9955; OnPoint collection "Building Breakthrough Businesses in Emerging Companies" 9971

MAY | 18

FORETHOUGHT

In Praise of Uncertainty The tech industry has a really good grasp of what works and how its products will be used – and that's killing innovation, says the Berkman Center's Jonathan Zittrain. **Reprint F0505A**

Trust, but Verify The unwillingness of autonomous teams to monitor members' work can depress performance, finds Washington University's Claus Langfred. **Reprint F0505B**

Real Products in Imaginary Worlds The online universe is ripe for product placements, suggests Edward Castronova of Indiana University. **Reprint F0505C**

Culture Matters Most Managers with different jobs in the same company are more likely to have similar leadership styles than managers with similar jobs in different companies, report Thomas Kell and Gregory T. Carrott of Heidrick & Struggles. **Reprint F0505D**

Treat Employees like Adults Businesses claim to revere intellectual capital but treat workers like children, says the University of Kent's Frank Furedi. **Reprint F0505E**

Emerging Expertise Emerging markets are increasingly becoming economies of expertise, says IBM's Steven Sams. **Reprint F0505F**

Innovate at Your Own Risk Risk aversion is undermining U.S. innovation, warns Deborah Wince-Smith, president of the Council on Competitiveness. **Reprint F0505G**

Lessons from the Egg Master Fabergé perfected the concept of the artisan brand, says author John Butman. **Reprint F0505H**

The New Tools of Trade Harvard Business School's Regina M. Abrami and Texas A&M's Leonard Bierman argue that companies only hurt themselves when they block legislation that would put labor standards into trade agreements. **Reprint F0505J**

Capturing Customers' Spare Change Software that "understands" psychology is helping fast-food restaurants capture customers' spare change, explains GE edgelab's Terri C. Albert and marketing professor Russell S. Winer. **Reprint F0505K**

MAY | 33

HBR CASE STUDY

Fat Chance

Bronwyn Fryer and Julia Kirby

Sid Shawn is a ten-year veteran of NMO Financial Services and a mainstay of the pensions marketing group. He's been a good, consistent worker – garnering above-average performance reviews and regular pay raises – and an invaluable resource for the salespeople and consultant relations managers, many of whom have come to depend on him to outline their talking points and pitch books.

Sid also weighs 400 pounds. So when he is the only internal candidate for the customer-facing position of consultant relations manager, sales and marketing VP Bill Houglan feels that he has a tough hiring decision to make. No question, Sid knows the company's products backward and forward. But to succeed in the new job, he would have to impress the polished professionals at major benefits consultancies. What kind of image would Sid present in face-to-face sales situations? Could he keep up with the job's physical demands and fast pace? Does Sid's weight matter? Bill wonders.

With obesity reaching epidemic proportions in the United States, companies are feeling its impact on their insurance costs and their employees' health. They are increasingly compelled to adopt policies concerning overweight workers. Is obesity a form of disability that should be accommodated? Or is it the outcome of personal failings that an employer need not tolerate?

Offering expert advice on this fictional case study are Howard Weyers, CEO of Weyco, which has fired employees for smoking and is now targeting the issue of obesity at work; Sondra Solovay, a California attorney focusing on weight-related issues and the author of *Tipping the Scales of Justice: Fighting Weight-Based Discrimination;* Mark V. Roehling, a Michigan State University professor whose research has focused on issues of obesity in the workplace; and Amy Wilensky, author of *The Weight of It: A Story of Two Sisters.*

Reprint R0505A

MAY | 47

Back Where We Belong

Michael J. Critelli

If you were the CEO of Pitney Bowes, the postage meter maker, how would you envision the future of the business? The company has an undeniable core competence in the solutions it provides to high-volume postal service users. But with snail mail on the decline, some would say that core has about as much future as the buggy whip.

In this article, Pitney Bowes chairman and CEO Michael Critelli gives us a glimpse of how he leads his company's strategy development – and how that development has supported a counterintuitive return to the company's core after decades of diversification. He and others in the company begin the process by tapping into deeply knowledgeable people and organizations to understand key trends in the business and the rate at which change is occurring. Then, it's a question of the firm reshaping the environment in which it does business, whether through R&D investments or work with regulators and policy makers who influence market forces; this is especially important in emerging markets. Focusing on a core business area enables a company to find adjacent high-margin opportunities and to offer comprehensive solutions to customers. What stands out most sharply in this account, however, is the importance of having a strategist's mind-set. Whether Critelli is reading the day's news, visiting a key account, or spending an hour with his own people working in the context of a customer mail room, he is constantly extrapolating possible long-term competitive implications from the immediate facts.

Often inspired by strategic thinkers, Critelli believes that the greatest thing he can do for his organization is to shift the terms of the debate. "Rarely am I credited with sterling words or bold, symbolic actions," he writes. "Instead, I help people to see the business we are in differently and to reach a shared vision as to where we want to end up. And, little by little, things move in the right direction."

Reprint R0505B

MAY | 72

Your Company's Secret Change Agents

Richard Tanner Pascale and Jerry Sternin

Organizational change has traditionally come about through top-down initiatives such as hiring experts or importing best-of-breed practices. Such methods usually result in companywide rollouts of templates mandated from on high. These do little to get people excited.

But within every organization, there are a few individuals who find unique ways to look at problems that seem impossible to solve. Although these change agents start out with the same tools and access to resources as their peers, they are able to see solutions where others do not. They find a way to bridge the divide between what is happening and what is possible.

These *positive deviants* are the key, the authors believe, to a better way of creating organizational change. Your company can make the most of their methods by following six steps.

In Step 1, Make the group the guru, the members of the community are engaged in the process of their own evolution. Step 2, Reframe through facts, entails restating the problem in a way that opens minds to new possibilities. Step 3, Make it safe to learn, involves creating an environment that supports innovative ideas. In Step 4, Make the problem concrete, the community combats abstraction by stating uncomfortable truths. In Step 5, Leverage social proof, the community looks to the larger society for examples of solutions that have worked in parallel situations. In Step 6, Confound the immune defense response, solutions are introduced organically from within the group in a way that promotes acceptance. Throughout the steps, the leader must suspend his or her traditional role in favor of more facilitatory practices.

The positive-deviance approach has unearthed solutions to such complicated and diverse problems as malnutrition in Mali and human trafficking in East Java. This methodology can help solve even the most extreme dilemmas.

Reprint R0505D

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MAY | 86

Break Free from the Product Life Cycle

Youngme Moon

Most firms build their marketing strategies around the concept of the product life cycle – the idea that after introduction, products inevitably follow a course of growth, maturity, and decline. It doesn't have to be that way, says HBS marketing professor Youngme Moon. By positioning their products in unexpected ways, companies can change how customers mentally categorize them. In doing so, they can shift products lodged in the maturity phase back – and catapult new products forward – into the growth phase.

The author describes three positioning strategies that marketers use to shift consumers' thinking. *Reverse positioning* strips away "sacred" product attributes while adding new ones (JetBlue, for example, withheld the expected first-class seating and in-flight meals on its planes while offering surprising perks like leather seats and extra legroom). *Breakaway positioning* associates the product with a radically different category (Swatch chose not to associate itself with fine jewelry and instead entered the fashion accessory category). And *stealth positioning* acclimates leery consumers to a new offering by cloaking the product's true nature (Sony positioned its less-than-perfect household robot as a quirky pet).

Clayton Christensen described how new, simple technologies can upend a market. In an analogous way, these positioning strategies can exploit the vulnerability of established categories to new positioning. A company can use these techniques to go on the offensive and transform a category by demolishing its traditional boundaries. Companies that disrupt a category through positioning create a lucrative place to ply their wares – and can leave category incumbents scrambling.

Reprint R0505E; HBR OnPoint 9963

MAY | 96

How Business Schools Lost Their Way

Warren G. Bennis and James O'Toole

Business schools are facing intense criticism for failing to impart useful skills, failing to prepare leaders, failing to instill norms of ethical behavior – and even failing to lead graduates to good corporate jobs. These criticisms come not just from students, employers, and the media but also from deans of some of America's most prestigious B schools.

The root cause of today's crisis in management education, assert Warren G. Bennis and James O'Toole, is that business schools have adopted an inappropriate – and ultimately self-defeating – model of academic excellence. Instead of measuring themselves in terms of the competence of their graduates, or by how well their faculty members understand important drivers of business performance, they assess themselves almost solely by the rigor of their scientific research. This scientific model is predicated on the faulty assumption that business is an academic discipline like chemistry or geology when, in fact, business is a profession and business schools are professional schools – or should be. Business school deans may claim that their schools remain focused on practice, but they nevertheless hire and promote research-oriented professors who haven't spent time working in companies and are more comfortable teaching methodology than messy, multidisciplinary issues – the very stuff of management.

The authors don't advocate a return to the days when business schools were glorified trade schools. But to regain relevancy, they say, business schools must rediscover the practice of business and find a way to balance the dual mission of educating practitioners and creating knowledge through research.

Reprint R0505F

How can your company grow profit from the mailstream?

Here are eight ideas. There may be one or more that applies to your organization's goals.

1. Direct marketing
2. Multi-channel integrated marketing
3. Personalization and color print on demand
4. Enhancing e-commerce via mailings
5. Using the mailstream's unique distribution characteristics
6. Including customized marketing messages on statements and invoices
7. Taking advantage of the U.S. Postal Service's on-time delivery record
8. Developing creative, customized shapes for direct mail pieces

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MAY | 124

Creating the Living Brand

Neeli Bendapudi and Venkat Bendapudi

It's easy to conclude from the literature and the lore that top-notch customer service is the province of a few luxury companies and that any retailer outside that rarefied atmosphere is condemned to offer mediocre service at best. But even companies that position themselves for the mass market can provide outstanding customer–employee interactions and profit from them, if they train employees to reflect the brand's core values.

The authors studied the convenience store industry in depth and focused on two that have developed a devoted following: QuikTrip (QT) and Wawa. Turnover rates at QT and Wawa are 14% and 22% respectively, much lower than the typical rate in retail.

The authors found six principles that both firms embrace to create a strong culture of customer service. *Know what you're looking for:* A focus on candidates' intrinsic traits allows the companies to hire people who will naturally bring the right qualities to the job. *Make the most of talent:* In mass-market retail, talent is generally viewed as a commodity, but that outlook becomes a self-fulfilling prophesy. *Create pride in the brand:* Service quality depends directly on employees' attachment to the brand. *Build community:* Wawa and QT have made concerted efforts to build customer loyalty through a sense of community. *Share the business context:* Employees need a clear understanding of how their company operates and how it defines success. *Satisfy the soul:* To win an employee's passionate engagement, a company must meet his or her needs for security, esteem, and justice.

Reprint R0505G

MAY | 135

Six Sigma Pricing

ManMohan S. Sodhi and Navdeep S. Sodhi

Many companies are now good at managing costs and wringing out manufacturing efficiencies. The TQM movement and the disciplines of Six Sigma have seen to that. But the discipline so often brought to the cost side of the business equation is found far less commonly on the revenue side.

The authors describe how a global manufacturer of industrial equipment, which they call Acme Incorporated, recently applied Six Sigma to one major revenue-related activity – the price-setting process. It seemed to Acme's executives that pricing closely resembled many manufacturing processes. So, with the help of a Six Sigma black belt from manufacturing, a manager from Acme's pricing division recruited a team to carry out the five Six Sigma steps:

- **Define what constitutes a defect.** At Acme, a defect was an item sold at an unauthorized price.
- **Gather data and prepare it for analysis.** That involved mapping out the existing pricing-agreement process.
- **Analyze the data.** The team identified the ways in which people failed to carry out or assert effective control at each stage.
- **Recommend modifications to the existing process.** The team sought to decrease the number of unapproved prices without creating an onerous approval apparatus.
- **Create controls.** This step enabled Acme to sustain and extend the improvements in its pricing procedures.

As a result of the changes, Acme earned $6 million in additional revenue on one product line alone in the six months following implementation – money that went straight to the bottom line. At the same time, the company removed much of the organizational friction that had long bedeviled its pricing process. Other companies can benefit from Acme's experience as they look for ways to exercise price control without alienating customers.

Reprint R0505H

June 2005

MAY

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JUNE | 80

COVER STORY

The Surprising Economics of a "People Business"

Felix Barber and Rainer Strack

When people are your most important asset, some standard performance measures and management practices become misleading or irrelevant. This is a danger for any business whose people costs are greater than its capital costs – that is, businesses in most industries. But it is particularly true for what the authors call "people businesses": operations with high employee costs, low capital investment, and limited spending on activities, such as R&D, that are aimed at generating future revenue.

If you run a people business – or a company that includes one or more of them – how do you measure its true performance? Avoid the trap of relying on capital-oriented metrics, such as return on assets and return on equity. They won't help much, as they'll tend to mask weak performance or indicate volatility where it doesn't exist. Replace them with financially rigorous people-oriented metrics – for example, a reformulation of a conventional calculation of economic profit, such as EVA, so that you gauge people, rather than capital, productivity.

Once you have assessed the business's true performance, you need to enhance it operationally (be aware that relatively small changes in productivity can have a major impact on shareholder returns); reward it appropriately (push performance-related variable compensation schemes down into the organization); and price it advantageously (because economies of scale and experience tend to be less significant in people businesses, price products or services in ways that capture a share of the additional value created for customers).
Reprint R0506D

JUNE | 18

FORETHOUGHT

The Eureka Myth In business lore, the eureka moment overshadows the more important matter of how an invention reaches the marketplace, says author Sir Harold Evans. **Reprint** F0506A

Outsourcing Integration An energy company's integration of a $2 billion firm it had acquired was smooth because much of the back end was outsourced, says consultant Jane C. Linder. **Reprint** F0506B

New Laws of the Jingle Does the ad jingle have a future? HBR senior editor Leigh Buchanan points out the appeal of simplicity in a complicated age. **Reprint** F0506C

Shareholder Votes for Sale To make legitimate and effective use of vote buying, managers should act with the company's best interests in mind, say Luh Luh Lan at the National University of Singapore and Loizos Heracleous at Oxford. **Reprint** F0506D

The Madness of Individuals Collective decisions are often better than individual ones, says researcher Laurence Prusak. **Reprint** F0506E

Little Decisions Add Up Consultant Frank Rohde describes a system for evaluating frontline workers' interactions with customers. **Reprint** F0506F

Knowing What to Listen For Blind since childhood, Herb Greenberg emphasizes character above presentation when he advises companies on how to make job interviews more meaningful. **Reprint** F0506G

The Low Value of Virtue Most consumers don't care where, how, or by whom products are made, says David Vogel at Berkeley's Haas School of Business. **Reprint** F0506H

Don't Blame the Metrics Improved measurement methods show marketing is losing its magic, say consultants Kevin J. Clancy and Randy L. Stone. **Reprint** F0506J

Hidden Harassment Workplace incivility can be as costly as sexual harassment, reports HBR senior editor Gardiner Morse. **Reprint** F0506K

Coal Cleans Up Its Act Coal is looking better as an energy source, says Amy Salzhauer of Ignition Ventures. **Reprint** F0506L

JUNE | 35

HBR CASE STUDY

Holding Fast

John T. Gourville

CEO Peter Walsh faces a classic innovator's dilemma. His company, Crescordia, produces high-quality metal plates, pins, and screws that orthopedic surgeons use to repair broken bones. In fact, because the company has for decades refused to compromise on quality, there are orthopedic surgeons who use nothing but Crescordia hardware. And now these customers have begun to clamor for the next generation technology: resorbable hardware.

Resorbables offer clear advantages over the traditional hardware. Like dissolving sutures, resorbable plates and screws are made of biodegradable polymers. They hold up long enough to support a healing bone, then gradually and harmlessly disintegrate in the patient's body. Surgeons are especially looking forward to using resorbables on children, so kids won't have to undergo a second operation to remove the old hardware after their bones heal, a common procedure in pediatrics. The new products, however, are not yet reliable; they fail about 8% of the time, sometimes disintegrating before the bone completely heals and sometimes not ever fully disintegrating. That's why Crescordia, mindful of its hard-earned reputation, has delayed launching a line using the new technology.

But time is running out. A few competitors have begun to sell resorbables despite their imperfections, and these companies are picking up market share. Should Crescordia join the fray and risk tarnishing its brand? Or should the company sit tight until it can offer a perfect product?

Commenting on this fictional case study are Robert A. Lutz, vice chairman of product development at General Motors; Clayton M. Christensen, the Robert and Jane Cizik Professor of Business Administration at Harvard Business School; Jason Wittes, a senior equity analyst covering medical supplies and devices at Leerink Swann; and Nick Galakatos, a general partner of MPM Capital.
Reprint R0506A

HBR Spotlight **Risk and Reward in World Markets**

JUNE | 51

Managing Risk in an Unstable World

Ian Bremmer

With emerging markets like China and politically unstable countries like Saudi Arabia figuring more than ever into companies' investment calculations, business leaders are turning to political risk analysis to measure the impact of politics on potential markets, minimize risks, and make the most of global opportunities. But political risk is more subjective than its economic counterpart. It is influenced by the passage of laws, the foibles of government leaders, and the rise of popular movements. So corporate leaders must grapple not just with broad, easily observable trends but also with nuances of society and even quirks of personality. And those hard-to-quantify factors must constantly be pieced together into an ongoing narrative within historical and regional contexts.

As goods, services, information, ideas, and people cross borders today with unprecedented velocity, corporations debating operational or infrastructural investments abroad increasingly need objective, rigorous assessments. One tool for measuring and presenting stability data, for example, incorporates 20 composite indicators of risk in emerging markets and scores risk variables according to both their structural and their temporal components. The indicators are then organized into four equally weighted subcategories whose ratings are aggregated into a single stability score. Countries are ranked on a scale of zero (a failed state) to 100 (a fully institutionalized, stable democracy).

Companies can buy political risk analyses from consultants or, as some large energy and financial services organizations have done, develop them in-house. Either way, a complete and accurate picture of any country's risk requires analysts with strong reportorial skills; timely, accurate data on a variety of social and political trends; and a framework for evaluating the impact of individual risks on stability.

Reprint R0506B; HBR OnPoint 1126

JUNE | 63

Strategies That Fit Emerging Markets

Tarun Khanna, Krishna G. Palepu, and Jayant Sinha

It's no easy task to identify strategies for entering new international markets or to decide which countries to do business with. Many firms simply go with what they know – and fall far short of their goals.

Part of the problem is that emerging markets have "institutional voids": They lack specialized intermediaries, regulatory systems, and contract-enforcing methods. These gaps have made it difficult for multinationals to succeed in developing nations; thus, many companies have resisted investing there. That may be a mistake. If Western companies don't come up with good strategies for engaging with emerging markets, they are unlikely to remain competitive.

Many firms choose their markets and strategies for the wrong reasons, relying on everything from senior managers' gut feelings to the behaviors of rivals. Corporations also depend on composite indexes for help making decisions. But these analyses can be misleading; they don't account for vital information about the soft infrastructures in developing nations. A better approach is to understand institutional variations between countries. The best way to do this, the authors have found, is by using the five contexts framework.

The five contexts are a country's political and social systems, its degree of openness, its product markets, its labor markets, and its capital markets. By asking a series of questions that pertain to each of the five areas, executives can map the institutional contexts of any nation.

When companies match their strategies to each country's contexts, they can take advantage of a location's unique strengths. But first firms should weigh the benefits against the costs. If they find that the risks of adaptation are too great, they should try to change the contexts in which they operate or simply stay away.

Reprint R0506C

JUNE | 92

Competent Jerks, Lovable Fools, and the Formation of Social Networks

Tiziana Casciaro and Miguel Sousa Lobo

When looking for help with a task at work, people turn to those best able to do the job. Right? Wrong. New research shows that work partners tend to be chosen not for ability but for likability.

Drawing from their study encompassing 10,000 work relationships in five organizations, the authors have classified work partners into four archetypes: the competent jerk, who knows a lot but is unpleasant; the lovable fool, who doesn't know much but is a delight; the lovable star, who's both smart and likable; and the incompetent jerk, who…well, that's self-explanatory.

Of course, everybody wants to work with the lovable star, and nobody wants to work with the incompetent jerk. More interesting is that people prefer the lovable fool over the competent jerk. That has big implications for every organization, as both of these types often represent missed opportunities.

Because they are liked by a disproportionate number of people, lovable fools can bridge gaps between diverse groups that might not otherwise interact. But their networking skills are often developed at the expense of job performance, which can make these employees underappreciated and vulnerable to downsizing. To get the most out of them, managers need to protect them and put them in positions that don't waste their bridge-building talents.

As for the competent jerks, too often their expertise goes untapped by people who just can't put up with them. But many can be socialized through coaching or by being made accountable for bad behavior. Others may need to display their competence in more isolated settings.

Intriguingly, managers aren't limited to leveraging people that others like and changing those that others loathe. They also can create situations in which people are more apt to like one another, whatever their individual qualities.

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JUNE | 100

The Coming Commoditization of Processes

Thomas H. Davenport

Despite the much-ballyhooed increase in outsourcing, most companies are in do-it-yourself mode for the bulk of their processes, in large part because there's no way to compare outside organizations' capabilities with those of internal functions. Given the lack of comparability, it's almost surprising that anyone outsources today. But it's not surprising that cost is by far companies' primary criterion for evaluating outsourcers or that many companies are dissatisfied with their outsourcing relationships.

A new world is coming, says the author, and it will lead to dramatic changes in the shape and structure of corporations. A broad set of process standards will soon make it easy to determine whether a business capability can be improved by outsourcing it. Such standards will also help businesses compare service providers and evaluate the costs versus the benefits of outsourcing. Eventually these costs and benefits will be so visible to buyers that outsourced processes will become a commodity, and prices will drop significantly. The low costs and low risk of outsourcing will accelerate the flow of jobs offshore, force companies to reassess their strategies, and change the basis of competition.

The speed with which some businesses have already adopted process standards suggests that many previously unscrutinized areas are ripe for change. In the field of technology, for instance, the Carnegie Mellon Software Engineering Institute has developed a global standard for software development processes, called the Capability Maturity Model (CMM).

For companies that don't have process standards in place, it makes sense for them to create standards by working with customers, competitors, software providers, businesses that processes may be outsourced to, and objective researchers and standard-setters. Setting standards is likely to lead to the improvement of both internal and outsourced processes.

Reprint R0506F

JUNE | 112

Developing First-Level Leaders

Andreas Priestland and Robert Hanig

Oil and energy corporation BP was well aware of the importance of its work group managers on the front lines. Their decisions, in aggregate, make an enormous difference in BP's turnover, costs, quality control, safety, innovation, and environmental performance. There were about 10,000 such supervisors, working in every part of the company – from solar plants in Spain, to drilling platforms in the North Sea, to marketing teams in Chicago. Some 70% to 80% of BP employees reported directly to these lower-level managers. Yet, until recently, the corporation didn't have a comprehensive training program – let alone an official name – for them. For their part, the frontline managers felt disconnected; it was often hard for them to understand how their individual decisions contributed to the growth and reputation of BP as a whole.

In this article, BP executive Andreas Priestland and Dialogos VP Robert Hanig describe how BP in the past five years has learned to connect with this population of managers. After one and a half years of design and development, there is now a companywide name – "first-level leaders" – and a comprehensive training program for this cohort. The authors describe the collaborative effort they led to create the program's four components: Supervisory Essentials, Context and Connections, the Leadership Event, and Peer Partnerships. The design team surveyed those it had deemed first-level leaders and others throughout BP; extensively benchmarked other companies' training efforts for lower-level managers; and conducted a series of pilot programs that involved dozens of advisers.

The training sessions were first offered early in 2002, and since then, more than 8,000 of BP's first-level leaders have attended. The managers who've been through training are consistently ranked higher in performance than those who haven't, both by their bosses and by the employees who report to them, the authors say.

Reprint R0506G

JUNE | 122

Every Employee an Owner. Really.

Corey Rosen, John Case, and Martin Staubus

Surveys indicate that when new rules on expensing stock options take effect, many companies are likely to limit the number of employees who can receive equity compensation. But companies that reserve equity for executives are bound to suffer in the long run. Study after study proves that broad-based ownership, when done right, leads to higher productivity, lower workforce turnover, better recruits, and bigger profits.

"Done right" is the key. Here are the four most important factors in implementing a broad-based employee equity plan: A significant portion of the workforce – generally, most of the full-time people – must hold equity; employees must think the amounts they hold can significantly improve their financial prospects; managerial practices and policies must reinforce the plan; and employees must feel a true sense of company ownership. Those factors add up to an ownership culture in which employees' interests are aligned with the company's. The result is a workforce that is loyal, cooperative, and willing to go above and beyond to make the organization successful.

A wide variety of companies have recorded exceptional business performance with the help of employee-ownership programs supported by management policies. The authors examine two: Science Applications International, a research and development contractor, and Scot Forge, which shapes metal and other materials for industrial machinery. At both companies, every employee with a year or so of service holds equity, and employees who stay on can accumulate a comfortable nest egg. Management's sharing of financial information reinforces workers' sense of ownership. So does the expectation that employees will accept the responsibilities of ownership. Workers with an ownership stake internalize their responsibilities and feel they have an obligation not only to management but to one another.

Reprint R0506H

JUNE | 133

Your Alliances Are Too Stable

David Ernst and James Bamford

A 2004 McKinsey survey of more than 30 companies reveals that at least 70% of them have major alliances that are underperforming and in need of restructuring. Moreover, JVs that broaden or otherwise adjust their scope have a 79% success rate, versus 33% for ventures that remain essentially unchanged. Yet most firms don't routinely evaluate the need to overhaul their alliances or intervene to correct performance problems. That means corporations are missing huge opportunities: By revamping just one large alliance, a company can generate $100 million to $300 million in extra income a year. Here's how to unlock more value from alliances:

1. Launch the process. Don't wait until your venture is in the middle of a crisis; regularly scan your major alliances to determine which need restructuring. Once you've targeted one, designate a restructuring team and find a senior sponsor to push the process along. Then delineate the scope of the team's work.

2. Diagnose performance. Evaluate the venture on the following performance dimensions: ownership and financials, strategy, operations, governance, and organization and talent. Identify the root causes of the venture's problems, not just the symptoms, and estimate how much each problem is costing the company.

3. Generate restructuring options. Based on the diagnosis, decide whether to fix, grow, or exit the alliance. Assuming the answer is fix or grow, determine whether fundamental or incremental changes are needed, using the five performance dimensions above as a framework. Then assemble three or four packages of restructuring options, test them with shareholders, and gain parents' approval.

4. Execute the changes. Embark on a widespread and consistent communication effort, building support among executives in the JV and the parent companies. So the process stays on track, assign accountability to certain groups or individuals.

Reprint R0506J

July–August 2005

JULY–AUGUST | 54

COVER STORY

Designing High-Performance Jobs

Robert Simons

Tales of great strategies derailed by poor execution are all too common. That's because some organizations are designed to fail.

For a company to achieve its potential, each employee's supply of organizational resources should equal the demand, and the same balance must apply to every business unit and to the company as a whole. To carry out his or her job, each employee has to know the answers to four basic questions: What resources do I control to accomplish my tasks? What measures will be used to evaluate my performance? Who do I need to interact with and influence to achieve my goals? And how much support can I expect when I reach out to others for help?

The questions correspond to what the author calls the four basic *spans* of a job—control, accountability, influence, and support. Each span can be adjusted so that it is narrow or wide or somewhere in between. If you get the settings right, you can design a job in which a talented individual can successfully execute on your company's strategy. If you get the settings wrong, it will be difficult for an employee to be effective.

The first step is to set the span of control to reflect the resources allocated to each position and unit that plays an important role in delivering customer value. This setting, like the others, is determined by how the business creates value for customers and differentiates its products and services. Next, you can dial in different levels of entrepreneurial behavior and creative tension by widening or narrowing spans of accountability and influence. Finally, you must adjust the span of support to ensure that the job or unit will get the informal help it needs.

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JULY–AUGUST | 17

HBR CASE STUDY

Feed R&D – or Farm It Out?

Nitin Nohria

From a converted muffler-repair shop, Ray Kelner launched RLK Media in 1985, selling its radical audio speakers to affluent connoisseurs for $20,000 a pop. By the 1990s, RLK had grown into a billion-dollar business through its single-minded focus on pricey, highly branded, handcrafted consumer electronics.

But things are no longer going so well, and chairman Keith Harrington lays it all at the feet of CEO Lars Inman. "Your margins have evaporated," he barks. "You're missing your numbers. The problem is not that you guys aren't working – the whole damn place is like a bunch of college kids pulling all-nighters. The problem is, people aren't buying the old product – no matter how good it is – and you don't have anything new."

But RLK might just have something new. Ray and his team have done it again – their astonishing iVid headset prototype is light-years ahead of the competition. All Ray needs is another 18 months (or so) and $6 million to hire ten elite software developers, and he could put RLK back on the map.

Lars considers hedging his bets by outsourcing software development to Inova Laboratories, an impressively tight-run contract company in Gurgaon, India, that promises to move RLK from prototype to volume manufacturing in 12 months – at a fifth the cost. But Ray is adamant. His group is just too tightly knit. "Outsource this, and you can kiss the iVid goodbye," he insists.

Should Lars outsource R&D nevertheless?

Commenting on this fictional case study are Larry Huston, vice president for innovation and knowledge at Procter & Gamble; former Xerox chief scientist John Seely Brown and consultant John Hagel III; Claremont Graduate University professor Jean Lipman-Blumen; and Azim Premji, chairman of IT services company Wipro, based in Bangalore, India.

Reprint R0507A

JULY–AUGUST | 30

Toward a Theory of High Performance

Julia Kirby

What does it mean to be a high-performance company? The process of measuring relative performance across industries and eras, declaring top performers, and finding the common drivers of their success is such a difficult one that it might seem a fool's errand to attempt. In fact, no one did for the first thousand or so years of business history. The question didn't even occur to many scholars until Tom Peters and Bob Waterman released *In Search of Excellence* in 1982. Twenty-three years later, we've witnessed several more attempts – and, just maybe, we're getting closer to answers.

In this reported piece, HBR senior editor Julia Kirby explores why it's so difficult to study high performance and how various research efforts – including those from John Kotter and Jim Heskett; Jim Collins and Jerry Porras; Bill Joyce, Nitin Nohria, and Bruce Roberson; and several others outlined in a summary chart – have attacked the problem.

The challenge starts with deciding which companies to study closely. Are the stars the ones with the highest market caps, the ones with the greatest sales growth, or simply the ones that remain standing at the end of the game? (And when's the end of the game?) Each major study differs in how it defines success, which companies it therefore declares to be worthy of emulation, and the patterns of activity and attitude it finds in common among them. Yet, Kirby concludes, as each study's method incrementally solves problems others have faced, we are progressing toward a consensus theory of high performance.

Reprint R0507B

JULY–AUGUST | 41

When Failure Isn't an Option

Michael R. Hillmann, Philippe Dongier, Robert P. Murgallis, Mary Khosh, Elizabeth K. Allen, and Ray Evernham

Some teams, by the very nature of their work, must consistently perform at the highest levels. How do you – as a team leader, a supervisor, a trainer, or an outside coach – ensure that this happens?

To answer this question, *Harvard Business Review* asked six people who work with high-performance teams to comment on developing and managing these teams. The result is a collection of commentaries from Michael Hillmann, deputy chief of the Los Angeles Police Department and commander of its Special Operations Bureau, which includes the SWAT team; Philippe Dongier, who headed up a joint United Nations/World Bank/Asian Development Bank reconstruction team in Afghanistan after the fall of the Taliban; the National Fire Academy's Robert Murgallis, who trains firefighting teams; Mary Khosh, former career coach for players with the Cleveland Browns; Elizabeth Allen, a planner of society weddings, charity galas, and corporate events; and Ray Evernham, who, as a stock-car-racing crew chief, helped driver Jeff Gordon win three NASCAR championships.

The types of teams represented in these commentaries are very different. Some are ad hoc, formed for a specific task, while others are ongoing, typically improving their performance with each task they undertake. For all of them, the stakes are high.

Despite their differences, some similarities emerge in the ways they achieve top performance. For example, selection of team members is crucial – as is a willingness to get rid of members who don't consistently deliver. A leader who supports and builds confidence in members is also key, and high-performance teams without such a leader will often informally create one. Finally, the stress that defines the work of these teams helps generate peak short-term performance – and poses the constant risk of members burning out.

Reprint R0507C

JULY–AUGUST | 64

Turning Great Strategy into Great Performance

Michael C. Mankins and Richard Steele

Despite the enormous time and energy that goes into strategy development, many companies have little to show for their efforts. Indeed, research by the consultancy Marakon Associates suggests that companies on average deliver only 63% of the financial performance their strategies promise.

In this article, Michael Mankins and Richard Steele of Marakon present the findings of this research. They draw on their experience with high-performing companies like Barclays, Cisco, Dow Chemical, 3M, and Roche to establish some basic rules for setting and delivering strategy:

Keep it simple, make it concrete. Avoid long, drawn-out descriptions of lofty goals and instead stick to clear language describing what your company will and won't do.

Debate assumptions, not forecasts. Create cross-functional teams drawn from strategy, marketing, and finance to ensure the assumptions underlying your long-term plans reflect both the real economics of your company's markets and its actual performance relative to competitors.

Use a rigorous analytic framework. Ensure that the dialogue between the corporate center and the business units about market trends and assumptions is conducted within a rigorous framework, such as that of "profit pools."

Discuss resource deployments early. Create more realistic forecasts and more executable plans by discussing up front the level and timing of critical deployments.

Clearly identify priorities. Prioritize tactics so that employees have a clear sense of where to direct their efforts.

Continuously monitor performance. Track resource deployment and results against plan, using continuous feedback to reset assumptions and reallocate resources.

Reward and develop execution capabilities. Motivate and develop staff.

Following these rules strictly can help narrow the strategy-to-performance gap.

Reprint R0507E; HBR OnPoint 1509; OnPoint collection "Great Strategy *and* Great Results" 1495

JULY–AUGUST | 74

Moments of Greatness: Entering the Fundamental State of Leadership

Robert E. Quinn

When we do our best work as leaders, we don't imitate others. Rather, we draw on our own values and capabilities. We enter what author Robert Quinn calls the *fundamental state of leadership.* This is a frame of mind we tend to adopt when facing a significant challenge: a promotion opportunity, the risk of professional failure, a serious illness, a divorce, the death of a loved one, or any other major life jolt. Crisis calls, and we rise to the occasion.

But we don't need to spend time in the dark night of the soul to reach this fundamental state. We can make the shift at any time by asking ourselves – and honestly answering – four transformative questions:

Am I results centered? (Am I willing to leave my comfort zone to make things happen?)

Am I internally directed? (Am I behaving according to my values rather than bending to social or political pressures?)

Am I other focused? (Am I putting the collective good above my own needs?)

Am I externally open? (Am I receptive to outside stimuli that may signal the need for change?)

When we can answer these questions in the affirmative, we're prepared to lead in the truest sense.

Of course, we can't sustain the fundamental state of leadership indefinitely. Fatigue and external resistance pull us out of it. But each time we reach it, we then return to our everyday selves a bit more capable, and we usually boost the performance of the people around us. Over time, we create a high-performance culture – and that *can* be sustained.

Reprint R0507F; HBR OnPoint 1460; OnPoint collection "What Great Leaders Do" 1479

JULY–AUGUST | 84

Learning in the Thick of It

Marilyn Darling, Charles Parry, and Joseph Moore

The U.S. Army's Opposing Force (OPFOR) is a 2,500-member brigade whose job is to help prepare soldiers for combat. Created to be the meanest, toughest foe that soldiers will ever face, OPFOR engages units-in-training in a variety of mock campaigns under a wide range of conditions. Every month, a fresh brigade of more than 4,000 soldiers takes on this standing enemy.

OPFOR, which is stationed in the California desert, always has the home-court advantage. But the force being trained – called BLUFOR – is numerically and technologically superior. It possesses more resources and better, more available data. It is made up of experienced soldiers. And it knows just what to expect, because OPFOR shares its methods from previous campaigns with BLUFOR's commanders. In short, each BLUFOR brigade is given practically every edge. Yet OPFOR almost always wins.

Underlying OPFOR's consistent success is the way it uses the after-action review (AAR), a method for extracting lessons from one event or project and applying them to others. AAR meetings became a popular business tool after Shell Oil began experimenting with them in 1998. Most corporate AARs, however, are faint echoes of the rigorous reviews performed by OPFOR. Companies tend to treat the process as a pro-forma wrap-up, drawing lessons from an action but rarely learning them. OPFOR's AARs, by contrast, generate raw material that is fed back into the execution cycle. And while OPFOR's reviews extract numerous lessons, the brigade does not consider a lesson to be learned until it is successfully applied and validated.

It might not make sense for companies to adopt OPFOR's AAR processes in their entirety, but four fundamentals are mandatory: Lessons must benefit the team that extracts them. The AAR process must start at the beginning of the activity. Lessons must link explicitly to future actions. And leaders must hold everyone, especially themselves, accountable for learning.

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JULY–AUGUST | 96

Collaboration Rules

Philip Evans and *Bob Wolf*

Corporate leaders seeking to boost growth, learning, and innovation may find the answer in a surprising place: the Linux open-source software community. Linux is developed by an essentially volunteer, self-organizing community of thousands of programmers. Most leaders would sell their grandmothers for workforces that collaborate as efficiently, frictionlessly, and creatively as the self-styled Linux hackers.

But Linux is software, and software is hardly a model for mainstream business. The authors have, nonetheless, found surprising parallels between the anarchistic, caffeinated, hirsute world of Linux hackers and the disciplined, tea-sipping, clean-cut world of Toyota engineering.

Specifically, Toyota and Linux operate by rules that blend the self-organizing advantages of markets with the low transaction costs of hierarchies. In place of markets' cash and contracts and hierarchies' authority are rules about how individuals and groups work together (with rigorous discipline); how they communicate (widely and with granularity); and how leaders guide them toward a common goal (through example).

Those rules, augmented by simple communication technologies and a lack of legal barriers to sharing information, create rich common knowledge, the ability to organize teams modularly, extraordinary motivation, and high levels of trust, which radically lowers transaction costs. Low transaction costs, in turn, make it profitable for organizations to perform more and smaller transactions – and so increase the pace and flexibility typical of high-performance organizations.

Once the system achieves critical mass, it feeds on itself. The larger the system, the more broadly shared the knowledge, language, and work style. The greater individuals' reputational capital, the louder the applause and the stronger the motivation. The success of Linux is evidence of the power of that virtuous circle. Toyota's success is evidence that it is also powerful in conventional companies.

Reprint R0507H

JULY–AUGUST | 106

Manage Your Human Sigma

John H. Fleming, *Curt Coffman*, and *James K. Harter*

If sales and service organizations are to improve, they must learn to measure and manage the quality of the employee-customer encounter. Quality improvement methodologies such as Six Sigma are extremely useful in manufacturing contexts, but they're less useful when it comes to human interactions. To address this problem, the authors have developed a quality improvement approach they refer to as Human Sigma. It weaves together a consistent method for assessing the employee-customer encounter and a disciplined process for managing and improving it.

There are several core principles for measuring and managing the employee-customer encounter: It's important not to think like an economist or an engineer when assessing interactions because emotions inform both sides' judgments and behavior. The employee-customer encounter must be measured and managed locally, because there are enormous variations in quality at the work-group and individual levels. And to improve the quality of the employee-customer interaction, organizations must conduct both short-term, transactional interventions and long-term, transformational ones.

Employee engagement and customer engagement are intimately connected – and, taken together, they have an outsized effect on financial performance. They therefore need to be managed holistically. That is, the responsibility for measuring and monitoring the health of employee-customer relationships must reside within a single organizational structure, with an executive champion who has the authority to initiate and manage change. Nevertheless, the local manager remains the single most important factor in local group performance. A local manager whose work group shows suboptimal performance should be encouraged to conduct interventions, such as targeted training, performance reviews, action learning, and individual coaching.

Reprint R0507J; HBR OnPoint 1533

JULY–AUGUST | 116

Virtuoso Teams

Bill Fischer and *Andy Boynton*

Managing a traditional team seems pretty straightforward: Gather up whoever's available, give them time and space to do their jobs, and make sure they all play nicely together. But these teams produce results that are often as unremarkable as the teams themselves. When big change and high performance are required, a virtuoso team is far more likely to deliver outstanding and innovative results.

Virtuoso teams are fundamentally different from the garden-variety work groups that most organizations form to pursue more modest goals. They comprise the top experts in their particular fields, are specially convened for ambitious projects, work with frenetic rhythm, and emanate a discernible energy. Not surprisingly, however, the superstars who make up these teams are renowned for being elitist, temperamental, egocentric, and difficult to work with. As a result, many managers fear that if they force such people to interact on a high-stakes project, the group just might implode.

In this article, Bill Fischer and Andy Boynton put the inner workings of highly successful virtuoso teams on full display through three examples: the creative group behind *West Side Story,* the team of writers for Sid Caesar's 1950s-era television hit *Your Show of Shows,* and the high-powered technologists who averted an investor-relations crisis for Norsk Hydro, the Norwegian energy giant. Each of these teams accomplished enormous goals and changed their businesses, their customers, even their industries. And they did so by breaking all the conventional rules of collaboration – from the way they recruited the best members to the way they enforced their unusual processes, and from the high expectations they held to the exceptional results they produced.

Reprint R0507K

JULY–AUGUST | 124

Managing for Creativity

Richard Florida and Jim Goodnight

A company's most important asset isn't raw materials, transportation systems, or political influence. It's *creative capital*– simply put, an arsenal of creative thinkers whose ideas can be turned into valuable products and services. Creative employees pioneer new technologies, birth new industries, and power economic growth. If you want your company to succeed, these are the people you entrust it to.

But how do you accommodate the complex and chaotic nature of the creative process while increasing efficiency, improving quality, and raising productivity? Most businesses haven't figured this out. A notable exception is SAS Institute, the world's largest privately held software company.

SAS makes *Fortune*'s 100 Best Companies to Work For list every year. The company has enjoyed low employee turnover, high customer satisfaction, and 28 straight years of revenue growth. What's the secret to all this success? The authors, an academic and a CEO, approach this question differently, but they've come to the same conclusion: SAS has learned how to harness the creative energies of *all* its stakeholders, including its customers, software developers, managers, and support staff. Its framework for managing creativity rests on three guiding principles. First, help employees do their best work by keeping them intellectually engaged and by removing distractions. Second, make managers responsible for sparking creativity and eliminate arbitrary distinctions between "suits" and "creatives." And third, engage customers as creative partners so you can deliver superior products. Underlying all three principles is a mandate to foster interaction – not just to collect individuals' ideas. By nurturing relationships among developers, salespeople, and customers, SAS is investing in its future creative capital.

Within a management framework like SAS's, creativity and productivity flourish, flexibility and profitability go hand in hand, and work/life balance and hard work aren't mutually exclusive.

Reprint R0507L

JULY–AUGUST | 136

Level 5 Leadership: The Triumph of Humility and Fierce Resolve

Jim Collins

Boards of directors typically believe that transforming a company from good to great requires an extreme personality, an egocentric chief to lead the corporate charge. Think "Chainsaw" Al Dunlap or Lee Iacocca.

But that's not the case, says author and leadership expert Jim Collins. The essential ingredient for taking a company to greatness is having a "Level 5" leader, an executive in whom extreme personal humility blends paradoxically with intense professional will.

In this 2001 article, Collins paints a compelling and counterintuitive portrait of the skills and personality traits necessary for effective leadership. He identifies the characteristics common to Level 5 leaders: humility, will, ferocious resolve, and the tendency to give credit to others while assigning blame to themselves. Collins fleshes out his Level 5 theory by telling colorful tales about 11 such leaders from recent business history. He contrasts the turnaround successes of outwardly humble, even shy, executives like Gillette's Colman M. Mockler and Kimberly-Clark's Darwin E. Smith with those of larger-than-life business leaders like Dunlap and Iacocca, who courted personal celebrity.

Some leaders have the Level 5 seed within; some don't. But Collins suggests using the findings from his research to strive for Level 5 – for instance, by getting the right people on board and creating a culture of discipline. "Our own lives and all that we touch will be the better for making the effort," he concludes.

Reprint R0507M; HBR OnPoint 5831; OnPoint collection "What Great Leaders Do" 1479

JULY–AUGUST | 148

Strategic Intent

Gary Hamel and C.K. Prahalad

In the early 1970s, when Canon took its first halting steps in reprographics, the idea of a fledgling Japanese company challenging Xerox seemed impossible. Fifteen years later, it matched the U.S. giant in global unit market share. The basis for Canon's success? A different approach to strategy, one that emphasized an organization's resourcefulness above the resources it controlled.

In this McKinsey Award–winning article, first published in 1989, Gary Hamel and C.K. Prahalad explain that Western companies have wasted too much time and energy replicating the cost and quality advantages their global competitors already experience. Familiar concepts like strategic fit and competitive advantage can foster a static approach to competition, while familiar techniques like portfolio planning and competitor analysis lead to strategies that rivals can easily decode. The sum total is a pathology of surrender that leads many managers to abandon businesses instead of building them.

Canon and other world-class competitors have taken a different approach to strategy: one of strategic intent. They begin with a goal that exceeds the company's present grasp and existing resources: "Beat Xerox"; "encircle Caterpillar." Then they rally the organization to close the gap by setting challenges that focus employees' efforts in the near to medium term: "Build a personal copier to sell for $1,000"; "cut product development time by 75%." Year after year, they emphasize competitive innovation – building a portfolio of competitive advantages; searching markets for "loose bricks" that rivals have left underdefended; changing the terms of competitive engagement to avoid playing by the leader's rules. The result is a global leadership position and an approach to competition that has reduced larger, stronger Western rivals to playing an endless game of catch-up.

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JULY–AUGUST | 162

The Discipline of Teams

Jon R. Katzenbach and Douglas K. Smith

Groups don't become teams just because that is what someone calls them. Nor do teamwork values alone ensure team performance. So what is a team? How can managers know when the team option makes sense, and what can they do to ensure team success? In this groundbreaking 1993 article, authors Jon Katzenbach and Douglas Smith answer these questions and outline the discipline that defines a real team.

The essence of a team is shared commitment. Without it, groups perform as individuals; with it, they become a powerful unit of collective performance. The best teams invest a tremendous amount of time shaping a purpose that they can own. They also translate their purpose into specific performance goals. And members of successful teams pitch in and become accountable with and to their teammates.

The fundamental distinction between teams and other forms of working groups turns on performance. A working group relies on the individual contributions of its members for collective performance. But a team strives for something greater than its members could achieve individually: An effective team is always worth more than the sum of its parts.

The authors identify three kinds of teams: those that recommend things–task forces or project groups; those that make or do things–manufacturing, operations, or marketing groups; and those that run things–groups that oversee some significant functional activity. For managers, the key is knowing where in the organization these teams should be encouraged. Managers who can foster team development in the right place at the right time prime their organizations for top performance.

Reprint R0507P; HBR OnPoint 4428

JULY–AUGUST | 172

The Balanced Scorecard: Measures That Drive Performance

Robert S. Kaplan and David P. Norton

Executives know that a company's measurement systems strongly affect employee behaviors. But the traditional financial performance measures that worked for the industrial era are out of sync with the skills organizations are trying to master. Frustrated by these inadequacies, some managers have abandoned financial measures like return on equity and earnings per share. "Make operational improvements, and the numbers will follow," the argument goes. But managers want a balanced presentation of measures that will allow them to view the company from several perspectives at once.

In this classic article from 1992, authors Robert Kaplan and David Norton propose an innovative solution. During a yearlong research project with 12 companies at the leading edge of performance management, the authors developed a "balanced scorecard," a new performance measurement system that gives top managers a fast but comprehensive view of their business. The balanced scorecard includes financial measures that tell the results of actions already taken. And it complements those financial measures with three sets of operational measures related to customer satisfaction, internal processes, and the organization's ability to learn and improve–the activities that drive future financial performance.

The balanced scorecard helps managers look at their businesses from four essential perspectives and answer some important questions. First, How do customers see us? Second, What must we excel at? Third, Can we continue to improve and create value? And fourth, How do we appear to shareholders? By looking at all of these parameters, managers can determine whether improvements in one area have come at the expense of another. Armed with that knowledge, the authors say, executives can glean a complete picture of where the company stands–and where it's headed.

Reprint R0507Q; HBR OnPoint 4096

What's driving the mailstream revolution?

The mailstream is a $250-billion business comprising 500 billion pieces per year. Has there ever been a quarter-trillion dollar industry that couldn't benefit from a little more efficiency?

The search for that efficiency, and resulting profitability, has given rise to the mailstream revolution – a revolution driven from two interrelated factors: technology and analytics. Not only is the combination making mail more personal and versatile than ever before, but it's also making it more efficient and cost-effective than other communication methods.

Mailstream technology is transforming the way businesses direct the flow of mail, documents and packages to do more: data management, creating, producing, sending, tracking, archiving and securing data in the most cost-effective fashion.

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September 2005

SEPTEMBER | 68

COVER STORY

Confessions of a Trusted Counselor

David A. Nadler

Advising CEOs sounds like a dream job, but doing so can be perplexing and perilous. At times, the questions you must ask yourself—about your own motivations and loyalty—can be thornier than the organizational problems that clients face. David Nadler knows, because he has been asking himself such questions for a quarter century while advising the chiefs of more than two dozen corporations.

If you're an adviser to CEOs, recognizing the pitfalls of your role may help you sidestep them. And understanding a problem's nuances and implications may help you uncover a solution. The challenges facing consultants include the following:

• The loyalty dilemma: *Is my ultimate responsibility to the CEO, who pays for my services, or to the institution, which pays for his?* Today's shorter CEO tenures and greater board oversight have diminished the top leader's power and autonomy; it's now routine for a CEO adviser to have conversations with directors about the CEO's performance. To defuse loyalty issues, the adviser should raise them with the executive at the outset of the relationship.

• The overidentification dilemma: *How do I immerse myself in the CEO's worldview without making it my own?* CEOs can be enormously persuasive, but if you don't push back, you're not doing your job. The trick is to ask probing questions without shaking the CEO's confidence that you fully comprehend the forces that shape her views.

• The friendship dilemma: *If the CEO and I like each other, can we—should we—become friends?* A successful, long-term advisory relationship with a CEO requires a strong personal connection; in some cases, that becomes a friendship. But the best relationships are characterized by the participants' clear-eyed recognition of each other's frailties—tempered, of course, by genuine affection and easy rapport.

Reprint R0509C; HBR OnPoint 1770

SEPTEMBER | 18

FORETHOUGHT

The Commerce Clause Wakes Up The *Granholm v. Heald* decision suggests that the Supreme Court is prepared to protect e-commerce initiatives. **Reprint F0509A**

When Good Customers Are Bad Delivered-cost analytics can tell you how much those supply chain services you're offering are *really* costing you. **Reprint F0509B**

Motivating Through Metrics To get front-line employees to work as a team, solicit performance rankings from customers and employees, not bosses. **Reprint F0509C**

Schizophrenia at GM You can execute product line extensions without confusing, and losing, your customers. **Reprint F0509D**

Create Colleagues, Not Competitors To maximize information exchange among employees, don't reward individual performance. **Reprint F0509E**

Save That Thought Marc Abrahams, a cofounder of the *Annals of Improbable Research,* says some ideas deserve second and third chances. **Reprint F0509F**

A United Defense Achieve better overall security by funding joint projects between physical and IT security departments. **Reprint F0509G**

Benchmarking Your Staff Here's how you can decide on the right size and composition of your corporate staff. **Reprint F0509H**

Give a Little, Get a Little Loosen your grip on your intellectual property, and you may realize lower fees and better service. **Reprint F0509J**

Denying the Urge to Splurge To sell more goods, separate the necessities from the luxuries. **Reprint F0509K**

How Markets Help Marketers Stock market simulations can help you determine optimal marketing strategies for products prior to launch. **Reprint F0509L**

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SEPTEMBER | 39

HBR CASE STUDY

The Tug-of-War

Yossi Sheffi

Jack Emmons, the CEO of Voici Brands, knew his apparel company needed a supply chain overhaul. Over the past couple of years, sales had dropped because of late deliveries, stock-outs, and other supply problems. Meanwhile, a major competitor had significantly reduced its time to market and boosted its bottom line by outsourcing all its product lines to a dazzlingly efficient "supply chain city" in Shanghai.

Unfortunately, Jack's company was just too decentralized to use the supply chain city. Each of Voici's five units was like a subsidiary, with its own legacy, management, and suppliers. The unit heads (particularly Margie Rosen) wouldn't sit still for a supply chain consolidation; they had worked too hard to forge vendor relationships.

Inspired by a magazine article, Jack decided to appoint a supply chain czar to oversee changes in logistics and procurement. He could hire Ravi Chandry, an aggressive outsider who had centralized supply chain operations for the world's second-largest snack food and beverage company. Or he could promote Tony Rini, a highly capable, trustworthy Voici veteran who had no experience consolidating supply operations but could win hearts and minds. Ravi told Jack that only a Rottweiler could do the job right. Tony lobbied for a more cautious approach: Start with low-hanging fruit, get a few quick wins, then move on to other areas. What kind of leadership will get Voici's units to pull together?

Commenting on this fictional case study are Shakeel Mozaffar, group vice president of Global Supply Chain at ICI in London; Robert W. Moffat, Jr., senior vice president of Integrated Supply Chain at IBM; John D. Blascovich, a vice president of Chicago-based A.T. Kearney and head of its sourcing practice in North America; and Nick LaHowchic, president and CEO of Limited Logistics Services, an internal service subsidiary of Limited Brands in Columbus, Ohio.

Reprint R0509A

SEPTEMBER | 57

A Stake in the Business

Chris T. Sullivan

When Chris Sullivan and three friends opened the first Outback Steakhouse in March 1988, in Tampa, Florida, they were hoping it would be successful enough to spawn a few more and maybe some other kinds of restaurants as well. Since then, their chain of Australia-themed restaurants has grown to some 900 locations and counting – plus another 300 or so "concept" restaurants that operate from under Outback's corporate umbrella. Growth like that doesn't happen accidentally, Sullivan says, but it certainly wasn't part of the original plan.

In this first-person account, Outback's chairman describes the organization's formula for growth and development, which is consciously rooted in the founders' belief in putting people first. They've created an organizational model in which field managers make most of the decisions, garner the rewards, and live with the consequences. Specifically, the founders believe that the most effective way to make customers happy is to first take care of the people who cook for them, serve them, and supervise operations at the restaurants. Outback servers have fewer tables to worry about than those at other restaurant chains; the cooks have bigger, cooler, better-equipped kitchens; and the supervisors work their way up the ranks toward an equity stake in the restaurant or region they run. There are no administrative layers between field managers and the executives at headquarters.

Giving employees good working conditions and the chance to become owners has proved to be good business: Turnover among hourly employees is low, and Outback and its subsidiaries opened 120 restaurants last year, increasing sales by 20.1%. The company must grow in order to keep offering career opportunities to its workers; in turn, those opportunities ensure that Outbackers remain committed to making customers happy and the company successful.

Reprint R0509B

SEPTEMBER | 78

Fixing Health Care from the Inside, Today

Steven J. Spear

Today, you are about as safe in a U.S. hospital as you would be parachuting off a bridge or a building. But it doesn't have to be that way. Right now, some hospitals are making enormous short-term improvements, with no legislation or market reconfiguration and little or no capital investment. Instead of waiting for sweeping changes in market mechanisms, these institutions are taking an operations approach to patient care.

In case after detailed case, the article describes how doctors, nurses, technicians, and managers are radically increasing the effectiveness of patient care and dramatically lowering its cost by applying the same capabilities in operations design and improvement that drive the famous Toyota Production System. They are removing ambiguity in the output, responsibilities, connections, and methods of their work processes. These changes – which can be done in the course of an ordinary workday, sometimes in a matter of hours – are designed to make the following crystal clear:

- Which patient gets which procedure (output);
- Who does which aspect of the job (responsibility);
- Exactly which signals are used to indicate that the work should begin (connection); and
- Precisely how each step is carried out (method).

Equally important, managers are being transformed from rescuers who arrive with ready-made solutions into problem solvers who help colleagues learn the experimental method. Thus, these hospitals are breaking free of the work-around culture that routinely obscures the root causes of so many problems, creates so much waste, and leads to so many unnecessary deaths.

Reprint R0509D; HBR OnPoint 1738; OnPoint collection "Curing U.S. Healthcare, 2nd Edition" 172X

SEPTEMBER | 94
All Strategy Is Local
Bruce Greenwald and Judd Kahn

The aim of strategy is to master a market environment by understanding and anticipating the actions of other economic agents, especially competitors. A firm that has some sort of competitive advantage – privileged access to customers, for instance – will have relatively few competitors to contend with, since potential competitors without an advantage, if they have their wits about them, will stay away. Thus, competitive advantages are actually barriers to entry and vice versa.

In markets that are exposed, by contrast, competition is intense. If the incumbents have even brief success in earning greater than normal returns on investments, new entrants will swarm in to grab a share of the profits. Sooner or later, the additional competition will push returns as far down as the firms' costs of capital. For firms operating in such markets, the only choice is to forget about strategy and run the business as efficiently as possible.

Barriers to entry are easier to maintain in a competitive arena that is "local," either in the geographic sense or in the sense of being limited to one product or a handful of related ones. The two most powerful competitive advantages – customer captivity and economies of scale – are more achievable and sustainable in circumscribed markets of this kind. Their opposites are the open markets and host of rivals that are features of globalization. Companies entering such markets risk frittering away the advantages they secured on smaller playing fields.

If a company wants to grow but still obtain superior returns, the authors argue, the best strategy is to dominate a series of discrete but preferably contiguous markets and then expand only at their edges. Wal-Mart's diminishing margins over the past 15 years are strong evidence of the danger of proceeding otherwise.

Reprint R0509E

SEPTEMBER | 108
The Dangers of Feeling like a Fake
Manfred F.R. Kets de Vries

In many walks of life – and business is no exception – there are high achievers who believe that they are complete fakes. To the outside observer, these individuals appear to be remarkably accomplished; often they are extremely successful leaders with staggering lists of achievements.

These *neurotic impostors* – as psychologists call them – are not guilty of false humility. The sense of being a fraud is the flip side of giftedness and causes a great many talented, hardworking, and capable leaders to believe that they don't deserve their success. "Bluffing" their way through life (as they see it), they are haunted by the constant fear of exposure. With every success, they think, "I was lucky *this* time, fooling everyone, but will my luck hold? When will people discover that I'm not up to the job?"

In his career as a management professor, consultant, leadership coach, and psychoanalyst, Manfred F.R. Kets de Vries has found neurotic impostors at all levels of organizations. In this article, he explores the subject of neurotic imposture and outlines its classic symptoms: fear of failure, fear of success, perfectionism, procrastination, and workaholism. He then describes how perfectionist overachievers can damage their careers, their colleagues' morale, and the bottom line by allowing anxiety to trigger self-handicapping behavior and cripple the very organizations they're trying so hard to please. Finally, Kets de Vries offers advice on how to limit the incidence of neurotic imposture and mitigate its damage through discreet vigilance, appropriate intervention, and constructive support.

Reprint R0509F

SEPTEMBER | 120
Strategy as Active Waiting
Donald N. Sull

Successful executives who cut their teeth in stable industries or in developed countries often stumble when they face more volatile markets. They falter, in part, because they assume they can gaze deep into the future and develop a long-term strategy that will confer a sustainable competitive advantage. But visibility into the future of volatile markets is sharply limited because so many different variables are in play. Factors such as technological innovation, customers' evolving needs, government policy, and changes in the capital markets interact with one another to create unexpected outcomes.

Over the past six years, Donald Sull, an associate professor at London Business School, has led a research project examining some of the world's most volatile markets, from national markets like China and Brazil to industries like enterprise software, telecommunications, and airlines. One of the most striking findings from this research is the importance of taking action during comparative lulls in the storm. Huge business opportunities are relatively rare; they come along only once or twice in a decade. And, for the most part, companies can't manufacture those opportunities; changes in the external environment converge to make them happen. What managers can do is prepare for these golden opportunities by managing smart during the comparative calm of business as usual.

During these periods of *active waiting,* leaders must probe the future and remain alert to anomalies that signal potential threats or opportunities; exercise restraint to preserve their war chests; and maintain discipline to keep the troops battle ready. When a golden opportunity or "sudden death" threat emerges, managers must have the courage to declare the main effort and concentrate resources to seize the moment.

Reprint R0509G; HBR OnPoint 1754; OnPoint collection "Strategy Despite Uncertainty: Cutting Through the Fog" 1746

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SEPTEMBER | 131

Building Loyalty in Business Markets

Das Narayandas

Companies often apply consumer marketing solutions in business markets without realizing that such strategies only hamper the acquisition and retention of profitable customers. Unlike consumers, business customers inevitably need customized products, quantities, or prices. A company in a business market must therefore manage customers individually, showing how its products or services can help solve each buyer's problems. And it must learn to reap the enormous benefits of loyalty by developing individual relationships with customers.

To achieve these ends, the firm's marketers must become aware of the different types of benefits the company offers and convey their value to the appropriate executives in the customer company. It's especially important to inform customers about what the author calls *nontangible nonfinancial benefits*–above-and-beyond efforts, such as delivering supplies on holidays to keep customers' production lines going.

The author has developed a simple set of devices–the benefit stack and the decision-maker stack–to help marketers communicate their firm's myriad benefits. The vendor lists the benefits it offers, then lists the customer's decision makers, specifying their concerns, motivations, and power bases. By linking the two stacks, the vendor can systematically communicate how it will meet each decision-maker's needs.

The author has also developed a tool called a loyalty ladder, which helps a company determine how much time and money to spend on relationships with various customers. As customers become increasingly loyal, they display behaviors in a predictable sequence, from growing the relationship and providing word-of-mouth endorsements to investing in the vendor company. The author has found that customers follow the same sequence of loyalty behaviors in all business markets.

Reprint R0509H

SEPTEMBER | 140

Using VoIP to Compete

Kevin Werbach

Internet telephony, or VoIP, is rapidly replacing the conventional kind. This year, for the first time, U.S. companies bought more new Internet-phone connections than standard lines. The major driver behind this change is cost. But VoIP isn't just a new technology for making old-fashioned calls cheaper, says consultant Kevin Werbach. It is fundamentally changing how companies use voice communications.

What makes VoIP so powerful is that it turns voice into digital data packets that can be stored, copied, combined with other data, and distributed to virtually any device that connects to the Internet. And it makes it simple to provide all the functionality of a corporate phone–call features, directories, security–to anyone anywhere there's broadband access. That fosters new kinds of businesses such as virtual call centers, where widely dispersed agents work at all hours from their homes.

The most successful early adopters, says Werbach, will focus more on achieving business objectives than on saving money. They will also consider how to push VoIP capabilities out to the extended organization, making use of everyone as a resource.

Deployment may be incremental, but companies should be thinking about where VoIP could take them. Executives should ask what they could do if, on demand, they could bring all their employees, customers, suppliers, and partners together in a virtual room, with shared access to every modern communications and computing channel. They should take a fresh look at their business processes to find points at which richer and more customizable communications could eliminate bottlenecks and enhance quality.

The important dividing line won't be between those who deploy VoIP and those who don't, or even between early adopters and laggards. It will be between those who see VoIP as just a new way to do the same old things and those who use it to rethink their entire businesses.

Reprint R0509J

Is the
mailstream
really the most cost-effective way to reach customers?

In a word, yes. True, physical mail is more expensive than electronic; however, it can be more efficient and increase return on investment.

Mail also does a better job than most other channels at reducing waste. Address management software helps ensure the accuracy of names and addresses on mail pieces. Businesses that don't take this step typically forfeit 15% of their mail investment to undeliverability. Add it up, and the waste is staggering: more than $7 billion in out-of-pocket costs for "undeliverable as addressed" mail each year.

Address management helps prevent this problem, leading to enhanced efficiency and less wasted communication. Plus, better-designed documents delivered through the mail can significantly reduce calls to service centers from confused consumers.

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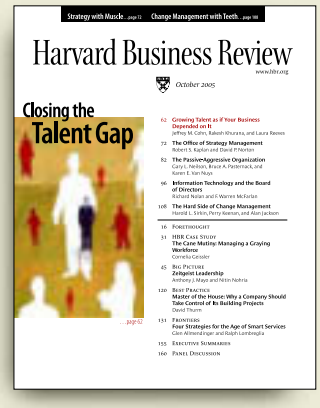
October 2005



OCTOBER | 62

COVER STORY

Growing Talent as if Your Business Depended on It

Jeffrey M. Cohn, Rakesh Khurana, and Laura Reeves

Traditionally, corporate boards have left leadership planning and development very much up to their CEOs and human resources departments – primarily because they don't perceive that a lack of leadership development in their companies poses the same kind of threat that accounting blunders or missed earnings do.

That's a shortsighted view, the authors argue. Companies whose boards and senior executives fail to prioritize succession planning and leadership development end up experiencing a steady attrition in talent and becoming extremely vulnerable when they have to cope with inevitable upheavals – integrating an acquired company with a different operating style and culture, for instance, or reexamining basic operating assumptions when a competitor with a leaner cost structure emerges. Firms that haven't focused on their systems for building their bench strength will probably make wrong decisions in these situations.

In this article, the authors explain what makes a successful leadership development program, based on their research over the past few years with companies in a range of industries. They describe how several forward-thinking companies (Tyson Foods, Starbucks, and Mellon Financial, in particular) are implementing smart, integrated, talent development initiatives.

A leadership development program should not comprise stand-alone, ad hoc activities coordinated by the human resources department, the authors say. A company's leadership development processes should align with strategic priorities. Senior executives should be deeply involved in finding and growing talent, and line managers should be evaluated and promoted expressly for their contributions to the organization-wide effort. The business units should take responsibility for development activities, and the board should ultimately oversee the whole system.
Reprint R0510C; **HBR OnPoint** 1924

OCTOBER | 16

FORETHOUGHT

Beware of Economists Bearing Greek Symbols Underneath every economic model involving math lies a substrate of great simplification and imagination, says Columbia University's Emanuel Derman. **Reprint** F0510A

"Bureaucracy" Becomes a Four-Letter Word The tension between bureaucracy and innovation dates back to the reign of Louis XIV, says University of Oregon's William H. Starbuck. **Reprint** F0510B

Every Product's a Platform To exploit your product's platform potential, say consultants John Sviokla and Anthony J. Paoni, you need creativity – and good intellectual property protection. **Reprint** F0510C

Masters of the Multicultural Chief diversity officers, in new roles, foster innovation and generate revenues, writes author Frans Johansson. **Reprint** F0510D

Hang On to Those Founders Companies that retain their CEO founders when preparing for IPOs often come out ahead in the long run, says Martin L. Martens at Concordia University. **Reprint** F0510E

The Hazards of Hounding Customers who buy your product because they want to – not because you *make* them – are the most loyal, says Rice University's Paul M. Dholakia. **Reprint** F0510F

Been There, Read That Robert Morris, an Amazon Top 10 reviewer, helps you decide which business books are worth your time and attention. **Reprint** F0510G

Room at the Top Line Across the S&P 500, companies' sustainable growth rates exceed analyst growth forecasts, which means companies are not optimizing shareholder value, say consultants Rekha Sampath and Ajit Kambil. **Reprint** F0510H

Talk About Brand Strategy Communicating your brand strategy to the financial community can boost share price, say Columbia Business School's Natalie Mizik and University of Washington Business School's Robert Jacobson. **Reprint** F0510J

The Hardest Hire If your new COO will eventually succeed your CEO, says consultant Anne Lim O'Brien, be clear about which role you're seeking to fill. **Reprint** F0510K

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OCTOBER | 31

HBR CASE STUDY

The Cane Mutiny: Managing a Graying Workforce

Cornelia Geissler

Frank Heberer, a human resources manager at Medignostics, has proposed a long-term HR strategy for the German midsize pharmaceutical company. All his research points to trouble on the horizon: In just 25 years, more than a quarter of the country's population will be over age 65. What will happen to the firm when workers start retiring in droves? How will it attract smart new hires from a much smaller talent pool?

But the executive team is focused on cutting costs here and now. In fact, to save money, Medignostics recently withdrew from an early-retirement program sponsored by the German government. Meanwhile, age-related tensions at the company are growing. A 58-year-old account manager, angry about being forced to resume full-time hours and report to a jargon-happy tyke, has been taking lots of sick days and otherwise disengaging from his job. Heberer believes it is only a matter of time before other employees stage unofficial "strikes," too.

Heberer is convinced that, for Medignostics to stay competitive, its leaders have to start thinking strategically about the demographic shift. He's trying to sound the alarm; he's even put together plans to create a child care center to help attract working parents – but his boss has rejected the idea as a luxury Medignostics can't afford. How can Heberer persuade his boss and the other executives, all nearing retirement age themselves, to take the long view?

Commenting on this fictional case study are Norbert Herrmann, an HR consultant in Bad Endorf, Austria; Barbara D. Bovbjerg, the director of Education, Workforce, and Income Security Issues at the U.S. Government Accountability Office in Washington, DC; Dietmar Martina, the director of Groupwide Performance Measurement at Deutsche Telekom in Bonn, Germany; and Eileen A. Kamerick, the chief financial officer of Heidrick & Struggles International, headquartered in Chicago.

Reprint R0510A

OCTOBER | 45

Zeitgeist Leadership

Anthony J. Mayo and Nitin Nohria

Companies and leaders don't succeed or fail in a vacuum. When it comes to long-term success, the ability to understand and adapt to changing business conditions is at least as important as any particular personality trait or competency.

A clear picture of how powerful the zeitgeist can be emerges from the authors' comprehensive study of the way the business landscape in the United States evolved, decade by decade, throughout the twentieth century. Six contextual factors in particular, they found, most affected the prospects for business: the level of government intervention in business, global events, demographics, shifts in social mores, developments in technology, and the strength or weakness of the labor movement.

A lack of contextual sensitivity can trip up even the most brilliant executive. No less a luminary than Alfred P. Sloan was relieved of GM's day-to-day management in the 1930s because he was unwilling to meet with the new UAW. Conversely, an understanding of the zeitgeist can play a crucial but unheralded role in business performance. Jack Welch is widely credited with GE's remarkable success during the 1980s and 1990s, for example, but far less attention has been paid to his predecessor, the statesmanlike and prudent Reginald Jones, who sustained strong revenue and profit growth during the heavily regulated stagflation of the 1970s.

To better understand this connection between business performance and context, the authors studied 1,000 great U.S. business leaders of the twentieth century and identified three distinct archetypes: *Entrepreneurs* overcame dire challenges to build something new. *Managers* excelled at exploiting the zeitgeist to grow their businesses. *Leaders* defied context to identify latent potential in businesses others considered mature, stagnant, or in decline.

In every decade, all three archetypes were vital. It is the ongoing regeneration of this pattern in the business life cycle that ultimately sustains development and progress.

Reprint R0510B

OCTOBER | 72

The Office of Strategy Management

Robert S. Kaplan and David P. Norton

There is a disconnect in most companies between strategy formulation and strategy execution. On average, 95% of a company's employees are unaware of, or do not understand, its strategy. If employees are unaware of the strategy, they surely cannot help the organization implement it effectively.

It doesn't have to be like this. For the past 15 years, the authors have studied companies that achieved performance breakthroughs by adopting the Balanced Scorecard and its associated tools to help them better communicate strategy to their employees and to guide and monitor the execution of that strategy. Some companies, of course, have achieved better, longer-lasting improvements than others. The organizations that have managed to sustain their strategic focus have typically established a new corporate-level unit to oversee all activities related to strategy: an *office of strategy management* (OSM).

The OSM, in effect, acts as the CEO's chief of staff. It coordinates an array of tasks: communicating corporate strategy; ensuring that enterprise-level plans are translated into the plans of the various units and departments; executing strategic initiatives to deliver on the grand design; aligning employees' plans for competency development with strategic objectives; and testing and adapting the strategy to stay abreast of the competition. The OSM does not do all the work, but it facilitates the processes so that strategy is executed in an integrated fashion across the enterprise. Although the companies that Kaplan and Norton studied use the Balanced Scorecard as the framework for their strategy management systems, the authors say the lessons of the OSM are applicable even to companies that do not use it.

Reprint R0510D; HBR OnPoint 1894; OnPoint collection "Focus Your Organization on Strategy – with the Balanced Scorecard, 3rd Edition" 1886

OCTOBER | 82

The Passive-Aggressive Organization

Gary L. Neilson, Bruce A. Pasternack, and Karen E. Van Nuys

Passive-aggressive organizations are friendly places to work: People are congenial, conflict is rare, and consensus is easy to reach. But, at the end of the day, even the best proposals fail to gain traction, and a company can go nowhere so imperturbably that it's easy to pretend everything is fine.

Such companies are not necessarily saddled with mulishly passive-aggressive employees. Rather, they are filled with mostly well-intentioned people who are the victims of flawed processes and policies. Commonly, a growing company's halfhearted or poorly thought-out attempts to decentralize give rise to multiple layers of managers, whose authority for making decisions becomes increasingly unclear. Some managers, as a result, hang back, while others won't own up to the calls they've made, inviting colleagues to second-guess or overturn the decisions.

In such organizations, information does not circulate freely, and that makes it difficult for workers to understand the impact of their actions on company performance and for managers to correctly appraise employees' value to the organization. A failure to accurately match incentives to performance stifles initiative, and people do just enough to get by.

Breaking free from this pattern is hard; a long history of seeing corporate initiatives ignored and then fade away tends to make people cynical. Often it's best to bring in an outsider to signal that this time things will be different. He or she will need to address every obstacle all at once: clarify decision rights; see to it that decisions stick; and reward people for sharing information and adding value, not for successfully negotiating corporate politics. If those steps are not taken, it's only a matter of time before the diseased elements of a passive-aggressive organization overwhelm the remaining healthy ones and drive the company into financial distress.

Reprint R0510E

OCTOBER | 96

Information Technology and the Board of Directors

Richard Nolan and F. Warren McFarlan

Ever since the Y2K scare, boards have grown increasingly nervous about corporate dependence on information technology. Since then, computer crashes, denial of service attacks, competitive pressures, and the need to automate compliance with government regulations have heightened board sensitivity to IT risk. Unfortunately, most boards remain largely in the dark when it comes to IT spending and strategy, despite the fact that corporate information assets can account for more than 50% of capital spending.

A lack of board oversight for IT activities is dangerous, the authors say. It puts firms at risk in the same way that failing to audit their books would. Companies that have established board-level IT governance committees are better able to control IT project costs and carve out competitive advantage. But there is no one-size-fits-all model for board supervision of a company's IT operations. The correct approach depends on what strategic "mode" a company is in – whether its operations are extremely dependent on IT or not, and whether or not it relies heavily on keeping up with the latest technologies.

This article spells out the conditions under which boards need to change their level of involvement in IT decisions, explaining how members can recognize their firms' IT risks and decide whether they should pursue more aggressive IT governance. The authors delineate what an IT governance committee should look like in terms of charter, membership, duties, and overall agenda. They also offer recommendations for developing IT policies that take into account an organization's operational and strategic needs.

Given the dizzying pace of change in the world of IT, boards can't afford to ignore the state of their IT systems and capabilities. Appropriate board governance can go a long way toward helping a company avoid unnecessary risk and improve its competitive position.

Reprint R0510F

OCTOBER | 108

The Hard Side of Change Management

Harold L. Sirkin, Perry Keenan, and Alan Jackson

Everyone agrees that managing change is tough, but few can agree on how to do it. Most experts are obsessed with "soft" issues, such as culture and motivation, but, say the authors, focusing on these issues alone won't bring about change. Companies also need to consider the hard factors – like the time it takes to complete a change initiative, the number of people required to execute it, and so forth.

When the authors studied change initiatives at 225 companies, they found a consistent correlation between the outcomes of change programs (success versus failure) and four hard factors, which they called DICE: project *duration,* particularly the time between project reviews; *integrity of performance,* or the capabilities of project teams; the level of *commitment* of senior executives and staff; and the additional *effort* required of employees directly affected by the change. The DICE framework is a simple formula for calculating how well a company is implementing, or will be able to implement, its change initiatives. The framework comprises a set of simple questions that help executives score their projects on each of the four factors; the lower the score, the more likely the project will succeed. Companies can use DICE assessments to force conversations about projects, to gauge whether projects are on track or in trouble, and to manage project portfolios.

The authors have used these four factors to predict the outcomes and guide the execution of more than 1,000 change management programs worldwide. Not only has the correlation held, but no other factors (or combination of factors) have predicted outcomes as successfully.

Reprint R0510G; HBR OnPoint 1916; OnPoint collection "Lead Change – Successfully, 3rd Edition" 1908

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OCTOBER | 120

Master of the House: Why a Company Should Take Control of Its Building Projects

David Thurm

When you head up a big construction project for your organization, coming in on time and on budget isn't enough. If you want to avoid squandering what is probably your company's largest capital investment, it's important to create a building that reflects your company's mission and produces a truly energizing work environment, says David Thurm, CIO of the New York Times Company and head of the team responsible for designing and building the Times' new corporate headquarters in Manhattan.

The only way to get this kind of package – great design and innovative features that together further your business goals – is to take an active role. Assemble the right team, and then stay involved, asking hard questions about things that are generally taken as givens. Articulate a vision of your future work space, and drive the search for ways to realize this vision. In short, be a builder, not merely an owner.

It's easy to understand why this approach is the exception rather than the rule. To most companies, design and construction seem foreign and forbidding, rife with pitfalls. Because of the murkiness of the field and a lack of experience and confidence, most companies play a relatively minor role in their construction projects. But it's a giant mistake to be a passive consumer when it comes to one of your most important assets. At best, you'll get well-intentioned guesses by others as to what you want; at worst, you'll end up with a building that's at odds with your identity.

The author shares a series of lessons learned. Implicit in all of them: You have to push yourself as hard as you push your contractors.

Reprint R0510H

OCTOBER | 131

Four Strategies for the Age of Smart Services

Glen Allmendinger and Ralph Lombreglia

Most industrial manufacturers realize that the real money isn't in products but in services. Companies such as General Electric and IBM have famously made the transition: A large proportion of their revenues and margins come from providing value-added services to customers. But other companies attempting to do the same might miss the boat.

It is not enough, the authors say, just to provide services. Businesses must now provide "smart services" – building intelligence (awareness and connectivity) into the products themselves. Citing examples such as Heidelberger Druckmaschinen's Internet-connected printing presses and Eaton Electrical's home-monitoring service, the authors demonstrate how a product that can report its status back to its maker represents an opportunity for the manufacturer to cultivate richer, longer-term relationships with customers.

Four business models will emerge in this new, networked world. If you go it alone, it may be as an *embedded innovator* – that is, your networked product sends back information that can help you optimize service delivery, eliminate waste and inefficiency, and raise service margins. Or, you may pursue a more aggressive *solutionist* business model – that is, you position your networked product as a "complete solution provider," able to deliver a broader scope of high-value services than those provided by the embedded innovator's product. In the case of a system that aggregates and processes data from multiple products in a building or home, you may be either an *aggregator* or a *synergist,* partnering with others to pursue a smart-services opportunity. An aggregator's product is the hub, collecting and processing usage information. A synergist's product is the spoke, contributing valuable data or functionality.

Woe to the company that takes none of these paths; it'll soon find its former customers locked in – and happily – to other smart service providers.

Reprint R0510J

Won't the Internet mean the end of mail?

Soothsayers keep forecasting that online technology will surely mark the end of mail. Apparently like the telegraph did. And the telephone. And overnight courier services. And the fax machine. And on and on. Yet, your family's mailbox is as stuffed now as it's ever been.

The fact is, the Internet and mail work in concert. Internet users receive more mail than non-users do, with mail volumes correlating directly to income and education. There's good reason for this. Demographically, Internet users are generally more affluent.

Reducing or eliminating any one channel simply because it faces roadblocks is an ill-conceived exercise. It upsets the delicate balance that makes for effective, successful customer communications.

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November 2005

NOVEMBER | 62

COVER STORY

Innovation Versus Complexity: What Is Too Much of a Good Thing?

Mark Gottfredson and Keith Aspinall

What's the number of product or service offerings that would optimize both your revenues and your profits? For most firms, it's considerably lower than the number they offer today. The fact is, companies have strong incentives to be overly innovative in new product development. But continual launches of new products and line extensions add complexity throughout a company's operations, and as the costs of managing that complexity multiply, margins shrink. To maximize profit potential, a company needs to identify its innovation fulcrum, the point at which an additional offering destroys more value than it creates.

The usual antidotes to complexity miss their mark because they treat the problem on the factory floor rather than at its source: in the product line. Mark Gottfredson and Keith Aspinall of Bain & Company present an approach that goes beyond the typical Six Sigma or lean-operations program to root out complexity hidden in the value chain.

The first step is to ask, What would our company look like if it made and sold only a single product or service? In other words, you identify your company's equivalent of Henry Ford's one-size-fits-all Model T–for Starbucks, it might be a medium-size cup of coffee; for a bank, a simple checking account–and then determine the cost of producing that baseline offering. Next, you add variety back into the business system, product by product, and carefully forecast the resulting impact on sales as well as the cost implications across the value chain. When the analysis shows the costs beginning to overwhelm the added revenues, you've found your innovation fulcrum.

By deconstructing their companies to a zero-complexity baseline, managers can break through entrenched ways of thinking to find the right balance between innovation and complexity.

Reprint R0511C; HBR OnPoint 222X

NOVEMBER | 18

FORETHOUGHT

Get Aggressive About Passivity If managers always acted on their values, heroic whistle-blowing might never be required. But, research shows, people don't think that doing the right thing is part of their jobs. **Reprint F0511A**

The Trouble with CFOs Because of high turnover, CFOs have less and less time to learn the ropes–yet they're shouldering more and more responsibility. A reallocation of time is in order. **Reprint F0511B**

Crap Circles The most dubious business plans can appear solid, even smart, when illustrated with snappy circle-and-arrow graphics. Look closely, though, and you'll see that many of these diagrams are full of it. **Reprint F0511C**

Leading from the Factory Floor Fixing a dysfunctional plant isn't easy, but it can be done if you involve everyone in the overhaul. **Reprint F0511D**

Banana War Maneuvers How Dole beat Chiquita by working around a restrictive EU trade policy instead of struggling against it. **Reprint F0511E**

Oil and Troubled Waters When a crisis forces outside directors to navigate major changes, investors and directors must adopt new roles. The case of Royal Dutch/Shell provides useful lessons. **Reprint F0511F**

What? Me, Worry? Espionage expert H. Keith Melton shows how executives can best guard their company secrets. **Reprint F0511G**

The Department of Mobility By centralizing oversight of business travel and transportation, companies can improve efficiency, raise employee satisfaction, and reduce costs. **Reprint F0511H**

If You Want to Lead, Blog Sun Microsystems president and COO Jonathan Schwartz explains how blogging has enhanced public perception of his company and fostered loyalty within. **Reprint F0511J**

Is There a Patient in the House? The best solution to the looming shortage of nurses and doctors may be to move chronic disease monitoring and care out of hospitals and into people's homes. **Reprint F0511K**

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NOVEMBER | 39

HBR CASE STUDY

Riding the Celtic Tiger

Eileen Roche

John Dooley, BioSol's vice president of strategic research, has been making a name for himself at the biotechnology company's offices in Ireland. He's been doing so well, in fact, that the firm has offered him a promotion to director of strategy at headquarters – in California.

He's lived abroad before. In the 1980s, making a living in Ireland was tough: Jobs were scarce and unemployment was high. So John and his wife, Fiona, moved to Massachusetts, where John attended MIT. They were not alone; many of their friends and family members also moved out of Ireland then. John and Fiona enjoyed their time in Boston; they became active in a large expatriate community and established reputations in their professional fields.

By 1999, however, the Celtic Tiger was running at full speed. The Irish economy was booming and the whole country seemed to be bursting with possibility. When John was offered a job at BioSol's Dublin subsidiary, he and Fiona moved home and never looked back – until now. The new promotion would give his career a huge boost, but accepting it would mean uprooting his family and becoming an expat again. Ireland's economy is going strong now, but what if it doesn't last? Should John cast his lot with his country or his company?

Commenting on this fictional case study are Raj Kondur, the CEO of Nirvana Business Solutions in Bangalore, India; James Citrin, a senior director at Spencer Stuart in Stamford, Connecticut; Maurice Treacy, the director of biotechnology at Science Foundation Ireland in Dublin; and Arno Haslberger, who teaches HR management at Webster University Vienna in Austria, and Sharman Esarey, also based in Vienna, editor of the annual report of the Organization for Security and Co-operation in Europe.

Reprint R0511A

NOVEMBER | 53

Are You Working Too Hard? A Conversation with Mind/Body Researcher Herbert Benson

Stress is an essential response in highly competitive environments. Before a race, before an exam, before an important meeting, your heart rate and blood pressure rise, your focus tightens, you become more alert and more efficient. But beyond a certain level, stress overloads your system, compromising your performance and, eventually, your health.

So the question is: When does stress help and when does it hurt? To find out, HBR talked with Harvard Medical School professor Herbert Benson, M.D., founder of the Mind/Body Medical Institute. Having spent more than 35 years conducting worldwide research in the fields of neuroscience and stress, Benson is best known for his 1975 best seller *The Relaxation Response,* in which he describes how the mind can influence stress levels through such tools as meditation. His most recent research centers on what he calls "the breakout principle," a method by which stress is not simply reduced but carefully controlled so that you reap its benefits while avoiding its dangers. He describes a four-step process in which you first push yourself to the most productive stress level by grappling intently with a problem. Next, just as you feel yourself flagging, you disengage entirely by doing something utterly unrelated – going for a walk, petting a dog, taking a shower. In the third step, as the brain quiets down, activity paradoxically increases in areas associated with attention, space-time concepts, and decision making, leading to a sudden, creative insight – the breakout. Step four is achievement of a "new-normal state," in which you find that the improved performance is sustained, sometimes indefinitely.

As counterintuitive as this research may seem, managers can doubtless recall times when they've had an "aha" moment at the gym, on the golf course, or in the shower. What Benson describes here is a way to tap into this invaluable biological tool whenever we want.

Reprint R0511B

NOVEMBER | 74

Leadership in Your Midst: Tapping the Hidden Strengths of Minority Executives

Sylvia Ann Hewlett, Carolyn Buck Luce, and Cornel West

All companies value leadership – some of them enough to invest dearly in cultivating it. But few management teams seem to value one engine of leadership development that is right under their noses, churning out the kind of talent they need most. It's the complicated, overburdened but very rich lives of their minority managers.

Minority professionals – particularly women of color – are called upon inordinately to lend their skills and guidance to activities outside their jobs. Sylvia Ann Hewlett, who heads the Center for Work-Life Policy, and her coauthors, Carolyn Buck Luce of Ernst & Young and Cornel West of Princeton, present new research on the extent to which minority professionals take on community service and other responsibilities outside the workplace and more than their share of recruiting, mentoring, and committee work within the workplace. These invisible lives, argue the authors, can be a source of competitive strength if companies can learn to recognize and further cultivate the cultural capital they represent. But it's hard to convince minority professionals that their employer respects and values their off-hours responsibilities. A lack of trust keeps many people from revealing much about their personal lives.

The authors outline four ways companies can leverage hidden skills: Develop a new level of awareness of minority professionals' invisible lives; appreciate the outsize burdens these professionals carry and try to lighten them; build trust by putting teeth into diversity goals; and, to finish the job of leadership development, help minorities reflect on their off-hours experiences, extract and generalize the lessons, and apply what's been learned in other settings.

Reprint R0511D; HBR OnPoint 2211; OnPoint collection "Required Reading for White Executives, 2nd Edition" 2203

NOVEMBER | 84

You Have More Capital than You Think

Robert C. Merton

Senior executives typically delegate the responsibility for managing a firm's derivatives portfolio to in-house financial experts and the company's financial advisers. That's a strategic blunder, argues this Nobel laureate, because the inventiveness of modern financial markets makes it possible for companies to double or even triple their capacity to invest in their strategic assets and competencies.

Risks fall into two categories: either a company adds value by assuming them on behalf of its shareholders or it does not. By hedging or insuring against non-value-adding risks with derivative securities and contracts, thereby removing them from what the author calls the *risk balance sheet,* managers can release equity capital for assuming more value-adding risk.

This is not just a theoretical possibility. One innovation – the interest rate swap, introduced about 20 years ago – has already enabled the banking industry to dramatically increase its capacity for adding value to each dollar of invested equity capital. With the range of derivative instruments growing, there is no reason why other companies could not similarly remove strategic risks, potentially creating billions of dollars in shareholder value. The possibilities are especially important for private companies that have no access to public equity markets and therefore cannot easily increase their equity capital by issuing more shares.

The author describes how derivative contracts of various kinds are already being employed strategically to mitigate or eliminate various risks. He also shows how companies can use the risk balance sheet to identify risks they should not bear directly and to determine how much equity capacity they can release for assuming more value-adding risk.

Reprint R0511E

NOVEMBER | 100

Hiring for Smarts

Justin Menkes

Yes, it's nice when a leader is charismatic and confident. And a great résumé can tell you a lot about a person's knowledge and experience. But such assets are no substitute for sheer business intelligence, and they reveal very little about a leader's ability to consistently reach the "right" answer.

How can hiring managers flag individuals with such smarts? Historically, the only reliable measure of brainpower has been the standard IQ test, which is rarely used in business settings because of the specific subjects it tests for – math, reading, and spatial reasoning – and because of its multiple-choice format.

Despite its shortcomings, the standard IQ test is still a better predictor of managerial success than any other assessment tool companies currently use, Justin Menkes argues. It's true that there isn't a version of IQ testing that applies to the corporate world, but in rejecting IQ tests altogether, hiring managers have thwarted their own attempts to identify true business stars.

The author defines the specific subjects that make up "executive intelligence" – namely, *accomplishing tasks, working with people,* and *judging oneself.* He describes how to formulate questions to test job candidates for their mastery of these subjects, offering several examples based on real situations. Knowledge questions, such as those used in standard behavioral interviews, require people to recite what they have learned or experienced; intelligence questions call for individuals to demonstrate their abilities. Therefore, the questions in an executive intelligence test shouldn't require specific industry expertise or experience; any knowledge they call for must be rudimentary and common to all executives. And the questions should not be designed to ask whether the candidate has a particular skill; they should be configured so that the candidate will have to demonstrate that skill in the course of answering them.

Reprint R0511F

NOVEMBER | 112

The Perfect Message at the Perfect Moment

Kirthi Kalyanam and Monte Zweben

Marketers planning promotional campaigns ask questions to boost the odds that the messages will be accepted: Who should receive each message? What should be its content? How should we deliver it? The one question they rarely ask is, *when* should we deliver it?

That's too bad, because in marketing, timing is arguably the most important variable of all. Indeed, there are moments in a customer's relationship with a business when she *wants* to communicate with that business because something has changed. If the company contacts her with the right message in the right format at the right time, there's a good chance of a warm reception.

The question of "when" can be answered by a new computer-based model called "dialogue marketing," which is, to date, the highest rung on an evolutionary ladder that ascends from database marketing to relationship marketing to one-to-one marketing. Its principal advantages over older approaches are that it is completely interactive, exploits many communication channels, and is "relationship aware": that is, it continuously tracks every nuance of the customer's interaction with the business. Thus, dialogue marketing responds to each transition in that relationship at the moment the customer requires attention.

Turning a traditional marketing strategy into a dialogue-marketing program is a straightforward matter. Begin by identifying the batch communications you make with customers, then ask yourself what events could trigger those communications to make them more timely. Add a question or call to action to each message and prepare a different treatment or response for each possible answer. Finally, create a series of increasingly urgent calls to action that kick in if the question or call to action goes unanswered by the customer.

Reprint R0511G; HBR OnPoint 219X; OnPoint collection "CRM – the Right Way, 3rd Edition" 2173

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NOVEMBER | 135

Scanning the Periphery

George S. Day and *Paul J.H. Schoemaker*

Companies often face new rivals, technologies, regulations, and other environmental changes that seem to come out of left field. How can they see these changes sooner and capitalize on them? Such changes often begin as weak signals on what the authors call the periphery, or the blurry zone at the edge of an organization's vision. As with human peripheral vision, these signals are difficult to see and interpret but can be vital to success or survival.

Unfortunately, most companies lack a systematic method for determining where on the periphery they should be looking, how to interpret the weak signals they see, and how to allocate limited scanning resources. This article provides such a method – a question-based framework for helping companies scan the periphery more efficiently and effectively. The framework divides questions into three categories: learning from the past (What have been our past blind spots? What instructive analogies do other industries offer? Who in the industry is skilled at picking up weak signals and acting on them?); evaluating the present (What important signals are we rationalizing away? What are our mavericks, outliers, complainers, and defectors telling us? What are our peripheral customers and competitors really thinking?); and envisioning the future (What future surprises could really hurt or help us? What emerging technologies could change the game? Is there an unthinkable scenario that might disrupt our business?).

Answering these questions is a good first step toward anticipating problems or opportunities that may appear on the business horizon. The article concludes with a self-test that companies can use to assess their need and capability for peripheral vision.

Reprint R0511H

NOVEMBER | 150

Defensive Marketing: How a Strong Incumbent Can Protect Its Position

John H. Roberts

There has been a lot of research on marketing as an offensive tactic – how it can help companies successfully launch new products, enter new markets, or gain share with existing products in their current markets. But for nearly every new product launch, market entrant, or industry upstart grabbing market share, there is an incumbent that must defend its position. And there has been little research on how these defenders can use marketing to preemptively respond to new or anticipated threats.

John H. Roberts outlines four basic types of defensive marketing strategies: *positive, inertial, parity,* and *retarding.* With the first two, you establish and communicate your points of superiority relative to the new entrant; with the second two, you establish and communicate strategic points of comparability with your rival. Before choosing a strategy, you need to assess the weapons you have available to protect your market position – your brand identity, the products and services that support that identity, and your means of communicating it. Then assess your customers' *value* to you and their *vulnerability* to being poached by rivals.

The author explains how Australian telecommunications company Telstra, facing deregulation, used a combination of the four strategies (plus the author's customer response model) to fend off market newcomer Optus. Telstra was prepared, for instance, to reach deep into its pockets and engage in a price war. But the customer response model indicated that a parity strategy – in which Telstra would offer lower rates on some routes and at certain times of day, even though its prices, on average, were higher than its rival's – was more likely to prevent consumers from switching. Ultimately, Telstra was able to retain several points of market share it otherwise would have lost.

The strategies described here offer lessons for any company facing new and potentially damaging competition.

Reprint R0511J

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December 2005

DECEMBER | 62

COVER STORY

Strategy and Your Stronger Hand

Geoffrey A. Moore

There are two kinds of businesses in the world, says the author. Knowing what they are – and which one your company is – will guide you to the right strategic moves.

One kind includes businesses that compete on a complex-systems model. These companies have large enterprises as their primary customers. They seek to grow a customer base in the thousands, with no more than a handful of transactions per customer per year (indeed, in some years there may be none), and the average price per transaction ranges from six to seven figures. In this model, 1,000 enterprises each paying $1 million per year would generate $1 billion in annual revenue.

The other kind of business competes on a volume-operations model. Here, vendors seek to acquire millions of customers, with tens or even hundreds of transactions per customer per year, at an average price of relatively few dollars per transaction. Under this model, it would take 10 million customers each spending $8 per month to generate nearly $1 billion in revenue.

An examination of both models shows that they could not be further apart in their approach to every step along the classic value chain. The problem, though, is that companies in one camp often attempt to create new value by venturing into the other. In doing so, they fail to realize how their managerial habits have been shaped by the model they've grown up with. By analogy, they have a "handedness" – the equivalent of a person's right- or left-hand dominance – that makes them as adroit in one mode as they are awkward in the other. Unless you are in an industry whose structure forces you to attempt ambidexterity (in which case, special efforts are required to manage the inevitable dropped balls), you'll be far more successful making moves that favor your stronger hand.
Reprint R0512C; **HBR OnPoint** 2394

DECEMBER | 18

FORETHOUGHT

No Monopoly on Innovation Many economists argue that monopolies stifle innovation. But before the breakup, AT&T and its R&D units constituted probably the most potent innovation engine the world has known. **Reprint** F0512A

Those Who Can't, Don't Know It Incompetent people don't perform up to speed, don't recognize their lack of competence, and don't recognize the competence of others. **Reprint** F0512B

How Not to Extend Your Luxury Brand Don't extend your premium brands into other product categories – unless they are adjacent to your core categories.
Reprint F0512C

The Cost-Benefit of Well Employees As major purchasers of health care, corporations have almost as much of a stake in maintaining employees' health as employees themselves do. **Reprint** F0512D

Heartless Bosses? If you're in the C-suite, your subordinates are probably more emotionally intelligent than you are.
Reprint F0512E

Revaluing Writing Good writers who are consulted early enough can improve the product development process and, potentially, the products themselves.
Reprint F0512F

Play to Win Henry Jenkins, the director of comparative media studies at MIT, talks about the influence of video games in and on the workplace. **Reprint** F0512G

The Changing Face of the Chinese Executive Researchers have identified four cultural tensions that will influence how Chinese leaders develop over the next 15 years.
Reprint F0512H

Bringing the College Inside As part of its R&D efforts, Porsche taps the resources and expertise of nearly 600 graduate students – saving innovation costs in the process. **Reprint** F0512J

When Stability Breeds Instability Low turnover – typically a sign of organizational health – seems to increase a company's vulnerability to the effects of losing social capital. **Reprint** F0512K

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DECEMBER | 39

HBR CASE STUDY

Just in Time for the Holidays

Eric McNulty

It's the busiest time of year for North Pole Workshops. Production is in high gear, and the elves are on overtime in the sprint toward Christmas. But an unexpected spike in demand for one toy may leave children around the world disappointed on Christmas morning, whether they've been naughty or nice. At the same time, another toy's popularity threatens to plummet, leaving Santa and his elves faced with the prospect of millions of unloved playthings left in the warehouse.

This is the third time in three years that Santa's elves have been caught off guard by a toy's sudden surge in popularity. Earlier in the season, even just a month ago, it would have been possible to find capacity, but now every line is running full tilt. "Oh, it used to be so simple," Santa ruminates. "Wooden blocks, a train set, a doll…Now we have more than a million SKUs…. Trends jump across the oceans in an instant. I've asked the elves in the field to go beyond reporting on kids' behavior and start trend spotting. I've invested in software. But still I can't help thinking that one of these days we're not going to be able to do it."

Santa and his staff are determined not to disappoint the children, but North Pole Workshops must find a way to improve its response to shifts in demand. Should Santa invest in better forecasting? Or does the answer lie in a more flexible supply chain?

Commenting on this fictional case study are M. Eric Johnson, the director of the Glassmeyer/McNamee Center for Digital Strategies at Dartmouth's Tuck School of Business; Horst Brandstätter, the owner of Playmobil; Warren Hausman, a professor of operations management at Stanford University; and Anne Omrod, the CEO of the consulting firm John Galt Solutions.

Reprint R0512A

DECEMBER | 53

How to Build Your Network

Brian Uzzi and Shannon Dunlap

Many sensational ideas have faded away into obscurity because they failed to reach the right people. A strong personal network, however, can launch a burgeoning plan into the limelight by delivering private information, access to diverse skill sets, and power. Most executives know that they need to learn about the best ideas and that, in turn, their best ideas must be heard by the rest of the world. But strong personal networks don't just happen around a watercooler or at reunions with old college friends. As Brian Uzzi and Shannon Dunlap explain, networks have to be carefully constructed through relatively high-stakes activities that bring you into contact with a diverse group of people.

Most personal networks are highly clustered – that is, your friends are likely to be friends with one another as well. And, if you made those friends by introducing yourself to them, the chances are high that their experiences and perspectives echo your own. Because ideas generated within this type of network circulate among the same people with shared views, though, a potential winner can wither away and die if no one in the group has what it takes to bring that idea to fruition. But what if someone within that cluster knows someone else who belongs to a whole different group? That connection, formed by an *information broker,* can expose your idea to a new world, filled with fresh opportunities for success. Diversity makes the difference.

Uzzi and Dunlap show you how to assess what kind of network you currently have, helping you to identify your *superconnectors* and demonstrating how you act as an information broker for others. They then explain how to diversify your contacts through shared activities and how to manage your new, more potent, network.

Reprint R0512B

DECEMBER | 74

Marketing Malpractice: The Cause and the Cure

Clayton M. Christensen, Scott Cook, and Taddy Hall

Ted Levitt used to tell his Harvard Business School students, "People don't want a quarter-inch drill – they want a quarter-inch hole." But 35 years later, marketers are still thinking in terms of products and ever-finer demographic segments.

The structure of a market, as seen from customers' point of view, is very simple. When people need to get a job done, they hire a product or service to do it for them. The marketer's task is to understand what jobs periodically arise in customers' lives for which they might hire products the company could make.

One job, the "I-need-to-send-this-from-here-to-there-with-perfect-certainty-as-fast-as-possible" job, has existed practically forever. Federal Express designed a service to do precisely that – and do it wonderfully again and again. The FedEx brand began popping into people's minds whenever they needed to get that job done. Most of today's great brands – Crest, Starbucks, Kleenex, eBay, and Kodak, to name a few – started out as just this kind of *purpose* brand.

When a purpose brand is extended to products that target different jobs, it becomes an *endorser* brand. But, over time, the power of an endorser brand will surely erode unless the company creates a new purpose brand for each new job, even as it leverages the endorser brand as an overall marker of quality. Different jobs demand different purpose brands.

New growth markets are created when an innovating company designs a product and then positions its brand on a job for which no optimal product yet exists. In fact, companies that have segmented and measured markets by product categories generally find that when they segment by job, their market is much larger (and their current share much smaller) than they had thought. This is great news for smart companies hungry for growth.

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DECEMBER | 86

Managing Authenticity: The Paradox of Great Leadership

Rob Goffee and Gareth Jones

Leaders and followers both associate authenticity with sincerity, honesty, and integrity. It's the real thing – the attribute that uniquely defines great managers. But while the expression of a genuine self is necessary for great leadership, the concept of authenticity is often misunderstood, not least by leaders themselves. They often assume that authenticity is an innate quality – that a person is either genuine or not. In fact, the authors say, authenticity is largely defined by what other people see in you and, as such, can to a great extent be controlled by you.

In this article, the authors explore the qualities of authentic leadership. To illustrate their points, they recount the experiences of some of the authentic leaders they have known and studied, including the BBC's Greg Dyke, Nestlé's Peter Brabeck-Letmathe, and Marks & Spencer's Jean Tomlin.

Establishing your authenticity as a leader is a two-part challenge. You have to consistently match your words and deeds; otherwise, followers will never accept you as authentic. But it is not enough just to practice what you preach. To get people to follow you, you also have to get them to relate to you. This means presenting different faces to different audiences – a requirement that many people find hard to square with authenticity. But authenticity is not the product of manipulation. It accurately reflects aspects of the leader's inner self, so it can't be an act.

Authentic leaders seem to know which personality traits they should reveal to whom, and when. Highly attuned to their environments, authentic leaders rely on an intuition born of formative, sometimes harsh experiences to understand the expectations and concerns of the people they seek to influence. They retain their distinctiveness as individuals, yet they know how to win acceptance in strong corporate and social cultures and how to use elements of those cultures as a basis for radical change.
Reprint R0512E

DECEMBER | 98

Regional Strategies for Global Leadership

Pankaj Ghemawat

The leaders of such global powerhouses as GE, Wal-Mart, and Toyota seem to have grasped two crucial truths: First, far from becoming submerged by the rising tide of globalization, geographic and other regional distinctions may in fact be increasing in importance. Second, regionally focused strategies, used in conjunction with local and global initiatives, can significantly boost a company's performance.

The business and economic data reveal a highly regionalized world. For example, trade within regions, rather than across them, drove the surge of international commerce in the second half of the twentieth century. Regionalization is also apparent in foreign direct investment, companies' international sales, and competition among the world's largest multinationals.

Harvard Business School professor Pankaj Ghemawat says that the most successful companies employ five types of regional strategies in addition to – or even instead of – global ones: home base, portfolio, hub, platform, and mandate. Some companies adopt the strategies in sequence, but the most nimble switch from one to another and combine approaches as their markets and businesses evolve. At Toyota, for example, exports from the home base continue to be substantial even as the company builds up an international manufacturing presence. And as Toyota achieves economies of scale and scope with a strong network of hubs, the company also pursues economies of specialization through interregional mandates.

Embracing regional strategies requires flexibility and creativity. A company must decide what constitutes a region, choose the most appropriate strategies, and mesh those strategies with the organization's existing structures. In a world that is neither truly global nor truly local, finding ways of coordinating within and across regions can deliver a powerful competitive advantage.
Reprint R0512F

DECEMBER | 110

"A Players" or "A Positions"? The Strategic Logic of Workforce Management

Mark A. Huselid, Richard W. Beatty, and Brian E. Becker

Companies simply can't afford to have "A players" in all positions. Rather, businesses need to adopt a portfolio approach to workforce management, systematically identifying their strategically important A positions, supporting B positions, and surplus C positions, then focusing disproportionate resources on making sure A players hold A positions.

This is not as obvious as it may seem, because the three types of positions do not reflect corporate hierarchy, pay scales, or the level of difficulty in filling them. A positions are those that directly further company strategy and, less obviously, exhibit wide variation in the quality of the work done by the people who occupy them. Why variability? Because raising the average performance of individuals in these critical roles will pay huge dividends in corporate value. If a company like Nordstrom, for example, whose strategy depends on personalized service, were to improve the performance of its frontline sales associates, it could reap huge revenue benefits.

B positions are those that support A positions or maintain company value. Inattention to them could represent a significant downside risk. (Think how damaging it would be to an airline, for example, if the quality of its pilots were to drop.) Yet investing in them to the same degree as A positions is ill-advised because B positions don't offer an upside potential. And C positions? Companies should consider outsourcing them – or eliminating them.

We all know that effective business strategy requires differentiating a firm's products and services in ways that create value for customers. Accomplishing this requires a differentiated workforce strategy, as well.
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DECEMBER | 122

Up to Code: Does Your Company's Conduct Meet World-Class Standards?

Lynn Paine, Rohit Deshpandé, Joshua D. Margolis, and Kim Eric Bettcher

Codes of conduct have long been a feature of corporate life. Today, they are arguably a legal necessity – at least for public companies with a presence in the United States. But the issue goes beyond U.S. legal and regulatory requirements. Sparked by corruption and excess of various types, dozens of industry, government, investor, and multisector groups worldwide have proposed codes and guidelines to govern corporate behavior. These initiatives reflect an increasingly global debate on the nature of corporate legitimacy.

Given the legal, organizational, reputational, and strategic considerations, few companies will want to be without a code. But what should it say? Apart from a handful of essentials spelled out in Sarbanes-Oxley regulations and NYSE rules, authoritative guidance is sorely lacking.

In search of some reference points for managers, the authors undertook a systematic analysis of a select group of codes. In this article, they present their findings in the form of a "codex," a reference source on code content. The Global Business Standards Codex contains a set of overarching principles as well as a set of conduct standards for putting those principles into practice.

The GBS Codex is not intended to be adopted as is, but is meant to be used as a benchmark by those wishing to create their own world-class code. The provisions of the codex must be customized to a company's specific business and situation; individual companies' codes will include their own distinctive elements as well. What the codex provides is a starting point grounded in ethical fundamentals and aligned with an emerging global consensus on basic standards of corporate behavior.

Reprint R0512H

DECEMBER | 135

Getting Offshoring Right

Ravi Aron and Jitendra V. Singh

The prospect of offshoring and outsourcing business processes has captured the imagination of CEOs everywhere. In the past five years, a rising number of companies in North America and Europe have experimented with this strategy, hoping to reduce costs and gain strategic advantage.

But many businesses have had mixed results. According to several studies, half the organizations that have shifted processes offshore have failed to generate the expected financial benefits. What's more, many of them have faced employee resistance and consumer dissatisfaction.

Clearly, companies have to rethink how they formulate their offshoring strategies. A three-part methodology can help. First, companies need to prioritize their processes, ranking each based on two criteria: the value it creates for customers and the degree to which the company can capture some of that value. Companies will want to keep their core (highest-priority) processes in-house and consider outsourcing their commodity (low-priority) processes; critical (moderate-priority) processes are up for debate and must be considered carefully.

Second, businesses should analyze all the risks that accompany offshoring and look systematically at their critical and commodity processes in terms of operational risk (the risk that processes won't operate smoothly after being offshored) and structural risk (the risk that relationships with service providers may not work as expected).

Finally, companies should determine possible locations for their offshore efforts, as well as the organizational forms that those efforts might take. They can do so by examining each process's operational and structural risks side by side.

This article outlines the tools that will help companies choose the right processes to offshore. It also describes a new organizational structure called the *extended organization,* in which companies specify the quality of services they want and work alongside providers to get that quality.

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Setting the Bar

"The way managers treat their subordinates is subtly influenced by what they expect of them. If a manager's expectations are high, productivity is likely to be excellent. If his expectations are low, productivity is likely to be poor. It is as though there were a law that caused a subordinate's performance to rise or fall to meet his manager's expectations."

J. Sterling Livingston
"Pygmalion in Management"
Harvard Business Review
July–August 1969

"Let me worry about the 1% inspiration. You just take care of the 99% perspiration."

"Your performance is interfering with my ability to criticize you."

"They can push me only so far before I do what they want."

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