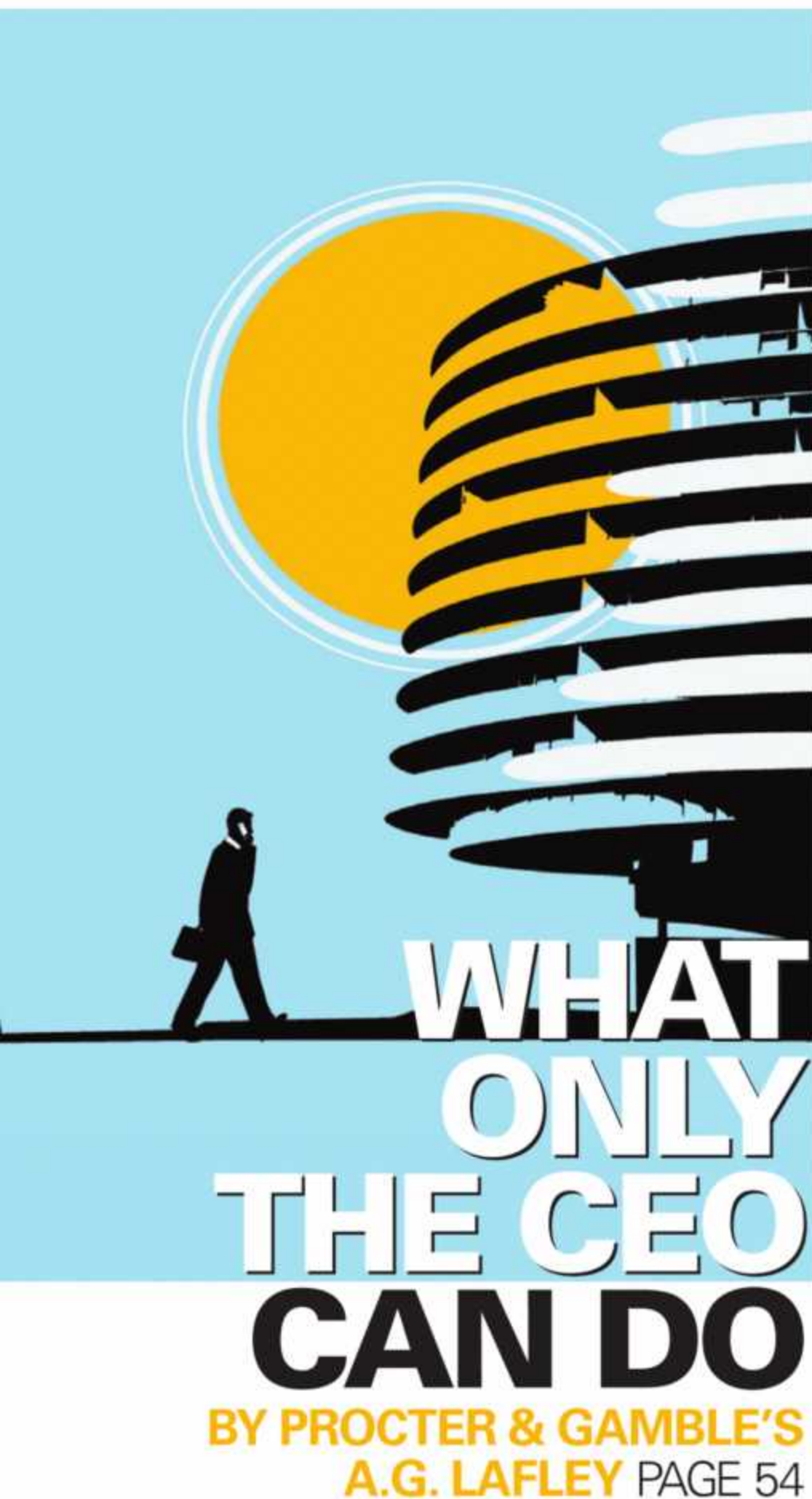


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May 2009



54 **What Only the CEO Can Do**

A.G. Lafley

45 **The Right Way
to Close an Operation**
Kenneth W. Freeman

64 **Need Cash?
Look Inside Your Company**
Kevin Kaiser and S. David Young

74 **The Definitive Guide to Recruiting
in Good Times and Bad**
Claudio Fernández-Aráoz, Boris Groysberg,
and Nitin Nohria

86 **Is Your Growth Strategy Flying Blind?**
Mehrdad Baghai, Sven Smit, and Patrick Viguerie

98 **THE HBR INTERVIEW**
Why Teams Don't Work
J. Richard Hackman

30 **HEALTH & WELL-BEING**
Do Take That Break
Samuel Z. Goldhaber, MD

35 **HBR CASE STUDY**
World-Class Bull
John Humphreys, Zafar U. Ahmed, and Mildred Pryor

106 **TOOL KIT**
**Making Better Investments
at the Base of the Pyramid**
Ted London

115 **BEST PRACTICE**
**How Emerging Giants Are
Rewriting the Rules of M&A**
Nirmalya Kumar



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Features

54 What Only the CEO Can Do

A.G. Lafley

Does the chief executive have a unique role? Yes, writes the CEO of Procter & Gamble: He or she is singularly positioned to have both a clear perspective across the organization and accountability to external stakeholders, and must link the inside to the outside.

64 Need Cash? Look Inside Your Company

Kevin Kaiser and S. David Young

When credit dries up, companies can find cash in their existing operations.

74 The Definitive Guide to Recruiting in Good Times and Bad

Claudio Fernández-Aráoz, Boris Groysberg, and Nitin Nohria

Someday, the recession will end and companies will need to start hiring again. If your company is like most, new research shows, it won't be ready. Now's the time to think about the best practices that will give you a clear advantage when things start looking up.

86 Is Your Growth Strategy Flying Blind?

Mehrdad Baghai, Sven Smit, and Patrick Viguerie

Your best opportunities for growth are probably hiding in unexpected places. Find them by analyzing market and company performance in fine-grained detail.

98 THE HBR INTERVIEW

Why Teams Don't Work

J. Richard Hackman

Interviewed by Diane Coutu

Most people are surprisingly bad at teamwork, says a leading organizational psychologist. Nevertheless, teams can be extraordinary – provided you create the right conditions.

continued on page 6



54



86



98



74



64


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20

Departments

10 COMPANY INDEX

12 FROM THE EDITOR

18 STRATEGIC HUMOR

20 FORETHOUGHT

Overcome fear and get your company moving...If you think a hospital is the last place people would want to shop, think again...How markets judge asset sales...What Spanish multinationals did to endear themselves to the leftist Chilean government...The smart way the World Bank transfers knowledge...Why would someone forgo the opportunity to be CEO?...What you *shouldn't* put in a contract...Anticipating extreme IT events.

30 HEALTH & WELL-BEING

Do Take That Break

Samuel Z. Goldhaber, MD

Many people know it's unhealthy to sit still for prolonged periods in an airplane. But a recent study from New Zealand finds that office workers who sit for several hours – in a meeting or at their desks – are also at risk of developing dangerous blood clots.

35 HBR CASE STUDY

World-Class Bull

John Humphreys, Zafar U. Ahmed, and Mildred Pryor

To win a lucrative new account, the star sales performer at Specialty Fleet Services doesn't go for a straightforward sales pitch. Instead, he researches the prospect's interests, gives gifts to the guy's wife, and engineers several "chance" encounters – some of them at the prospect's home. Only after establishing a good rapport does he reveal his position at SFS. Is this a brilliant approach or an ethics violation? Commentary by Kirk O. Hanson, Don Peppers and Martha Rogers, and James Borg.

45 FIRST PERSON

The Right Way to Close an Operation

Kenneth W. Freeman

After deciding to shrink an operation or a workforce, the leader should stay involved in executing the decision – treating employees with dignity, fairness, and respect; treating customers and suppliers like valued partners; and managing the process like a project.

FINANCIAL
CRISIS
SPOTLIGHT

106 TOOL KIT

Making Better Investments at the Base of the Pyramid

Ted London

Ventures that serve the world's poor depend on feel-good stories to demonstrate their success. But anecdotes are no substitute for making an objective assessment of what's working and what isn't. Here's a tool for doing just that.

115 BEST PRACTICE

How Emerging Giants Are Rewriting the Rules of M&A

Nirmalya Kumar

Indian aluminum producer Hindalco and other companies in emerging markets are using takeovers to build competencies, not just to create economies of scale. Western companies should take note.

122 LETTERS TO THE EDITOR

126 EXECUTIVE SUMMARIES

132 PANEL DISCUSSION

That's Going to Cost You

Don Moyer

Nonpaying customers can generate revenue by spreading the word or otherwise attracting customers willing to pay.



35



45



106



115



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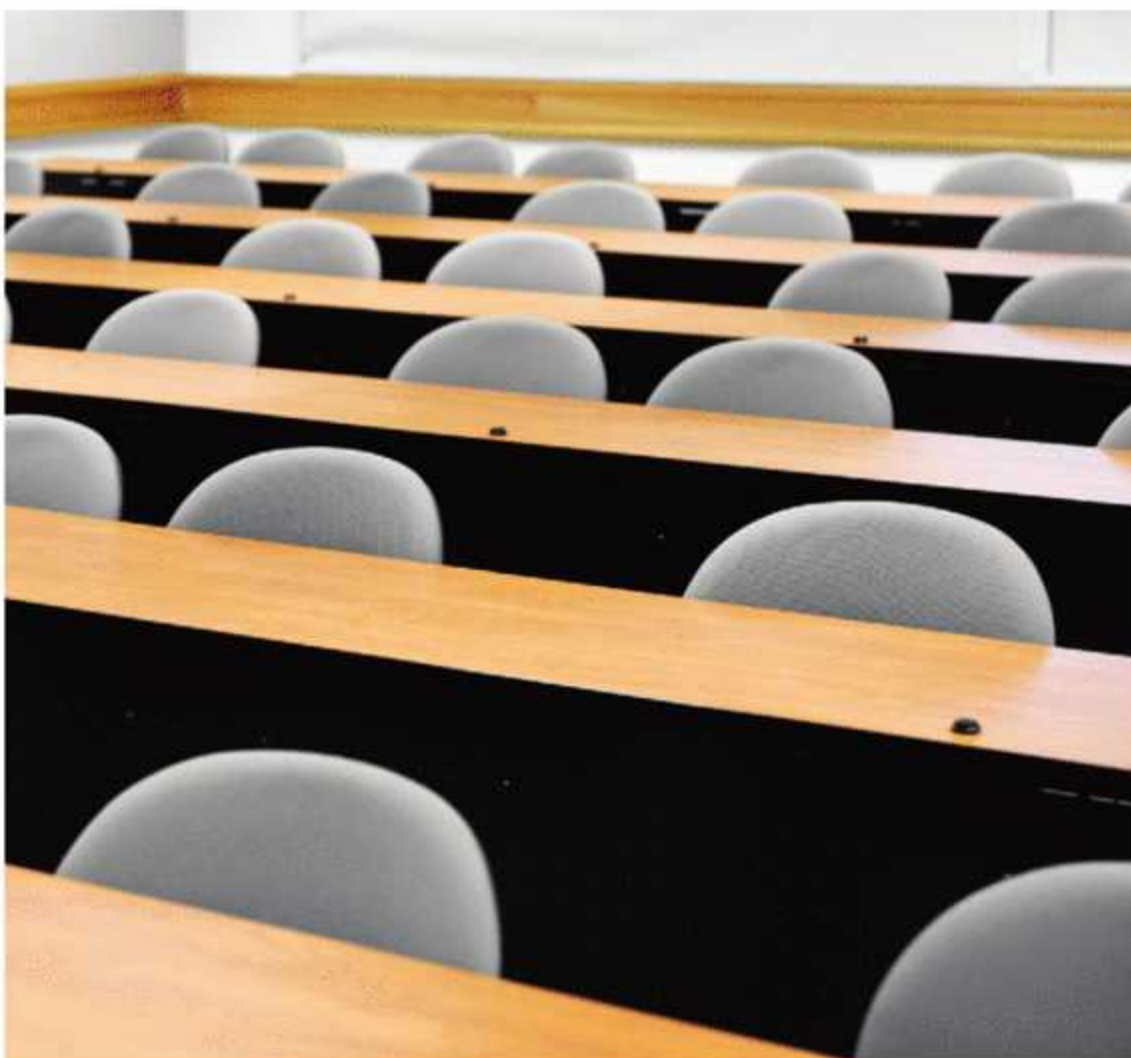
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The HBR Debate: How to Fix Business Schools

mba-future.hbr.org

As banks converted bailout money into bonuses, an unlikely villain emerged in the media: the MBA. Have B schools brought on this global recession by failing to teach students properly? *Harvard Business Review* leads an online discussion with commentary from Henry Mintzberg, Joel Podolny, HBR editors, and many others.

SPOTLIGHT ON HEALTH & WELL-BEING

Do Take That Break

health.hbr.org

Deep-vein thrombosis (DVT) afflicts upwards of 600,000 Americans a year, and not just those who take long airplane flights. This month, learn how to avoid DVT in our special section.

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What Only the CEO Can Do

essentialreading.hbr.org

A.G. Lafley's May article is just one of a number of notable HBR articles inspired by Procter & Gamble. Here you can read the entire collection and also watch a video interview with Lafley on innovation.

THE HBR CASE ONLINE

Clever or Unethical?

sales-ethics.hbr.org

A star salesman finally breaks through with a prized customer. Was his method a brilliant sales ploy or an ethical breach? Weigh in with your opinion.

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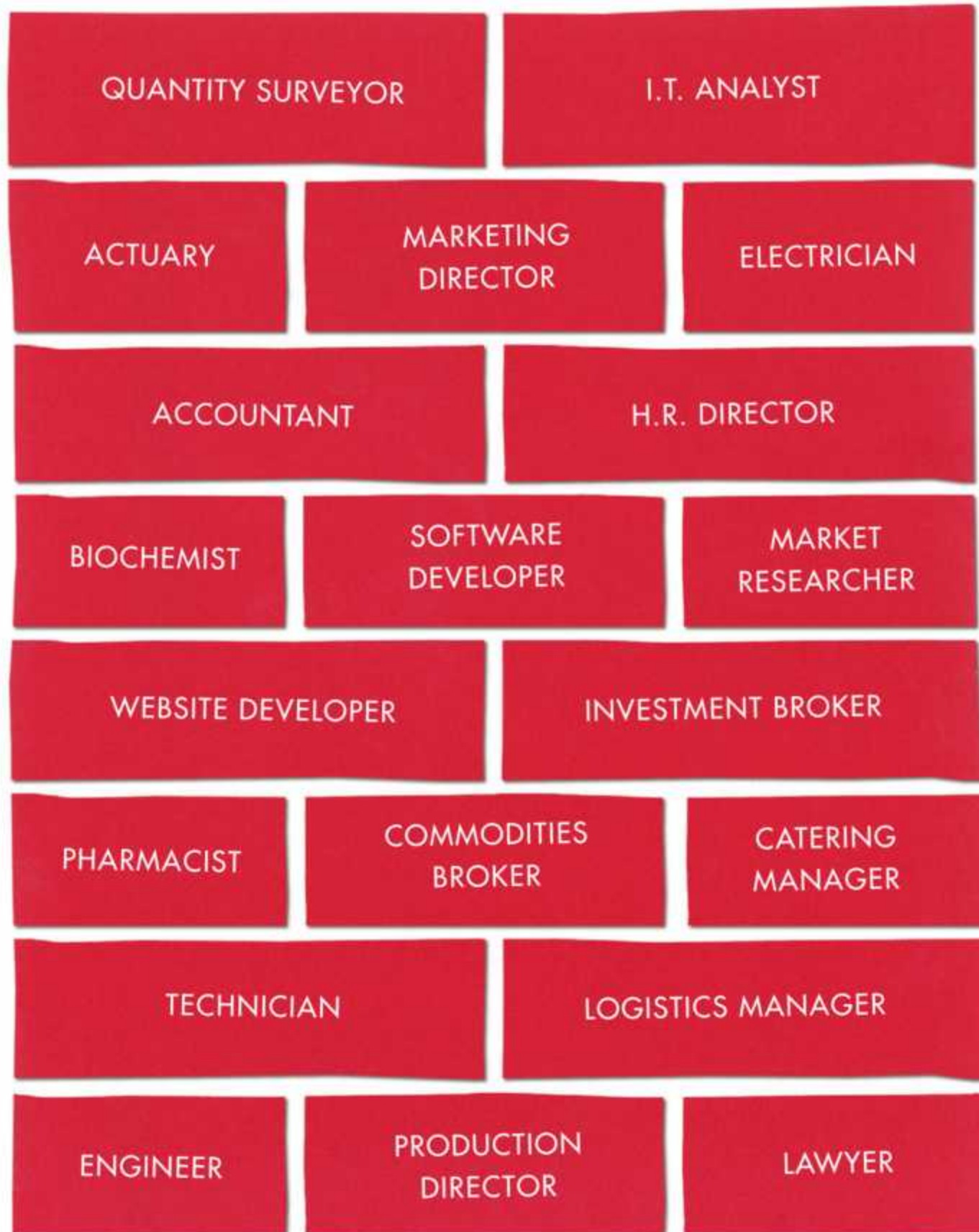
Accellent.....	45	McKinsey.....	74	Carnegie Mellon University.....	20
Aditya Birla Group.....	115	New York Yankees.....	20	Columbia Business School.....	20
Aditya Birla Minerals.....	115	Nissan.....	20	Corning.....	45
Air Products and Chemicals.....	20	Novelis.....	115	Duke University's Fuqua School of Business.....	35
Alcan.....	115	Peoples Action for Creative Education.....	106	Egon Zehnder International.....	74
Alcoa.....	115	Ping An.....	86	Fahad Bin Sultan University.....	35
Amazon.....	86	Pioneer Hi-Bred International.....	106	Harvard Business School.....	20, 74
Amgen.....	74	Procter & Gamble.....	54	Harvard Health Publications.....	30
Annapurna Foils.....	115	Quest Diagnostics.....	45	Harvard Medical School.....	30
BBVA.....	20	Renault.....	20	Harvard University.....	98
Better Place.....	20	Rio Tinto.....	115	HEC Paris.....	20
BHP Billiton.....	115	Rusal.....	115	Imperial College Business School.....	20
CARE.....	106	SAP.....	20	Insead.....	64
CEMEX.....	106	Sapa.....	115	Kohlberg Kravis Roberts.....	45
China Minmetals.....	115	ServiceMaster.....	74	KPMG.....	20
Corning.....	45	SmithKline Beecham Clinical Laboratories.....	45	London Business School.....	115
Corning Clinical Laboratories.....	45	Société Générale.....	20	McKinsey.....	86
Dell.....	64	Sony.....	20	The Ohio State University's Fisher College of Business.....	20
Dubai.....	115	Southwest Airlines.....	74	Peppers & Rogers Group.....	35
DuPont.....	20, 86	Tata Consultancy Services.....	74, 115	Procter & Gamble.....	54
E.F. Hutton.....	35	Telefónica.....	20	Quest Diagnostics.....	45
General Electric.....	74, 86	Toyota.....	64	Santa Clara University.....	35
General Motors.....	86	TransWorks Information.....	115	SAP.....	20
Handel and Haydn Society.....	98	Verizon.....	20	SKK Graduate School of Business.....	20
HCL Technologies.....	115	VisionSpring.....	106	Stanford University's Graduate School of Business.....	35
Hindalco.....	115	Wipro Technologies.....	74	Sunnybrook Health Services Centre.....	20
Indal.....	115	World Bank Group's International Finance.....	20	Texas A&M University—Commerce.....	35
Infosys Technologies.....	74			University of Illinois's College of Business.....	20
Intuit.....	74			University of Michigan's Stephen M. Ross School of Business.....	106
ITC.....	106			University of Michigan's William Davidson Institute.....	106
Kohlberg Kravis Roberts.....	45			University of Pennsylvania's Wharton School.....	20
London Stock Exchange.....	20			University of the Andes's ESE Business School.....	20
Los Angeles Dodgers.....	20				
Masonite International.....	45				

AUTHOR AFFILIATIONS

Alchemy Growth Partners.....	86
Arizona State University.....	20
Better Place.....	20
Brigham and Women's Hospital.....	30



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LET ME INTRODUCE MYSELF—I'm Adi Ignatius, the new editor in chief of *Harvard Business Review*. I joined the *Review* in late January, and I've been learning the ropes since then. (I was deputy managing editor of *Time* magazine most recently; for many years before that, I was a foreign correspondent for the *Wall Street Journal* based in China, Russia, and elsewhere overseas.)

Harvard Business Review has an extraordinary history—for more than 80 years it has been the source of great management ideas from aca-

demics, consultants, and business practitioners. I'm proud to inherit that history and the respect that comes with it. But I'm not here as a historian or a curator. My hope is to marry HBR's timeless quality with a renewed focus on what's timely. I suspect that would have been my inclination had I become editor at any point in the past 10 years—after all, I've spent most of my career covering news—but at this particular moment it's critical. The global finan-

cial meltdown is the story of this young century, and it cries out for the kind of informed analysis that HBR can offer. In the coming months and years, the rules of global capitalism will be renegotiated. HBR will help to present the ideas and the conversations that lead to those new rules.

Here are my hopes for HBR: I want the magazine to facilitate the discussions that companies, financial institutions, and managers have as they reinvent themselves. I want to bring a new sense of urgency to how we cover management thinking. I want HBR's website to be smart and exciting and to engage daily with the kinds of issues that the print magazine will explore in greater depth. And I plan to redesign the print version so that it's easier to use and more in tune with the world around it.



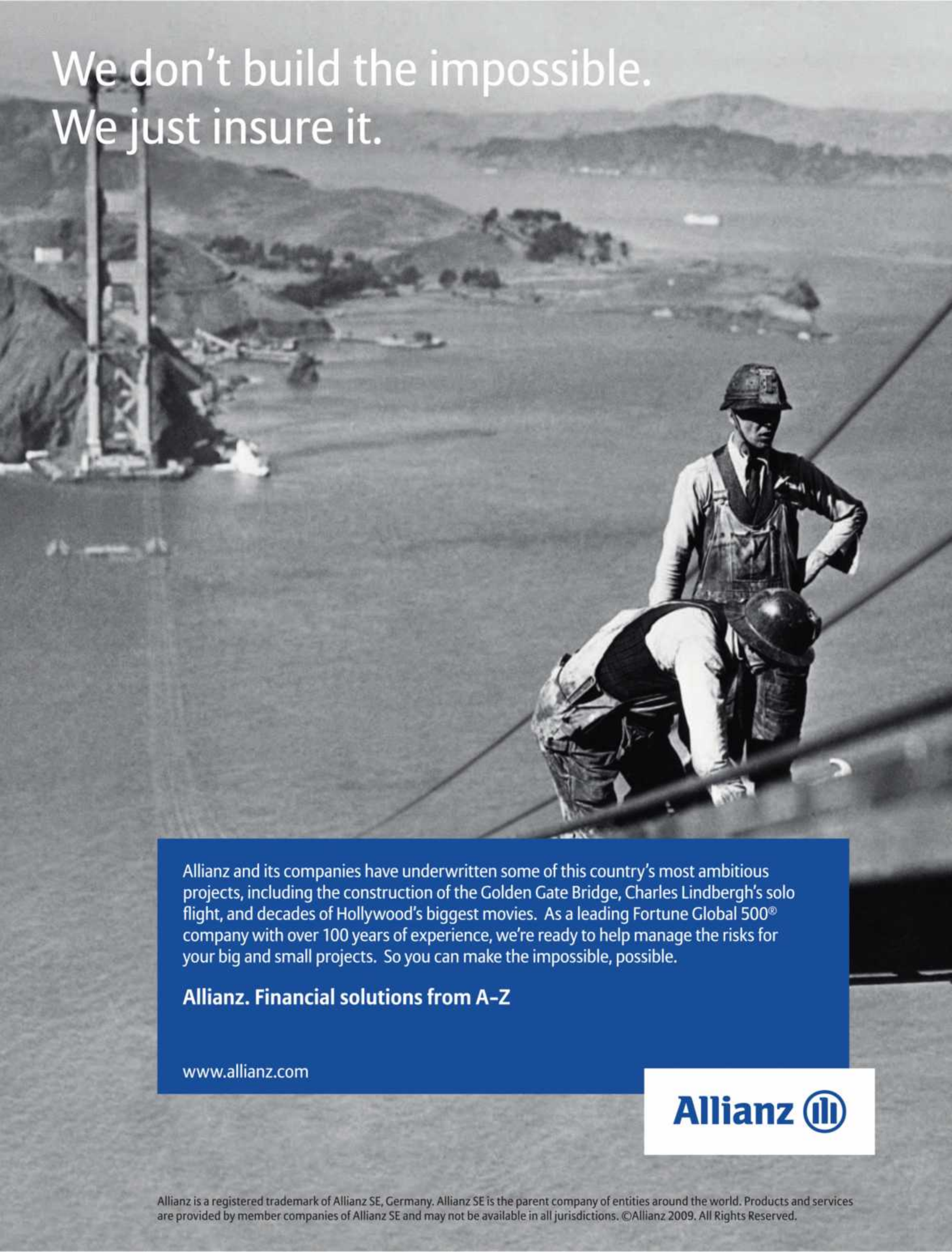
These changes won't happen overnight, but we're already hard at work. For the time being, I hope you'll enjoy the May issue. It includes the kinds of traditional HBR articles that we trust will still be read years from now, like A.G. Lafley's lead piece on the work that only a CEO can do. Lafley writes about what he has learned in his nine years of leading Procter & Gamble; his article is both down to earth and quietly inspirational. "Is Your Growth Strategy Flying Blind?" will, we hope, be another classic: The authors argue persuasively that managers need to dig deeper into their own data, because an aggregated perspective often masks pockets of high profitability—or steep loss.

As we're doing every month, we also focus in this issue on new challenges that the economic crisis has spawned. For example, it's extremely difficult to borrow cash at the moment, which puts a serious damper on innovation investments. "Need Cash? Look Inside Your Company" will help you manage your working capital—you're probably sitting on more cash than you knew (or needed to know when credit was cheap). Smart companies realize that they can scoop up great talent for less money during a downturn; "The Definitive Guide to Recruiting in Good Times and Bad" tells you how. Of course, chances are your company will have to lay off staff or close down some operations in the near future, if it hasn't already. In "The Right Way to Close an Operation," an experienced manager outlines how to do that unpleasant job humanely and effectively.

As we continue to innovate over the coming months, I'd love to hear from you about how we're doing, how you'd change HBR if you could, and what you'd keep the same. Let me know at hbr_letters@harvardbusiness.org.

A stylized, handwritten signature in black ink. The signature is fluid and cursive, with a long horizontal line extending to the right.

Adi Ignatius



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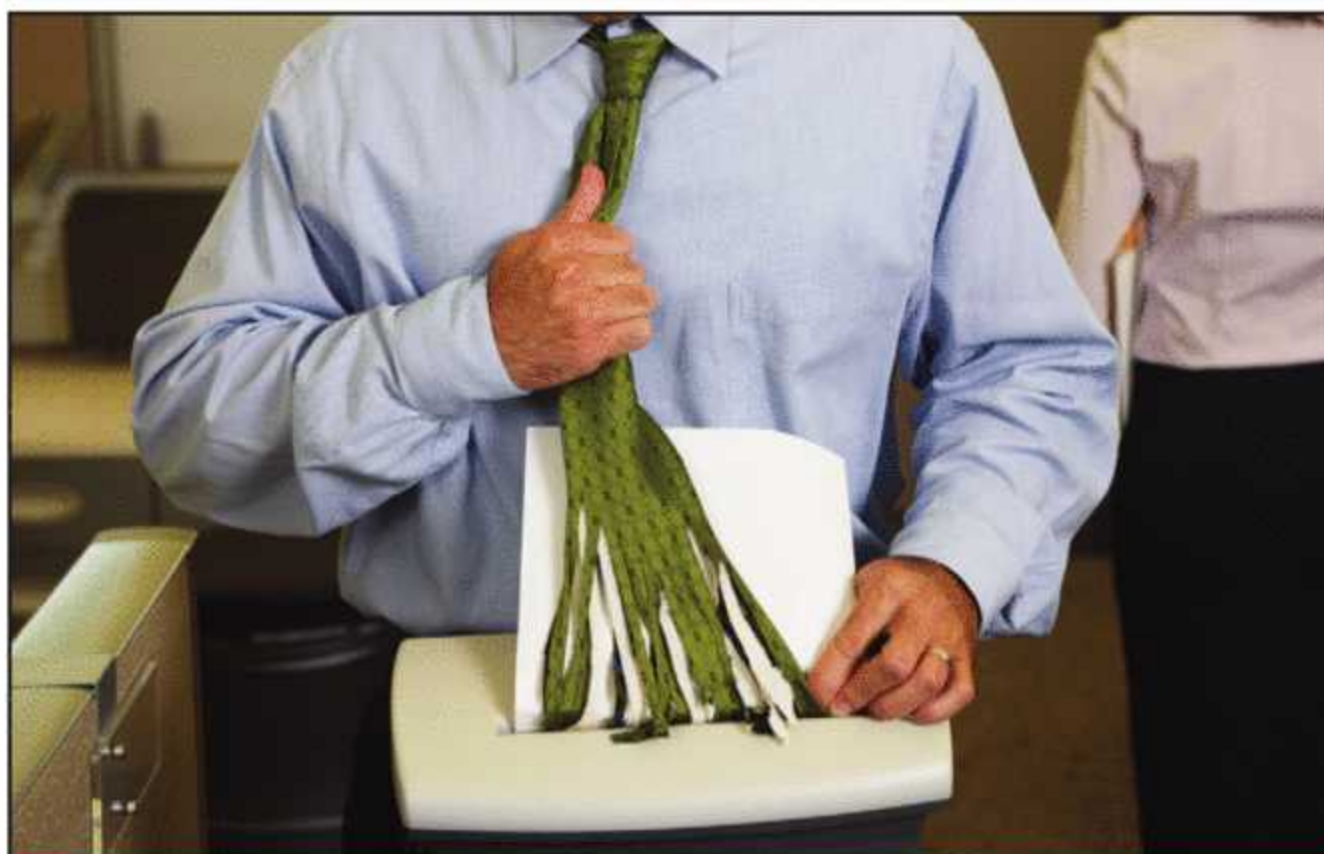
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Peter F. Drucker

“The Effective Decision”
Harvard Business Review
January–February 1967



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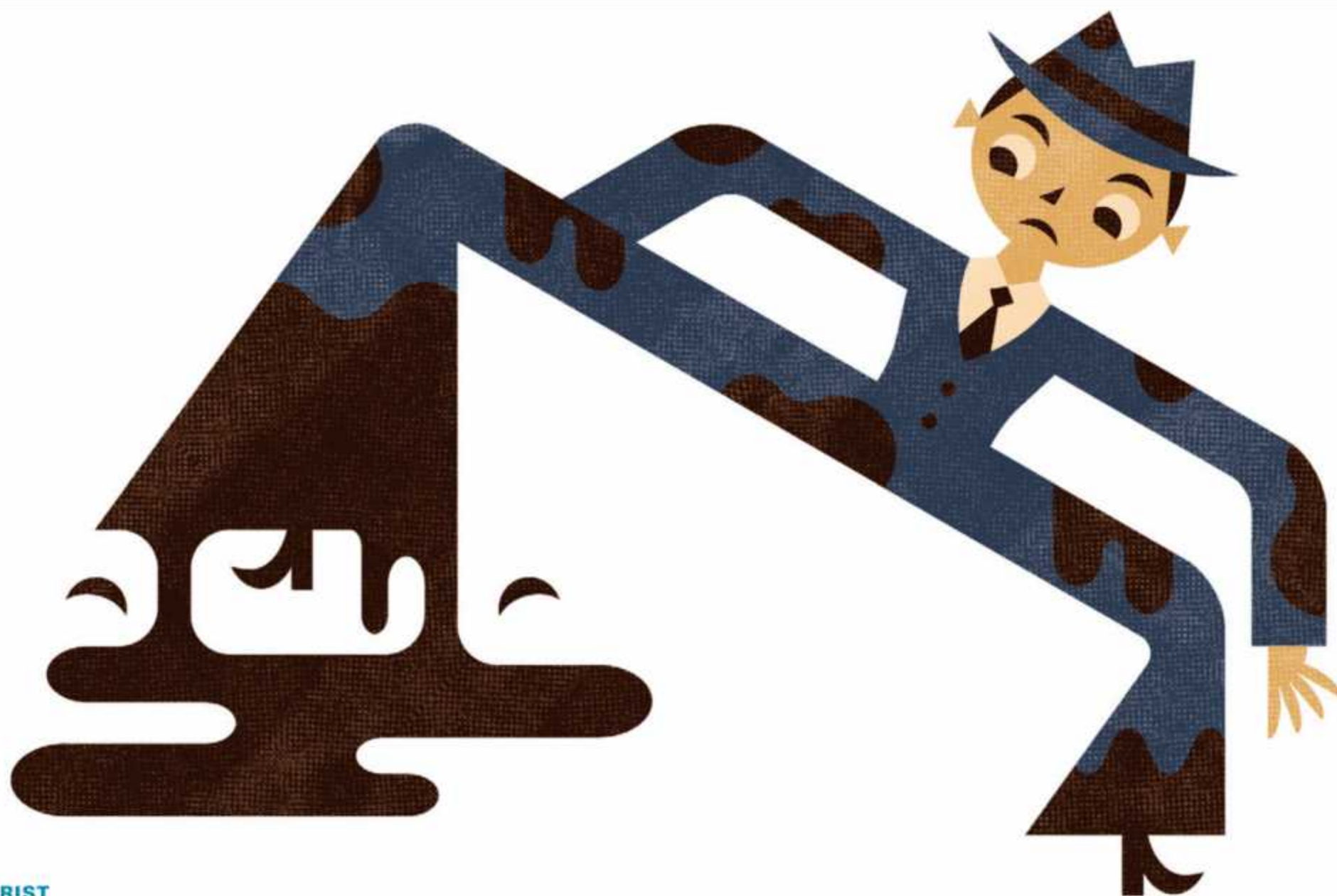


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A survey of ideas, trends, people, and practices on the business horizon



GRIST

How to Get Unstuck by Rita Gunther McGrath and Ian C. MacMillan

A lot of businesspeople seem to be frozen in the headlights, paralyzed by uncertainty, fear of failure, and lack of trust. In this economy, inaction is understandable but shortsighted. Those who face their fear and get unstuck can outrun hesitant competitors and seize advantage. In studying how leaders prevail in uncertain times, we've observed four practices you can use to get yourself, your people, and your firm moving again.

Decrease uncertainty. Doubts about the near term can cause managers to avoid pursuing long-term goals because

uncertainty obscures the path. But rather than wait until you can clearly see the entire route to a distant goal, focus on getting to the next bend. Identify a series of near-term goals that can serve as checkpoints along the way, indicating your progress and illuminating the best way forward. As you proceed down the path, you can stop, change direction, or continue on the same trajectory, depending on what you learn en route to each checkpoint. This approach is cost-effective and reduces risk because only relatively small investments are required

to move from one milestone to the next and because it reveals false starts early.

Air Products and Chemicals proceeded this way when it decided to enter a new market in China. Although the long-term goal was clear, the route to it was murky. So the company set a near-term market-testing goal and subcontracted the job of reaching it to another supplier. What the firm learned in arriving at that bend led it to change course and adopt a new, and ultimately successful, business model.

Reduce the fear of failure. People fear failing, particularly in a downturn,

Bob Daly

when they think any misstep might cost a job. As a result, they tend to freeze because it appears that the easiest way to avoid failing is to do nothing. To spur action, shift your emphasis from cutting the *rate* of failure to minimizing the *cost* of failure. The checkpoint method is one good way to allow for failure while containing costs. If each disappointment (a term we prefer to “failure”) is cheap and you learn from it, you can afford more of them. To reduce people’s anxiety, give them permission to be wrong but not to make expensive mistakes. Silicon Valley’s famous discipline – fail fast, fail cheap, and move on – applies here.

Hedge your bets. Decreasing uncertainty and reducing the fear of failure both involve linear experimentation: Try A; if that fails try B and so on. In some cases, the shortest route to the goal involves investing in simultaneous experiments whose outcomes are mutually exclusive: Try A, B, and C in tandem; whichever succeeds first necessarily negates the others. That’s what some U.S. mobile-phone operators did in the face of uncertainty about which fourth-generation network standard would prevail. Verizon, for instance, hedged its bets by experimenting with several network technologies at once. But as evidence mounted that the LTE technology favored by Nokia and others would dominate, Verizon shut down its other experiments and committed to this technology.

Create momentum. Once you’ve settled on a course, two further steps can give the final push needed to get moving: First, remember that the more uncertain things are, the more people prefer to stick with comfortable and predictable routines. Leaders need to insist on substantial, coordinated changes that depart from obsolete practices and make business-as-usual impossible. Second, they need to defang or otherwise neutralize the people who persist in resisting change.

DuPont did this in 2002, after two years of experimentation with a concept it called “knowledge-intensive growth.” It learned that the current organizational structure was hampering its ambitions and reorganized into five growth platforms while exiting profitable but slow-moving areas such as textiles. The shift to a new structure was accompanied by significant management changes, with the old guard giving way to growth-oriented leaders. Today, DuPont is thriving in emerging markets, as well as through

exciting new technologies, such as those used in optical light-emitting diodes.

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Reprint F0905A

RETAIL

Hospital Visitors Ask for More Shopping Outlets

by Andreas B. Eisingerich and Leslie Boehm

An institution that instills fear in many people seems the last place a retailer would want to open a shop, but companies that set up small outlets in hospital lobbies might be helping to create an emotional bond with consumers.

In our survey of more than 3,000 visitors and outpatients at seven hospitals in the Toronto area, seven out of 10 people indicated that the presence of businesses added great value to the hospital experience – specifically, many said they appreciated that the companies were there for customers in a time of need. Some 68% of respondents also reported that a retailer’s presence in a hospital had a positive influence on whether they would purchase from the business again at another location – and whether they would provide favorable word of mouth to relatives and friends. People in hospitals said they were interested in shopping for books, electronics, apparel, and jewelry and visiting hairdressers, banks, and grocery stores on site.

Shops benefit hospitals too, allaying visitors’ and outpatients’ anxiety and giving people something to do. The number and variety of shops was the second strongest driver (after the expertise and friendliness of staff) of consumers’ positive overall impression of hospitals and their willingness to recommend the institutions.

We found that hospital managers weren’t aware that the number and variety of shops was important to visitors. Most of the institutions we studied had only two to five shops and little variety.

Floor space is admittedly a limitation, but administrators should reimagine their lobbies as valuable tools for pleasing the thousands of people who stream through every day, and retailers should focus on unlocking the business opportunity that hospitals offer.

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Reprint F0905B

BUSINESS DEALS

Equity or Cash? The Signal Sent by the Way You Pay

by Marie E. Sushka and Ulrich Hege

It's well known that the stock market reacts more favorably if a company is bought with cash than with stock. But the opposite holds true when you buy just a business unit: It's better to pay with your equity rather than cash. Why? In simple terms, because the choice between cash and equity reveals private information that the market uses to gauge value.

In collaboration with our colleagues Stefano Lovo and Myron B. Slovin, we examined how share prices respond to announcements of intercorporate asset sales and analyzed the effects of the means of payment. We found that when the buyer paid with equity, both companies' share prices increased; in cash deals, the seller's value increased modestly while the buyer's fell slightly. By contrast, numerous studies show, when entire companies are bought, the seller's shareholders are richly rewarded in both cash and equity deals while the buyer's shares rise modestly in cash deals but fall in equity deals.

As a general rule, buyers prefer to pay with equity when they think their shares are overvalued. And sellers prefer to receive equity when they're confident that the asset in question will create value for the buyer, since the seller will have a stake in the buyer after the sale. Thus, a buyer's offer to pay with equity sends a negative signal about the buyer, but a seller's acceptance of equity signals the seller's positive private information about the asset.

In practice, asymmetric information pervades all acquisitions and is held by both sides. Sellers have private information about the value of what they are selling, while buyers know more about what potential synergies the assets may have as part of their operations.

The difference between buying an asset and buying an entire company lies in the identity of the party whose private information governs the cash-equity choice. In a merger, a buyer must make a formal offer that requires shareholders to vote. Hence it is the buyer that decides whether to offer cash or equity, and the means of payment reveals the buyer's private information. Buying assets does not involve shareholders; the seller conducts competitive auctions, which does induce potential buyers to

reveal information through their bids. But by accepting, or even soliciting, payment in buyer equity, it is the seller that conveys any positive private information it has about the quality of the deal (and vice versa when insisting on a cash deal).

Our findings have implications for other types of corporate transactions. For example, in earn-outs and in joint ventures, which often are effectively delayed-asset sales, the seller retains an interest in the cash flow

that the buyer generates after the asset is added to its existing operations. In general, when a seller retains such an equity interest, studies show, the transaction tends to generate positive share price reactions; our research explains why.

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Reprint F0905C

STRATEGY

Embrace Your Enemy

by Marcelo Bucheli and Erica Salvaj

From party leaders to people on the street, the left in Latin America tends to assume that foreign investors are allied with the right. That can create real problems for firms trying to enter markets there, because left-wing governments can place restrictions on companies they don't trust. But consider how Spanish multinationals have successfully entered Chile in recent decades. They've figured out how to turn the leftist political mood to their advantage.

During Augusto Pinochet's dictatorship in the 1970s and 1980s, the right-wing government suppressed opposition political activity and unions while embracing free-market policies and welcoming foreign investors. Naturally, the left saw foreign firms, and Chilean business generally, as allied with the regime. When Pinochet stepped down in 1990 and a center-left coalition, the Concertación, took power, the sense remained that business was in bed with the right – and indeed it was. While the boards of many important Chilean companies had influential members with right-wing ties, none had members connected with the Concertación government. The business community distrusted the Concertación and the unions, and vice versa.

Two Spanish firms – the telecom company Telefónica and the bank BBVA, which controlled the retirement fund Provida – saw a way to defuse this tension when they entered Chile in the 1990s. To the astonishment of the Chilean business community, both appointed influential Concertación members to their boards. These weren't garden-variety leftists, either. They included former Socialist Party officials who had occupied high-ranking positions in the Marxist Allende regime, which preceded Pinochet. Among them were officials who had directed the expropriation of private property during Allende's administration and activists who had been arrested or exiled to Cuba under Pinochet.

In both firms, the more politically balanced boards opened up dialogues

with the unions and the government, removing barriers to their businesses. At Telefónica, one director, a well-known former Socialist labor activist, used his political influence and appreciation of labor issues to negotiate a contentious restructuring with the unions that included layoffs. BBVA Provida, meanwhile, was up against strong opposition from left-wing politicians who objected to private control of retirements funds. By appointing a large number of Concertación members to its board, the company legitimized its participation in the sector and ended the attacks from the left.

The Spanish firms' successes eventually led some Chilean companies to shed right-wing directors and invite leftists in, balancing the mix. As the left gains power and popularity throughout Latin America, foreign investors would be wise to choose political integration rather than confrontation as they compose their boards.

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DEBRIEFINGS

To Boost Knowledge Transfer, Tell Me a Story

by Shad Morris and James B. Oldroyd

Field reports that global companies routinely ask employees to create are too often ignored by coworkers and thus of little use. But there are ways to make these internal debriefings into what they were intended to be: highly effective tools for knowledge transfer.

We studied a particularly successful program of the World Bank Group's International Finance Corporation called SmartLessons. Started in 2005 in response to a push from managers in the field, the voluntary program teaches employees how to deliver information through human stories that people can

connect with. It offers a simple guide for writing narratives to post online, as well as the services of an editor, who ensures that the articles and multimedia presentations posted on the SmartLessons site really are in story form.

We found that storytelling dramatically increased IFC employees' ability to absorb information. Here's the organization's recipe for success:

Encourage honesty. IFC, which provides investment funding and advice to emerging-market businesses, considers it a plus if the submissions include descriptions of setbacks and of the emotional impact of the knowledge gained from them. A contributor told us that under the program, "I have felt empowered to write a no-holds-barred account of lessons I learned." For example, one report says finding a management consultant in a particular locale was like "panning for gold – time consuming, generally disappointing, [but] with the odd, exceptional shining star."

Highlight contributors. The site provides biographies, which include outside interests, to help readers connect with contributors and their ideas.

Talk it up. IFC sends out daily News Flashes, summarizing stories. The pub-

licity signals that the organization values the knowledge system, and creating buzz helps boost readership and increase the flow of information.

Let users determine the value.

Readers can rate each posting by how interesting it is (not its technical perfection). Additionally, the stories are rated by a panel of judges, who award \$1,500 twice a year to the top-ranked post; the next-ranked gets \$500.

Early survey results show that more than 80% of IFC employees who read SmartLessons find them relevant. "SmartLessons are now an integral part of how I think through project design," a user told us. In an organization of some 3,225 employees, SmartLessons are being viewed an average of 1,800 times per month. And, excluding portal pages, the SmartLessons website is the most frequently visited of the 159 intranet sites that IFC tracks.

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Reprint F0905E



Conversation

Energy CEO Shai Agassi on recognizing a “sliding-doors” moment



Shai Agassi had just accepted the top job at software giant SAP when he did a U-turn, deciding to return to his entrepreneurial roots and start a venture capital-backed project to end the world's dependence on oil as a transportation fuel. Agassi, 40, has attracted substantial interest in his global vision: His company, Better Place, has raised more than \$200 million and has agreements with governments in Israel, Denmark, Australia, Hawaii, California, and Ontario to build an infrastructure of battery-exchange and recharging stations to support the mass deployment of electric vehicles. Full-scale production of electric cars by Renault-Nissan is planned for 2011.

How did you go from global corporate executive to energy entrepreneur?

I had a sliding-doors moment in 2006 – a moment when if you turned one way, your life and career would go in one direction, and if you turned another way, you would go off on a completely different track. I was in Paris, and I was pondering whether to continue on and become co-CEO at SAP. It was a job I had been groomed for, and I was ready to lead. But I was also fascinated by the idea of powering vehicles with wind- and solar-charged batteries. At that point, Better Place didn't even have a business plan – it was just an idea. And the moment could have passed me by quite easily.

I remember walking down the Champs-Élysées, so that I could think. I paced it one way, imagining myself at 50 years old having decided to stay at SAP. I imagined not only that SAP had succeeded under my leadership but that we had beaten Microsoft – we were number one. Then I walked the other way, picturing myself at 50 but having left SAP and pursued my dream. I pictured the worst-case scenario – that Better Place had been a failure. At five o'clock in the morning, after walking all night, I said to myself: “This is the sliding-doors moment, and there's no question which path I should take. I'd rather fail at Better Place than succeed at SAP because no other job could compare to trying to save the world.”

When did you come up with this business model?

At a 2005 meeting of the WEF's Forum of Young Global Leaders, Klaus Schwab, founder and executive chairman of the World Economic Forum, asked participants, “How

do you make the world a better place by 2020?” It was intended as a conversation starter, but I took it seriously.

Every night I went to Wikipedia, picked a term like “ethanol” or “natural gas,” and studied for hours. Eventually I wrote a white paper proposing a plan that relies on existing technology: cars that run on lithium-ion batteries recharged by renewable energy. Customers buy the cars and the miles, but Better Place owns the batteries (I took the idea from mobile phone companies, which charge for minutes). Battery-exchange stations would allow drivers to drop off spent batteries and get fully charged replacements in less time than it takes to fill up at the pump. They'd also be able to plug in at home and in parking lots. In places like Israel and Hawaii, which have pressing political or economic motives for ending their oil dependence, this makes perfect sense now, but in the long run, the whole world will need to switch to electric, for all the reasons we hear about so often: cost, energy security, limited oil resources, and carbon emissions reduction.

Once you had the idea, what did you do with it?

I presented my plan at a few conferences and won support from the Israeli government, which has a stated goal of being oil-free by 2020. Then I went to petroleum companies, car companies – anybody who would listen – and handed them the plan. They all said the same thing: “If it's such a great idea, why don't you do it yourself?”

I accepted that challenge, but I continue to hope that other companies will get involved. I want Better Place to attract not only investors but also imitators. If the world is to end its oil addiction, hundreds of millions of electric cars must be put on the road in the next five to eight years – if it's just 10 million, 20 million, 30 million cars, we're dead. Cars are not a niche market, and climate change will not wait for us to invent the perfect car, battery, or business model. For us, that means a global vision of people driving electric cars across not only Israel, Hawaii, Australia, and Denmark but also the rest of the United States and China. Change of that magnitude will require the efforts of many people and many companies, but we will all benefit from turning the vision of oil-free transportation into reality.

—Josette Akresh-Gonzales
Reprint F0905F

When Contracts Destroy Trust

by Deepak Malhotra

Contracts are designed to reinforce trust and reduce risk. Unfortunately, when they're too detailed or rigid, or when they send mixed signals, they can exacerbate the very problems they're supposed to prevent. At a time when trust is already in short supply, managers can't afford to make these mistakes.

Trust requires that parties see each other as ethical and well-intentioned. *Overly detailed contracts* that codify every potential interaction can undermine trust by preventing spontaneous displays of good intentions.

That's a lesson one financial services firm recently learned. Its relationship managers would complain when corporate clients asked them to instantly remedy the client's own mistakes. The managers would inform the client that, as explained in the contract, such problems take three business days to address. Inevitably, the client would plead for a quicker solution. Seeing an opportunity to increase revenues and discourage mistakes, a VP suggested that the firm offer expedited solutions for a sizable fee and put that arrangement in the contract.

To his surprise, the relationship managers unanimously opposed this idea. Why? As one manager explained: "Do you know how little relationship managing we actually do? Everything is mandated by contract! But when the contract is up for renewal, the only day the client remembers is the one when we went beyond the contract to help them." By giving managers room for such volition, he reasoned, the company would more than offset the short-term inconvenience and lost revenue with greater goodwill and loyalty.

Contracts that are too rigid can also be problematic if they lock parties into arrangements that seem like a good idea in the moment but don't allow for important adjustments as circumstances change. For example, three Harvard Business School students recently cofounded a social-networking website. At the time,

they crafted a contract indicating that the equity would be split almost equally, with slightly more going to Michael, since the venture had originally been his idea. Problems surfaced when Michael started to feel that he was doing more work than his partners and asked for a renegotiation. His cofounders didn't agree with Michael's assessment and felt that he was reneging on their contract. Was the conflict inevitable? Not if the initial agreement had been less rigid.

Parties to a contract often overestimate the level of certainty in the environment and underestimate the likelihood of a future divergence in perspectives. As a result, they include fewer contingencies than they should and are eager to finalize terms even when it would be wiser to postpone settling some matters. In this case, the partners should have waited to assign at least a portion of the equity until after their roles and contributions were clarified. Instead, even as the company's strategy evolved and the value each brought to the venture changed, the contract provided no scope for a smooth adjustment of equity – eroding trust and goodwill. Wisely structured contracts postpone agreement on terms that would be more effectively handled after more information is available, and they include contingencies commensurate with the current level of uncertainty.

Many contracts include incentives such as performance pay, earn-outs, and vesting schedules. Unfortunately, in some contexts such *incentives can signal mistrust*. Look at what happened when, after 12 years as manager of the New York Yankees – a period in which the team made the play-offs each year and won the World Series four times – Joe Torre was offered a one-year renewal. The contract lowered Torre's base pay but included a large incentive for reaching the play-offs and winning the World Series. Torre was insulted, saying the deal implied he couldn't be trusted to deliver his best effort without an incentive. He rejected the offer and joined the Los Angeles Dodgers, where he was paid less in total compensation than the Yankees had proposed as a base salary!

One way to avoid outcomes like that is to limit the use or scope of contractual incentives, especially when the target is already a very high performer or when noncontractual inducements are available (such as social or competitive pressure). Alternatively, parties can reframe an incentive as a way to "share in the value we all create when good things happen."

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Reprint F0905G





ORGANIZATIONAL CULTURE

Risk Gone Wild

by Jonathan Rosenoer and William Scherlis

In late 2007, UK government workers lost two computer discs containing personal and banking data for approximately 25 million residents, information with an estimated black-market value of \$2.5 billion. In early 2008, a failure at an outsourced data center in Denmark disrupted the operations of its clients – knocking out a major bank's ATM network and halting milk delivery across the country. Then, last September, a network failure stopped trading on the London Stock Exchange on what would have been one of the busiest days of the year.

These are all cases of what we call "technology-enabled extreme events": improbable, hard-to-foresee disasters in which IT often plays a starring role. Until recently, the risk of these large-scale events seemed infinitesimal, and so businesses paid little attention to mitigating them. But such calamities have become increasingly common, and they're all but ensured by the growing and pivotal role of IT in business.

IT used to be isolated within silos in a single company. Modern systems, however, not only interconnect all aspects of a business but often have real-time links to suppliers' and customers' systems. This opening and blurring of boundaries, while creating efficiencies and enabling new business models, allows errors to cascade across businesses and geographies, growing in impact as they spread. It can also, often unintentionally, vest small groups of employees with the power to take actions that reach far beyond their purview. When that happens, minor mistakes may instantaneously turn into catastrophes. In one recent case, a brokerage employee's honest typing error transformed a \$4 million trade into a \$4 billion trade, contributing to a 2.36% drop in the S&P 500 that day. Consider also Sony's sale of 6 million music CDs incorporating antipiracy software that inadvertently exposed consumers to hackers, resulting in an onslaught of bad publicity and lawsuits.

Standard risk-management strategies are too outmoded to help companies contain catastrophic IT-linked risks. These strategies tend to assume that the risks are well understood and that the possibility of extreme events is tiny. As

a result, organizations typically concentrate on ensuring that they have good policies and procedures for managing known risks and are using high-quality processes for creating and operating IT. But this old-fashioned focus can prevent firms from seeing new risks.

How do you identify events that, by definition, are hard to anticipate? Start by instilling from the top down an organizational culture that encourages employees to take ownership of risks and weigh their potential rewards and hazards. This means modeling risks and analyzing their business impact and, even more important, making the process integral both to corporate risk management systems and to every stage of IT system development. The culture must encourage employees to bring concerns about risk forward early, particularly when IT is being applied in new ways. That mindset was missing at Société Générale in 2007, when trading irregularities were not reported to bank management by staffers who noticed them because, as a report by the bank's own investigators noted, "This was not specifically a part of their job description." The bank later reported a \$7.3 billion loss, which was allegedly due to unauthorized trades by one employee, Jérôme Kerviel.

It's critical to make the consideration of extreme events part of the technology development process. This ensures that true risks are appropriately weighted in IT design and ROI calculations. The right culture can transform battles about risk between technology optimists and naysayers into a focused dialogue about the nature of risk and how to manage it. There are many ways to reduce and hedge IT-linked risks, and carefully developing a strategy to address those dangers at the outset can mitigate them without compromising the reward.

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Reviews

Management Rewired

Why Feedback Doesn't Work and Other Surprising Lessons from the Latest Brain Science

Charles S. Jacobs
(Portfolio, 2009)

"Many of the management practices we've taken for granted are not only ineffective," asserts consultant Charles S. Jacobs, "they actually produce the opposite of what we intend." If that doesn't make you sit up in your chair, his claim that "the latest developments in brain science are teaching us a better way to manage" surely will. Whether or not you sink back into the cushions

and drift off will depend on your willingness to suspend disbelief and let Jacobs lead you on a quirky and speculative journey.

Don't get me wrong. This is a lively and often likably eccentric book that does a solid job of surveying some sensible management practices. But in his eagerness to show how neuroscience is revolutionizing business, Jacobs mostly just reminds us that the field has yet to produce much that's practical.

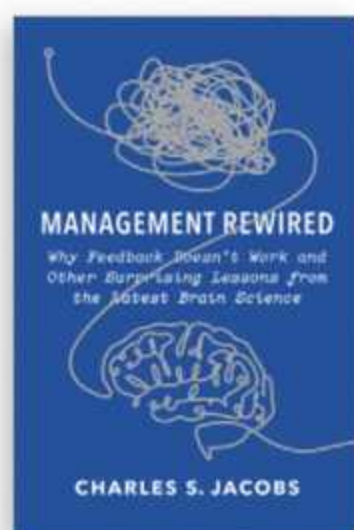
Jacobs claims that neuroscience has transformed our understanding of the way the mind works and upended our notions about reality and the nature of self. At the heart of his sprawling argument is actu-

ally a well-worn idea: that each person's mental world is subjective and that we mistake this perception for reality and assume that other people experience the world as we do. Duped by this illusion, managers think and act, and interact, as if they and their reports, colleagues, customers, and competitors inhabit a common reality. That leads to all manner of suboptimal and self-defeating behavior. Because managers fail to step out of their mental worlds and into those of their reports, for example, they dispense rewards, set objectives, give feedback, and punish poor performance in ways that often backfire. By understanding other people's perceptions and motivations, we can create better competitive strategies, build higher-performing organizations, and unleash employees' full potential.

This isn't rocket science, or even brain science. It's mostly behavioral science that's been knocking around for a while. Still, the book offers a useful refresher course. Layered among the discussions of how management thinking has changed from Machiavelli to Frederick Taylor to John Kotter, you'll find chestnuts like Milgram's shocking research on obedience, Tucker's Prisoner's Dilemma, and Damásio's stacked decks. What gives the book some zing is its unexpected turns: the author's claim "I don't exist," for example; his question "What does it mean for a dolphin to go crazy?"; the tale of the gin-and-tonic-swilling chimp; the assertion "One can envy slime mold." These sometimes goofy setups often lead to reasonable arguments. Slime mold, for instance, balances independent and collective effort and doesn't require cumbersome organizational structures to do it – collaborative perfection human organizations should aspire to.

In the end, Jacobs seems to backpedal a bit, concluding, "for all of its great discoveries and insights," neuroscience offers no better advice than to love your work and be mindful. That may not be revolutionary, but it's still good counsel.

—Gardiner Morse



Animal Spirits: How Human Psychology Drives the Economy and Why It Matters for Global Capitalism

George A. Akerlof and Robert J. Shiller
(Princeton University Press, 2009)

The severity of the downturn shocked many economists, but not Akerlof and Shiller, who had already largely prepared this book on why the standard antirecession policies can fail. They argue not just for a Keynesian approach but for Keynes's original ideas, which emphasize that all-too-human prejudices can muck up the most rational policies. As executives have always known better than economists or government officials, feelings of optimism or pessimism, notions of "fair" wages and prices, and other nonrational factors do a lot to drive decision making. Unfortunately the book's remedies for recessions are still bluntly rational: an immense fiscal stimulus and aggressive investment in banks and lending. We need a follow-up book to explain what indirect or symbolic measures governments (and executives) can take to turn animal spirits from fear to hope.

Ecological Intelligence: How Knowing the Hidden Impacts of What We Buy Can Change Everything

Daniel Goleman
(Doubleday, 2009)

Most executives are familiar with value chain analysis. They may soon become equally aware of life cycle analysis, the study of how products interact with the natural world. Seemingly "green" cotton grocery bags, for example, still take a heavy toll on the environment. Goleman, the prominent author of books on emotional capabilities, urges us to cultivate not just a deep understanding of products' impact but also deep feelings for nonhuman life. He doesn't explain how we can nurture such ecological intelligence while maintaining the psychic distance from the natural world that has led us to wonderfully bountiful technologies. We're still far from a truly bio-empathic approach to economic development.

—John T. Landry

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BY SAMUEL Z. GOLDHABER, MD

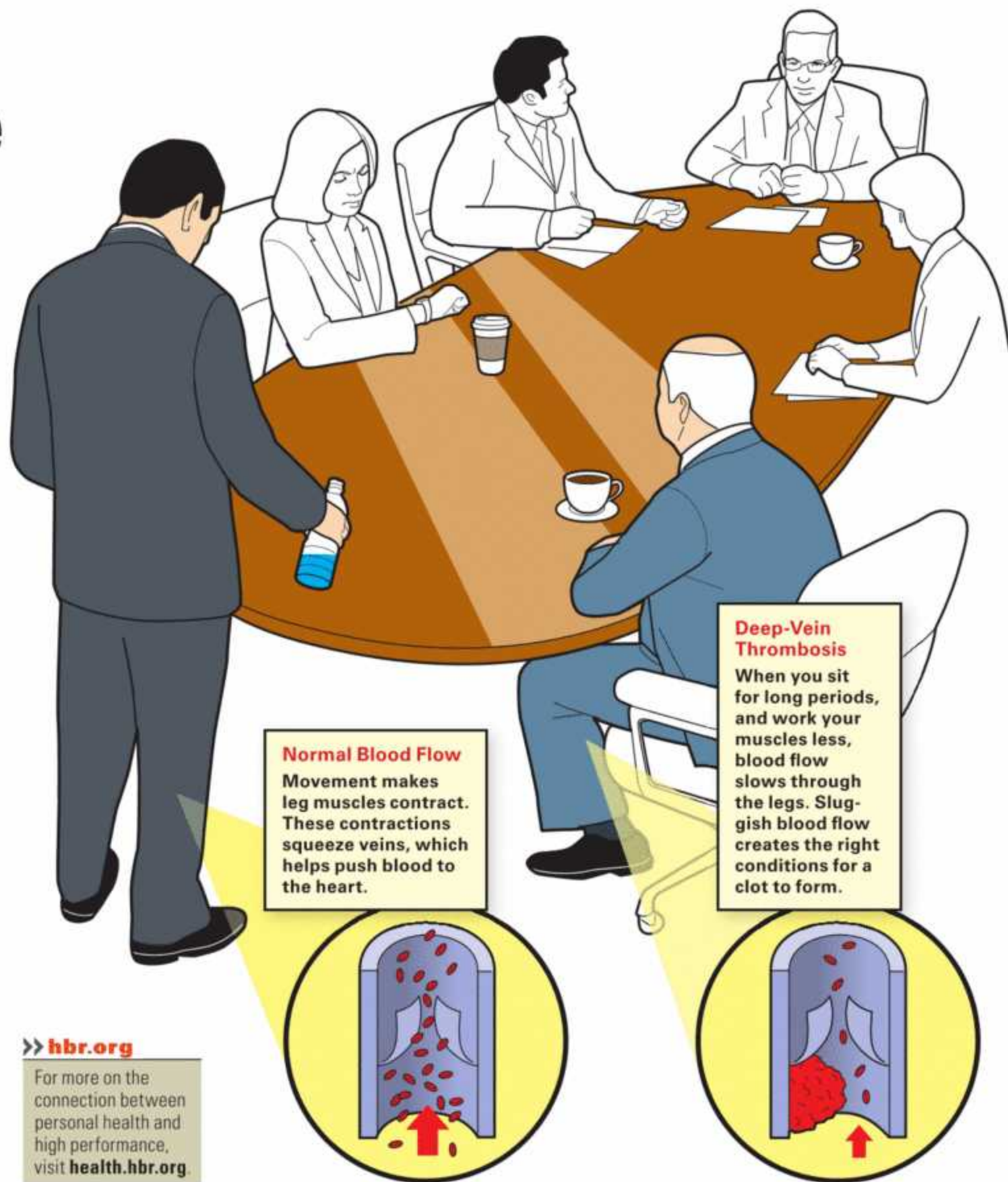
Do Take That Break

TENSE NEGOTIATIONS have been under way for three hours without a break, and they aren't over by a long shot. By the end of the day, after factoring in your commute, you'll have been sitting for a dozen hours with hardly any chance to move around. This amount of immobility can set the stage for a blood clot to form in a vein deep in the leg – a deep-vein thrombosis (DVT).

Most people think of DVT as a risk associated with long flights. But a new study from Wellington Hospital in New Zealand places the problem in the workplace, too. It found that employees who sat for several hours without getting up – at a meeting, say, or even at their desks – were more likely to develop DVT than those who moved about more often.

This doesn't mean an epidemic of DVT in the workplace, but it does raise a concern for those predisposed to the condition – for example, people who frequently take long trips (eight hours or more), are advanced in age, have recently had surgery, are overweight, or have a clotting disorder or cancer. DVT afflicts up to 600,000 Americans a year.

Samuel Z. Goldhaber is a professor of medicine at Harvard Medical School and the director of the Venous Thromboembolism Research Group at Brigham and Women's Hospital in Boston. This article was created in partnership with Harvard Health Publications. Reprint R0905A



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SYMPTOMS

DVT feels like a pulled muscle or charley horse. It usually intensifies over several days and can be accompanied by swelling in the leg or a reddening of the skin.

PREVENTION

Movement is the best antidote. Stand up and walk around to rev up blood flow through your legs. If you're in charge of a meeting, schedule a break every 90 minutes or so. If you're trapped in a meeting, try heel and toe lifts at your chair. And drink plenty of water – dehydration thickens the blood.

WORST-CASE SCENARIO

A pulmonary embolism (PE) occurs when a piece of a clot breaks away and blocks blood flow to the lungs. Along with DVTs, PEs kill as many as 180,000 Americans each year, more than the number that die from breast, prostate, colon, and skin cancers combined.

Jason Lee

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from the article

FIXING HEALTH CARE FROM THE INSIDE, TODAY

As many as 98,000 people die each year in U.S. hospitals from medical error, according to studies reviewed by the Institute of Medicine. Other studies indicate that nearly as many succumb to hospital-acquired infections. The Centers for Disease Control and Prevention estimates that for each person who dies from an error or infection, five to ten others suffer a nonfatal infection. With approximately 33.6 million hospitalizations in the United States each year, that means as many as 88 people out of every 1,000 will suffer injury or illness as a consequence of treatment, and perhaps six of them will die as a result.

from the article

SAVING MONEY, SAVING LIVES

A sense of mission, of course, is critical to any organization's identity. The institutional mission of a hospital is to promote the health of the community. But during difficult periods, it's easy to lose sight of the big picture. Cost cutting in a vacuum traumatizes patients, frustrates clinicians, and ultimately cripples the hospital's mission.

from the article

WHEN YOUR CARE INVOLVES A HOSPITALIST

Hospitalism is the fastest-growing medical specialty in the United States. According to a survey by the Society of Hospital Medicine, the number of hospitalists has grown from about 800 in the mid-1990s to more than 15,000 in 2006. Demand for this specialty was initially fueled by managed care efforts to bolster efficiency, cut costs, and improve care. Today, patients admitted to the hospital tend to be more severely ill. Hospital-based doctors can better attend to such patients, respond to their problems, and navigate hospitals' increasingly complex systems.

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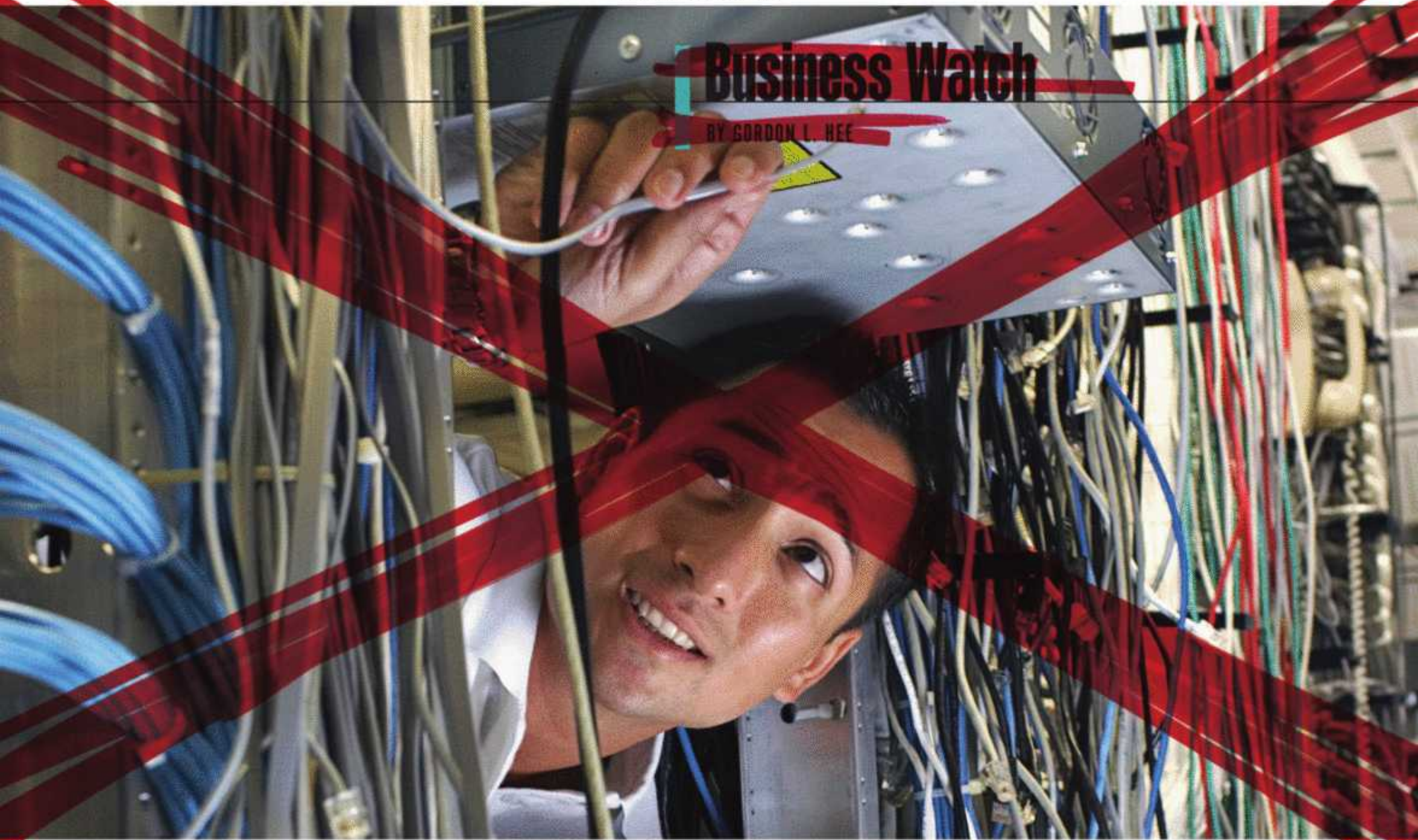


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Business Watch

BY GORDON L. HEE



When profits are scarce, loading up on servers is still the way to go.

Microsoft

When it comes to business these days, many companies are saying the more servers you have, the better off you are. The conventional wisdom is reflected in a comment overheard at a recent CEO luncheon, "Look, it's not that difficult of a thing to understand. The more servers you have, the more computing power you have, the more data you have, the more you get done. And in today's economy one thing is certain. You need to get things done. Everybody's trying to figure this whole thing out. And you can't do that without more, right?"

With business conditions looking increasingly grim, many people look at servers as one thing they can't have too many of. Says one CEO, "I really don't know how many servers we have, but we have a lot. In every department, in every office, in every country. I keep my people happy

by making sure they've got servers. That's the way I serve the company and the shareholders. And we've got to keep them happy. What keeps me up at night is that I might not have enough servers."

IT, already overburdened, keeps getting called upon to do the heavy lifting. The emphasis on having more servers everywhere is giving way to a new syndrome within the IT community, "Server Fatigue." According to one employee, "None of the IT people I know have much time to deal with the downturn at the moment. They're all busy putting out fires, bringing up servers, doing systems maintenance and upgrades, which means they don't have time to think about company performance or the terrible news that comes in every day. Which in the long run is a good thing, more or less. Don't you think?"



BY JOHN HUMPHREYS, ZAFAR U. AHMED,
AND MILDRED PRYOR

COMMENTARY BY KIRK O. HANSON,
DON PEPPERS AND MARTHA ROGERS,
AND JAMES BORG

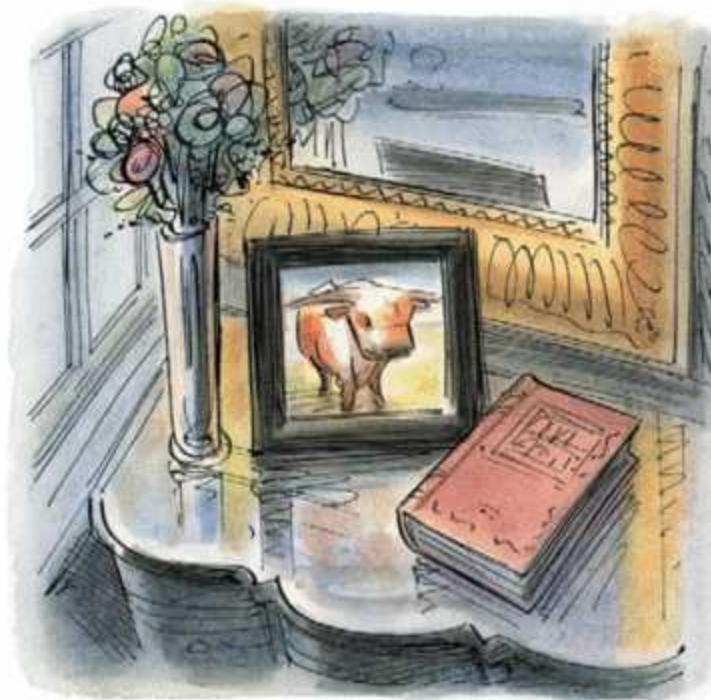
World-Class Bull

Inspired sales ploy or ethical breach?

"YOU'VE GOT TO be kidding me, Sam," Jeremy sputtered. "Chris brought in the single biggest piece of business we've won here in more than two years. He's our top performer! He broke that logjam with Armadillo! He was absolutely brilliant!"

From the window of his 10th-floor office at Specialty Fleet Services, sales vice president Jeremy Silva spied two of the bright yellow repair trucks of Armadillo Gas & Power a block away, flanking a rectangular gash in South Polk near the old Paramount building. Getting Armadillo's lucrative fleet-management business had been a long, hard slog. Had it not been for the fiendishly clever machinations of sales ninja Christopher Knox (known as "Fort" to his colleagues, because of his golden touch), SFS would still be trying to dent Armadillo's famously resistant armor. And now, to Jeremy's amazement, human resources vice president Samantha Williams was informing him that she wanted to reprimand Knox for a breach of the SFS code of ethics.

"If 'brilliant' is a synonym for 'devious,' maybe so," said Sam, eyebrows raised. Sam was Jeremy's friend and frequent ally, having helped him push through a reorganization of the sales force, including new incentive and commission structures. But she was also currently the chair of SFS's ethics review board.



"An ethics breach is an ethics breach. As our code states, 'deceptive business practices' are unethical. There have to be consequences. And *you*, of all people, should know that."

True enough, Jeremy thought. When he had arrived at SFS five years ago, on the heels of an embarrassing kickback scandal, Jeremy had been a driving force behind creating the corporate code of ethics. And now it was being wielded against his star sales animal, Fort Knox. How had it come to this?

One Tough Customer

Six months earlier, regional sales manager Will Meyers had returned from yet another frustrating visit with Armadillo's CFO, Dale Landry. "I just never get any closer," he said with a sigh, collapsing into a booth with Jeremy and Fort, who were already digging into a late lunch at Texas Two-Step, Amarillo's leading shrine to barbecue. Will was going to make them listen to him vent no matter what, and Jeremy got him going.

"So, Dale didn't like the FleetNet demo?"

"He sat and watched, didn't ask a single question, and shrugged when it was over," Will grumbled.

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

FleetNet was SFS's new online system for providing customized support to clients. Using GPS-enabled modules installed in every vehicle, the system tracked location, miles traveled, fuel efficiency, and the driver's behavior (speed, jackrabbit starts, hard stops, and so on) in real time. It also compiled maintenance and accident records, and tracked the cost of upkeep and repair for every vehicle a customer owned or leased, the vehicle's up-to-the-minute resale value, and countless other data points of vital interest to clients'

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fleet managers. It was consequently a thorn in Will's side that even though Armadillo's fleet manager was enthusiastic about FleetNet, he had to defer to Dale Landry, the only person authorized to pull the trigger on a change in the company's fleet-service providers.

"Worst thing is Dale's always encouraging me to drop by to make another pitch," Will complained. "I think he's kinda sadistic."

Chris Knox licked barbeque sauce off his fingers. "Dale Landry...isn't he

the guy with the hobby ranch by Palo Duro?"

"Yeah, I think that's him," Will said. "Only time he shows signs of life is when he's talking about his bull. He said he showed it down in Lubbock last weekend, and it won some kind of a ribbon. Whoop-de-freakin'-do."

Fort nodded and stared at the pile of bones on his plate. "Would you mind if I took a run at the guy? I think maybe I can get his attention."

Will looked over at Jeremy, and Jeremy shrugged. "At this point, we've got nothing to lose, right?"

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The Benefits of Beefing Up Servers

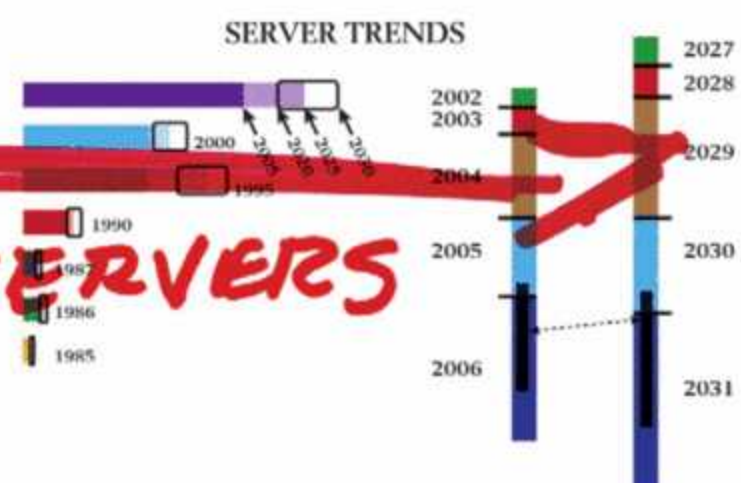
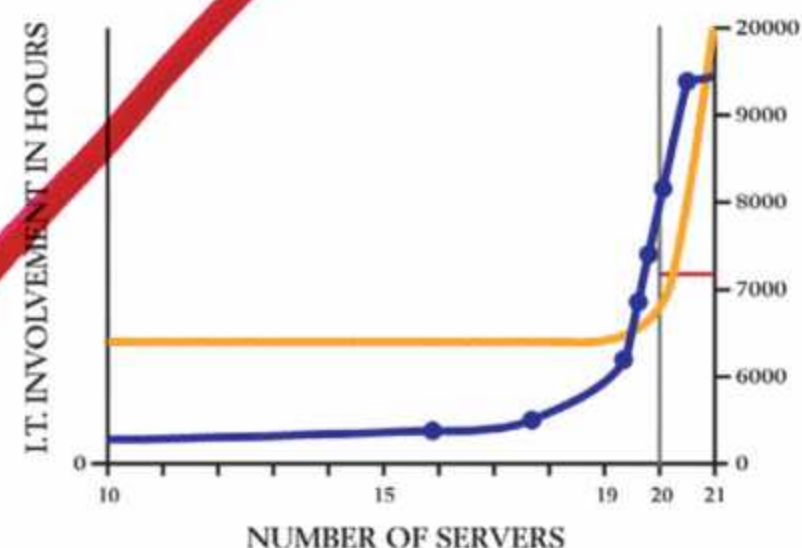
When it comes to servers, Ken the IT guy knows how to handle things. "It's important that you've got a separate server for every different process. Ideally, we'd have a separate server for every single department. It makes our job about a thousand times harder, but I'm pretty sure that more servers means more power. And more power means you get more done. At least that's what we're banking on."

It seems many companies are following Ken's lead these days, which is to say they're spending more time fixing servers than solving problems. Indeed, running around and having to maintain servers all day long has become the bane of Ken's department. "Frankly, it's kind of a nightmare, when you think about it. But that's just how we do things around here, I guess."

And while business may not exactly be booming, managing resources and reacting quickly to problems aren't a concern for the company. "We've got bigger fish to fry with all these server issues we have. Look, we've got a lot of computers around here. And we're counting on those computers to help us get more done. Everything else should work itself out. If not, well, then I guess we've got problems. But we'll cross that bridge when we get to it."

Thanks to the high maintenance costs and licensing fees, many poor performers seem to

be on track with the lack of growth enjoyed prior to these troubling times. "I'm not sure the economy makes much difference. Things have been this way around here for a long, long time. It might not be the smartest way, but it's our way. And now's no time to change what we've been doing or haven't been doing. Stay the course, that's our motto. Sure, we could probably be doing a lot more. But we could be doing a lot less, too."



"Nope," Will agreed. "I've done everything I can think of. It's time for someone else to try."

"The commission'd be all yours," Fort offered.

"Nah," Will said. "It'll take Armageddon to land Armadillo. If you pull it off, you'll have earned the commission – and you're welcome to it."

"The two of you will split it," Jeremy said. "Fair's fair."

Bull Artist

Fort did his research. Dale and Carol Landry had inherited their small but picturesque ranch (which Dale, being a CFO, would have admitted was the size of a rounding error compared with some of the far bigger spreads nearby). The Landrys had a small herd of longhorn cattle and, indeed, one bull in particular that they were bumper-sticker proud of – as in, "My Bull's Smarter than Your Honor Student."

Fort drove down to the Landry ranch on a Saturday morning. He'd planned

want you to think I was up to anything fishy."

"By all means," she said. "My husband and I are very proud of Big Buddy. He's won numerous awards." Fort could almost swear that Carol Landry blushed. He thanked her, excused himself, walked back down the fence line to where the bull was standing, took a dozen digital photos, and then went on his way.

On the long drive back to town, Fort stopped by a bridge over a modest brook that ran along the edge of some woods. He watched the water sluice over colorful stones. It was hypnotic and serene, belying the restive forces at play beneath the surface.

Taking the Bait

"Hi there, remember me?" Fort inquired in a playful tone. Carol Landry did indeed remember the polite young man who had asked to take pictures of Big Buddy. She invited him in. It had been a couple of weeks since their first encounter, and Fort had a surprise for the

"I wouldn't want you to think I was up to anything fishy."

for the encounter to seem like a happy accident. As he turned up the winding drive to the residence, he saw an enormous longhorn bull standing by the fence, aloof from the herd. "If pursuing Dale Landry hasn't worked," he thought, "let's see if I can get him to chase me."

Knocking at the front door, Fort was in chess-player mode, thinking several moves ahead. Carol Landry answered the door. The game was on.

"Hi, there," Fort offered cheerfully, his bright smile and personality on full display as the two introduced themselves. "I hate to bother you, but I was passing by and caught sight of that big bull of yours. If you wouldn't mind, I'd like to take some pictures of him. He's pretty amazing." Then he added, "I always believe it's best to ask permission – I wouldn't

Landrys. He handed Carol Landry an elegantly framed photo of the impressive bovine.

"The pictures turned out so well, I thought you might like to have one," he said, beaming. In truth, Fort was an above-average amateur photographer. Even if it hadn't been part of his scheme, he would have been proud of the photo, the way he'd captured something essential about the subject – an impassive stubbornness, black eyes like glass. Fort's pleasure with the print radiated to Carol. "Wow, it's just magnificent, Mr. Knox!" she exclaimed.

"Please. Call me Chris."


She angled the photo on an entry table beside a leather-bound biography of the British explorer Henry Stanley. She continued to thank him as he grinned

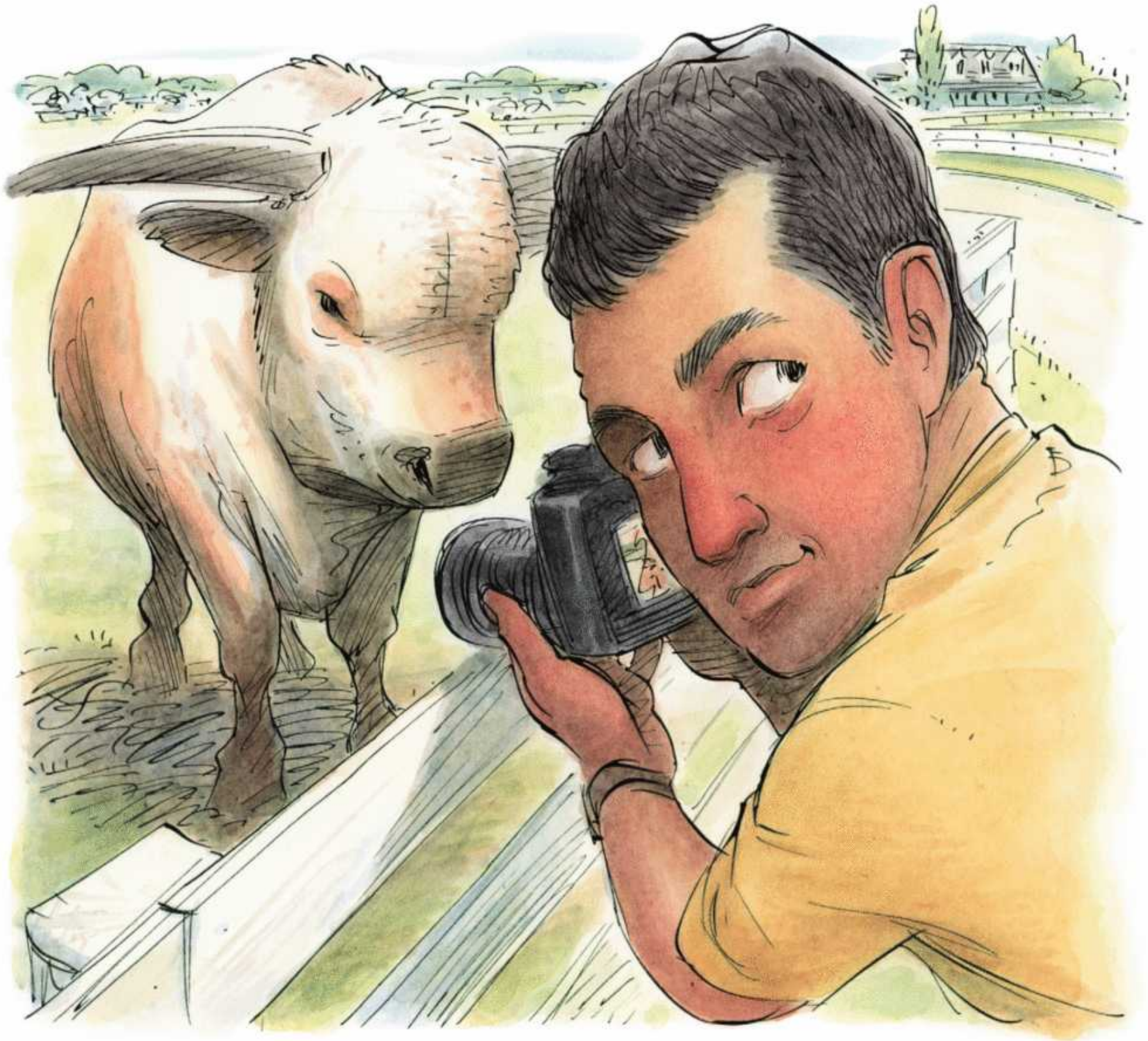
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and made his getaway. But he wouldn't be gone for long.

As Fort headed back down the road, away from the Landry ranch, a car came toward him over a rise. Behind the wheel he saw the impassive face of Dale Landry, full of chiseled concentration, entirely unsuspecting. (Of course, Fort had Googled Dale and Big Buddy and had found a number of photos of the two of them posed together, Big Buddy looking utterly indifferent to the ribbons in which, judging by the size of his grin, Dale was taking such pleasure.) Fort noted the make and model of the

car (Cadillac Escalade) so that he could ensure that Dale would be home for his next "spontaneous" visit.

He let three weeks pass – three weeks during which Dale Landry would see and appreciate daily the artful portrait of his beloved Big Buddy and would hear from his wife (more than once, Fort was certain) about the polite, thoughtful, generous young man who had taken the picture and had it framed for them. Time was his ally. It would be foolish to betray any eagerness. Like rich tea, the ingredients of Fort's strategy needed to steep.

Springing the Trap

By the time of his next visit, Fort could barely refrain from congratulating himself as the Landrys' driveway came into view. He was brilliant! He was positively clairvoyant! During the intervening weeks, through "casual observation" (a term he preferred to "surveillance") Fort had discovered that Dale Landry typically came home by noon on Fridays. "Bingo!" Fort said to himself. Not only was Dale's Escalade parked in front of the house, but he and Carol were outside, each brushing one of Big Buddy's hefty flanks.

"Dr. Landry, I presume?" Fort said, echoing, in a feeble British accent, Henry Stanley's famous salutation upon finding the elusive Dr. Livingstone.

"That's me," said CFO Landry.

"Dale," said Carol Landry, "this is Chris, the nice man who brought us that wonderful picture of Big Buddy." Then, turning to Fort, she said, "I'm very sorry to say I've forgotten your last name!"

"Knox. Chris Knox, Mr. Landry." They shook hands.

"Well, Chris Knox, I'm real glad to be here to meet you. We truly do love the picture you took. This old bull is almost like family. So, thank you very much."

At Carol's insistence, they went inside for iced tea. "So, tell me, Chris, what do you do besides photographing large farm animals?" Dale asked. Fort told Dale that he worked in sales for Specialty Fleet Services.

"Really?" Dale exclaimed. "That's a heckuva coincidence. I'm with Armadillo Gas & Power, and you folks have been chasing my business for years." After explaining that he worked a different territory, Fort offered a morsel. "We provide our customers with lots of data, very customized. Because of that we tend to focus on really large accounts. I'm not that familiar with Armadillo Gas, but maybe you don't need the high level of service we offer. Maybe we're a little more expensive than what you've got now."

Fort noted the slight flaring of Dale's nostrils – so interesting how people really do start to look like their pets. "Well, I gotta run," he said. "But, hey, I'm real glad you liked the photo." He drained his iced tea, said his thank-yous, and left.

Dale Landry called first thing Monday morning – just as Fort figured he would. But Fort didn't return the call. Instead, that Friday, he brought the Landrys a calendar with photos of prize longhorns. "This is so beautiful," Carol said. But Dale seemed preoccupied, mostly asking Fort questions about "this online service-net thing you do."

Fort also engineered a couple of other encounters (too many might have

aroused suspicion). Camera in hand, he ran into Dale Landry at a livestock auction one beautiful Saturday morning. And in the middle of the following week, Fort went to watch his nephew play a Little League game, and there was Dale, watching his own kid – Dale, Jr. (nicknamed Little Buddy!) – play second base for the other team.

Every time he spoke with Fort, Dale seemed more agitated and more curious about SFS. Fort tried hard to contain himself. He couldn't help thinking that Dale Landry was so accustomed to being pursued that he seemed kind of lame as a pursuer. Fort was invariably nonchalant, often redirecting their conversation away from business, as though that was the last thing on his mind.

"Look," said Sam Williams, holding up a printout of Jeremy's e-mail in praise of Fort's tactics, "what if somebody sent this over to Landry? How do you think he would feel about SFS? He'd feel like we made a fool of him – and his wife! And he'd be right! So, I think we have to ask ourselves, as an organization, when does a so-called smart sales strategy cross the line to become deceitful? Does this sort of thing put our relationships with clients at risk? Does it damage our reputation? The code requires us to deal honestly with customers and other stakeholders. Is this honest?"

Jeremy sputtered, "Where's the harm? Nobody got cheated. Nobody paid a kickback. Armadillo is getting a *better* service than it had before. And Fort

■ "Where's the harm? Nobody got cheated. Nobody paid a kickback."

On a day when Dale had left two messages before lunch and one after, Fort figured it was time to call back. He'd barely gotten out "Hey, Dale" when the Armadillo CFO cut him off. "I'd like to see that demo again," he said. "Can you and Will Meyers come over here sometime tomorrow and run me through it?"

Time to Cut the Bull?

It was a happy day when Armadillo signed its contract with SFS. So pleased was Jeremy Silva with Fort's performance that he sent an e-mail to the entire sales team (subject line: "world-class bull") describing Fort's every maneuver. Jeremy wisely credited Will with having paved the way for what Fort finally achieved, making it easy for Will to be gracious toward his cocky colleague.

But some at SFS were less delighted than Jeremy and his team. Copies of Jeremy's e-mail made their way through the company and, eventually, to the ethics review board. Now Jeremy was forced to defend Fort from the very ethics process he had initiated.

didn't violate a *single item* in our ethics code. When all this happened, Landry wasn't even a customer of SFS!"

"Technically speaking, maybe not," Sam said. "But the story of what Fort did is now an official source of motivation for our sales force. God forbid, but will people be out in the field trying to top him? The whole thing has me thinking that maybe the code of ethics has a blind spot in it."

Does the SFS sales team deserve an ethics reprimand or a clean bill of health? Four commentators offer expert advice.

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WHEN I was young, my father, a lifelong sales executive, proudly showed me his three-by-five card file, a rich trove of personal facts about each of his prospects: their children, their hobbies, their illnesses. "In the end," he told me, "people buy from their friends." He would spend a portion of every sales call asking about customers' personal lives. He took them to baseball games and helped them find the best summer camps for their children. He became their friend. And boy, did he sell!

In the SFS case, "Fort" Knox raised the "friendship strategy" to high art while, in my estimation, crossing several ethical lines along the way. I side with Samantha Williams on this one. Fort should have his hand, and probably his face, slapped publicly. However, I think Jeremy Silva deserves even greater opprobrium for his e-mail in praise of Fort. But more about that in a moment.

I believe it's permissible, even desirable, to share interests and passions with a prospect. ("I have always wanted to know more about bull semen. Tell me about it.") Where Fort went astray was in deceiving Dale and Carol Landry about why he was photographing Big Buddy. Such behavior would have been

and did not evaporate once the sales contract was signed. Likewise, he could participate in activities that would bring him in contact with the Landrys as long as his interest was somewhat sincere. One of the salesperson's most ecstatic moments, of course, is to find that a longtime friend has suddenly become a sales prospect.

I'm never surprised when salespeople like Fort push the envelope of acceptable behavior. They get paid – and paid well – for making sales. The incentive structure, particularly in a time of recession, makes this an unavoidable ethical hazard and a prime ethical risk for many kinds of companies.

What appalls me is Jeremy's behavior. His e-mail shows that he doesn't understand that such risks must be managed. By baldly describing and praising Fort's deception, Jeremy has jeopardized the company. In an era of blogs and forwarded e-mail, there's a good chance his will be posted on a sales blog or sent to Dale. Can you imagine his bull rage on reading it? He might launch a vendetta against SFS, damaging its sales for years to come.

Moreover, as Samantha warns, Jeremy's e-mail encourages every SFS salesperson to

Fort crossed an ethical line by intruding into the Landrys' private lives.

borderline if he "ran into" them at a bull exhibition, but Fort crossed an ethical line by intruding into the Landrys' private lives. His repeated violation of their personal space makes the deception particularly distasteful and objectionable.

How far can you go in developing a common interest with a prospect? The ethical principle here is from Immanuel Kant: It is improper to treat an individual merely as a means to an end. A salesperson cannot feign an interest or manipulate a prospect just to get the sale. If Dale or Carol were involved in a charity, Fort could volunteer for it or contribute to it as long as his altruism was genuine

try to top Fort's ruse. Deceptive strategies will inevitably erupt elsewhere until there is a public airing of the company's manipulative behavior. Jeremy's kind of "praise" has done significant damage in several well-known cases. For example, in the early 1980s, after top managers at E.F. Hutton praised a branch for its creative new ways of managing cash flow, check kiting spread across many of the brokerage firm's branches. Hutton never recovered from the scandal.

I think Sam and the ethics board should publicly reprimand Fort. Jeremy's e-mail has made that necessary. I doubt Jeremy is salvageable.

Deception is never allowed in a customer relationship.

FORT'S ACTIONS were unethical. Aggressive sales tactics are often celebrated, as they should be. But deceiving a current or prospective customer is always unethical. Period, case closed.

Don't get us wrong: Secrets and deception are a necessary part of business competition. No business would want competitors to know the truth about its strategic plans, for instance, and outright deception of competitors is completely ethical in many circumstances. But there's a big difference between deceiving to compete more effectively and deceiving to trick a particular customer.

Our plain-and-simple rule for avoiding this kind of lapse? *Deception is never allowed in a customer relationship.* Any company that hopes to build long-term value for shareholders has to earn its customers' trust. A con man can nearly always make money on a one-off deal. But only a trusted adviser can succeed with a customer over time.

It shouldn't have taken a visit from Samantha to make Jeremy realize that circulating a description of Fort's sales conquest, including all the little deceptions he perpetrated, was highly irresponsible. When that e-mail comes to Dale's attention – and eventually it will – SFS will be embarrassed and wounded. By hitting the "send" button, Jeremy demonstrated that he does not understand the policies and behaviors that build long-term shareholder value. By itself, Jeremy's e-mail reduced the value of the company.

Ironically, had Fort used what he already knew about Dale in a completely ethical, forthright way, he would have been nearly as effective at winning Armadillo's business in the short term and far more effective at not losing it in the long term – which may well happen.

There's nothing wrong with a salesperson's cultivating an interest in bulls or ranches or cattle shows in order to forge a bond with a prospect. Fort could have invited the Landrys

to be his guest in the SFS box at the Amarillo rodeo. He could have introduced himself to Dale – immediately disclosing his position at SFS – and asked permission to take a picture of the prize bull for his own photography collection (later sharing the photo with the Landrys). And arranging to run into Dale at the local Little League field was completely legitimate.

Because of the short-term bias built into the structure of most sales commissions and incentives, great sales personalities like Fort will always be tempted to resort to subterfuge and tricks. The immediate reward is certain, and the long-term consequences probably aren't even tracked. But what kind of future can SFS possibly have with Dale? After the subterfuge is revealed, how will any SFS manager look someone from Armadillo in the eye and even pretend to offer trustworthy advice?

The CEO of SFS should immediately fire Jeremy, discipline Fort, send an e-mail to all employees firmly asserting that deceiving customers or prospects is not the SFS way of doing business, rewrite the ethics code to specify that "deceiving a customer or prospect is always a violation of company policy," and meet personally with Dale to let him know what has happened (before he hears about it from others).

At this meeting, the CEO should tell Dale everything SFS is doing to make sure that this kind of deception doesn't happen again and offer to release Armadillo from the contract and to refund any setup costs already incurred. If the CEO is sincere in his apology, perhaps Armadillo's business can be saved (although that should not be the objective of the meeting).

SFS should pledge never again to initiate a faux relationship but instead to forge genuine, trusting, collaborative relationships that benefit customers and SFS alike.



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LIKE HIM or not, you have to acknowledge the style of the man with the Midas touch. Although Fort's methods may look shady, he certainly achieved a positive outcome – one that satisfied both parties.

At first glance, some people might conclude that this was not an admirable display of persuasive technique but rather the darker side of manipulation. Indeed, many people confuse persuasion with manipulation because they have never considered the difference between the two. Persuasion is all about

a customer of Specialty Fleet Services was an especially good move, helping Fort turn Dale from quarry into pursuer. Fort's failure to return Dale's phone calls troubled me a bit, because it undercut the polite, thoughtful nature that he had taken the trouble to establish (and that was so prized by Carol Landry). But he redeemed himself by showing up at the Landrys' house with yet another present.

Fort pursued a strategy of reciprocity to good effect: I give you something; you may give me something back. What did Fort want

Fort simply got Dale's attention and let his persuasive skills do the rest.


relationships and, therefore, the long term. If the outcome is not pleasing to both parties, the relationship eventually crumbles. Manipulation aims to satisfy the needs and wishes of only one party, with no regard for – and often at the expense of – the other.

The tactics that the "brilliant" Mr. Knox employed are carried out, to varying degrees, by sales reps and businesspeople on a daily basis. It's just that we don't often hear about them. Sales professionals are, by nature, particularly creative in the pursuit of results. Bear in mind that they experience more callous rejection in a fortnight than most of us do in a very bad year. Keeping one's ego intact can be a challenge. In most companies, stars like Fort come with certain idiosyncrasies that are tolerated when they accompany above-average success. Our man Knox used his special skills to strike up a rapport, in the first instance, with Dale's wife; then he ended up with the holy grail – a strong third-party referral by the time he engineered the first meeting with her husband. The salesperson's dream!

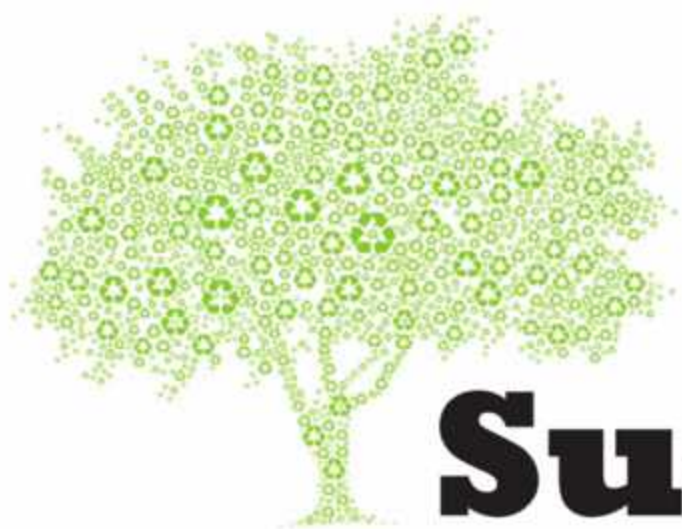
Having established a relationship – something his predecessor, Will Meyers, failed to do – Fort then played on Dale's ego-driven nature through a combination of logic and emotion, eventually enticing him to take the bait. Challenging Armadillo's suitability to become

in return for the photo of Big Buddy? An audience with Dale. That's what he got. He didn't coerce Landry into considering the services of SFS. He simply got Dale's attention and let his persuasive skills do the rest. There is a clear difference between persuasion and coercion, and Knox didn't cross that line.

Should Fort be hauled in front of an ethics board? I say let him off with a warning that focuses on his having concealed from Dale the knowledge of Dale's position at Armadillo. But given that this sort of thing happens often enough in business and that the client was enticed to buy, as opposed to needing to be sold (an essential requirement for ego-driven people like Dale), I'm comforted by the fact that both parties ended up with something valuable. Dale got an arguably superior product for his company, and SFS got a solid new customer.

As for Jeremy, he should be hauled in front of the company's Idiocy Review Board for sending an ill-advised, potentially damaging e-mail. Some best practices are better left to oral history. 

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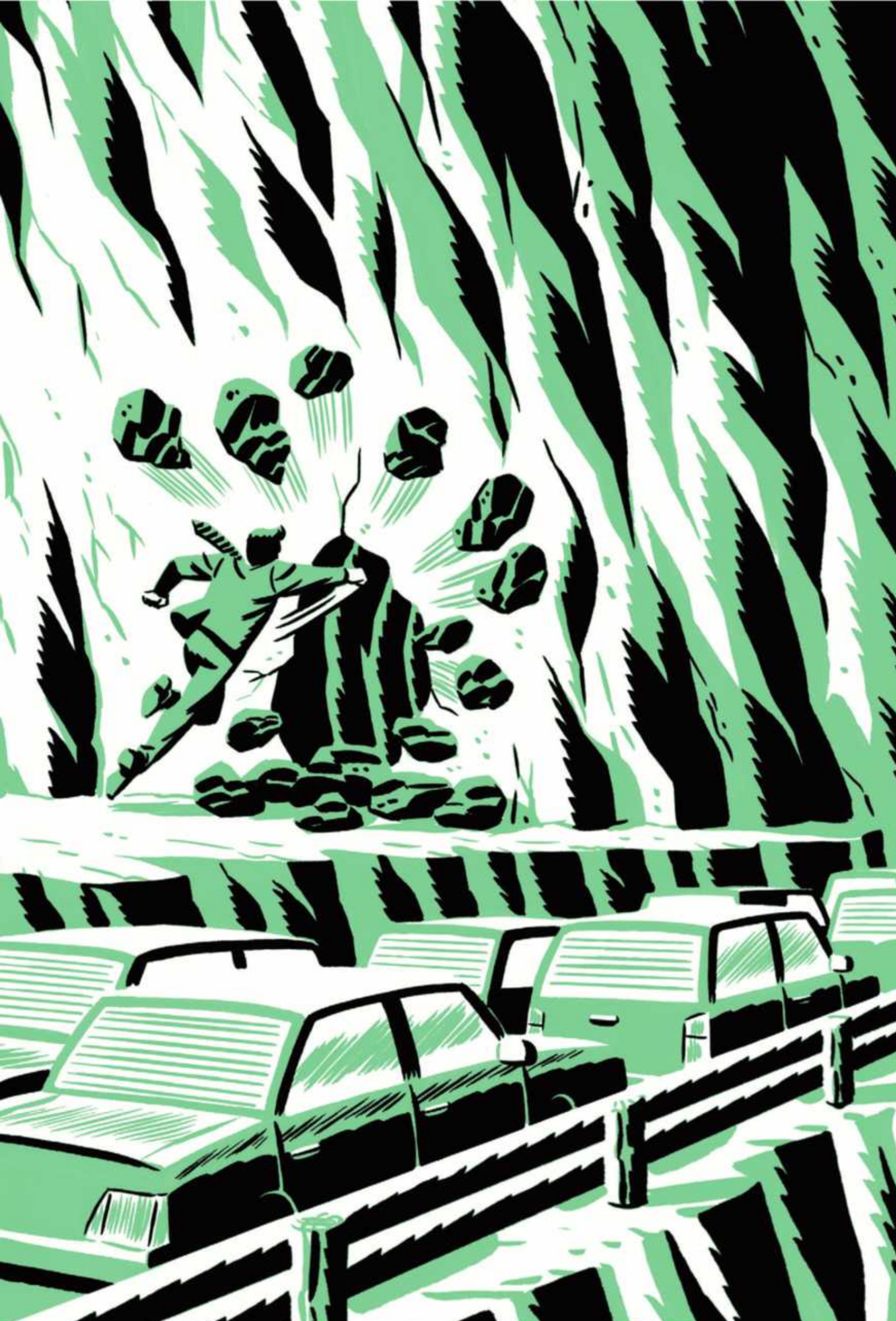
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The Right Way to Close an Operation

It pays to go the extra mile for employees, customers, and suppliers.

AS THE RECESSION has intensified its grip on the world, and I've watched companies resort to extreme actions to weather the storm, it has struck me that this is a new experience for a whole generation of leaders. Many managers have never had to shrink their operations or workforces drastically, and as a result they are making a common mistake. They assume that they have to be the tough guys who make the decisions and that afterward they can delegate the implementation to others with one marching order: "Go fast!"

This approach makes no sense. It can destroy shareholder value. In my more than 35 years in industry, much of it in turnaround situations, I've come to believe that leaders have to use "soft hands" as well as "hard hands" to be successful. Yes, they must be decisive – they can't shy away from making the call to close or shrink an operation.

But they must also be heavily engaged in ensuring that employees, customers, suppliers, and communities are treated with consideration and compassion.

Morality aside, such behavior is good business. All too often the negative impact of a closure on the surviving business is underestimated. If employees who lose their jobs are treated impersonally, unfairly, or without respect, the productivity and loyalty of their remaining colleagues will suffer. Recruiting new talent will be more difficult. And customers and suppliers that feel burned by a shutdown may retaliate against the rest of the company by diverting business to competitors. How leaders can avoid, or at least greatly minimize, these repercussions is the subject of this article.

Unfortunately, I've been involved in many cutbacks and closures – at Corning, where I spent most of my career; at Quest Diagnostics, a medical testing business I headed; and most recently at Kohlberg Kravis Roberts, the private equity firm where I've been actively involved with Masonite International, a door manufacturer, and Accellent, a supplier of precision components for medical devices. Those experiences taught me the right way to close an operation.

Learning by Doing

Before I tell you the details of my approach, let me give you some background about how I've come to feel the way I do.

In 1972 I joined what was then Corning Glass Works as an internal auditor right after graduating from Bucknell. In August 1975 I was on leave, earning an MBA at Harvard Business School and working in the summer at a Corning operation in Medfield, Massachusetts, when the company announced the largest layoff in its nearly 125-year history. Almost 25% of Corning's managers were victims of the "Guns of August," as it was dubbed. My wife and I had friends of all ages who were affected.

Corning had been a paternalistic company, and the cuts marked a radical departure. Their very magnitude

IDEA IN BRIEF

- **When you're closing or shrinking an operation, you've got to be a tough guy, right? Making the hard decision and then getting on with it in order to reap the maximum savings is what matters, isn't it?**
- **This conventional approach may please Wall Street, but as Kenneth W. Freeman learned from his experiences at Corning, Quest Diagnostics, Masonite International, and Accellent, it can alienate surviving employees, anger customers and suppliers, and destroy shareholder value.**
- **A better way is to treat these important constituents with consideration and compassion and manage the shutdown like a complex project. When the medical components maker Accellent shut its Memphis plant, in 2008, it gave employees and core customers several months' notice, assisted customers through the transition, and helped most workers find new jobs. The results were stronger customer relationships, a highly appreciative group of ex-employees, and greater loyalty among remaining workers.**

was shocking; making matters worse, the company provided only a limited explanation and offered affected employees virtually no help in coping with the shock. Because the layoff was so sudden and quickly carried out, it severely damaged the morale of the survivors for quite some time.

After business school I worked as a financial controller for various parts of Corning and had an insider's view throughout the 1980s of other decisions to close or shrink operations and lay off employees. Each time, friends and neighbors of mine were let go. Again and again, it appeared that for all the agonizing that might have gone into the decision to reduce staff, the decision often ended up being the "easy" part. Usu-

ally I felt that insufficient attention had been paid to how it was implemented. After getting to a decision, leaders felt relieved but didn't seem to be significantly involved in carrying it out.

A major exception was the 1983 shutdown of a unionized Corning plant that made glass for color televisions in Bluffton, Indiana, a small town near Fort Wayne. I was the division controller at the time. We had two U.S. plants that made the product, but because of a drop in demand we needed only one.

The head of the business was a man named Forrest Behm. He had been at Corning forever. As a kid he'd been badly burned in a fire and had lost the use of his legs for a while, but he'd gone on to become an all-American tackle at the University of Nebraska. Forry was a class act. He really set the tone for the Bluffton closure. He emphatically stated, "We're going to be honest with our employees. We're going to tell them what's happening. We're going to give them advance notice even though we aren't obligated to do so under the union contract. And we're going to make sure our customers are served."

Accordingly, we told the employees of our plans about nine months before we closed the plant. We explained that we needed to build up enough inventory to serve our customers during the transition and that we couldn't afford to have workers leave or to let productivity and quality decline. And we helped our workers line up new jobs. The result: Rather than leaving their brains in the parking lot, they delivered the highest quality and productivity ever. Customers were so appreciative that they not only stuck with us after the closure but gave us more business. That experience convinced me that there was indeed a better way.

Since the mid-1990s I've put the "soft hands" approach to some major tests, and in the process developed the principles described in the following pages. In 1995 Corning sent me to head Corning Clinical Laboratories, which at the time was the biggest business in the company.

In a bid to become a major player in and consolidate the fragmented blood-testing industry, Corning had bought more than 100 competitors. My predecessors had not integrated the acquisitions, however.

When I arrived, the business was in free fall. We had far too much capacity and no common systems, processes, company name, or brand. We were being fined by the federal government for alleged Medicare fraud and abuse. Morale and service were horrible, and our customers and employees were leaving us in droves. To build a sustainable business, I had to get out and help improve employee satisfaction and loyalty to the company. It became crystal clear that if my employees were satisfied and loyal, the customers would follow; if the customers followed, the owners would be happy; and if the owners were happy, some of their happiness would circle back to the employees. Although I had learned this lesson from Forry, it became an integral part of my personal leadership approach at the lab business.

At the end of 1996, after I'd been there about a year and a half, Corning spun us off. I then served as chairman and CEO of the new company, Quest Diagnostics. We embarked on a number of measures to regain the loyalty of customers and employees. We launched major initiatives to improve our processes for everything from collecting and transporting specimens to performing diagnostic tests and billing for them. Equally important, we changed the culture by creating and then religiously adhering to a set of values and goals, which resulted in a radical shift in management and employee behavior. We told people the truth about the business. We let them know how they fit in – how they could help the company succeed – and then recognized their accomplishments. And we made the senior leadership visible and accessible. For example, I invited employees to e-mail me personally with any questions or concerns they might have, vowed that either I or a more

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knowledgeable person would respond within 48 hours, and then kept that promise.

Once we had stabilized the company, we made a bold move to further consolidate

the lab industry by buying the slightly larger SmithKline Beecham Clinical Laboratories (SBCL) in 1999. The integration involved reducing the combined workforce by more than 10% and the number of lab centers from 40 to 27. Making such significant cuts added tremendously to the challenge of melding two fierce competitors into one company. We met that challenge. Tellingly, Quest went on to win accolades for its earnings and stock performance, and the results of employee-engagement surveys dramatically improved.

At the end of 2004 I retired from Quest and a short time later accepted an offer to join Kohlberg Kravis Roberts, where I've been ever since. My main responsibility has been helping to improve

the performance of a number of companies in KKR's portfolio. In the cases of Masonite and Accellent this has meant stepping in for a time as interim CEO.

KKR bought Masonite, a global manufacturer of residential and commercial doors, in 2005. I was sent in to stabilize the business and upgrade its processes. As our efficiency increased, we closed a handful of operations and trimmed the workforce a bit. Then, in late 2006, the housing market started to collapse. Since then we've lost almost 30% of our sales volume and have had to make radical cuts. All told, we've reduced the employee base from about 15,000 to 8,500 and the number of facilities from 80 to 57. Given the dismal state of the housing market, I can't say that we're finished. Nonetheless, product quality and customer service have improved, the senior leadership has experienced zero attrition, and employee morale has remained remarkably strong. Executives running the business say that the



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soft-hands approach largely accounts for these results.

Like Quest, Accellent has been a consolidator in its industry, medical components, and has grown through acquisitions. Shortly before my arrival, in January 2007, the company had gone through major layoffs involving about 530 people, or almost 15% of the workforce, because of weak sales. The cuts had been made in a rush. The leadership did not play an active role in implementation. Neither employees nor customers were given adequate information. As a result, their attitudes were off-the-charts negative. Unfortunately, the slow market forced us to trim our workforce even more in 2008 and to close a factory in Memphis, Tennessee. But we used the soft-hands approach this time around, which made all the difference.

Using Soft Hands

Let me describe in detail what using soft hands means. Although many of these principles may seem obvious or just plain commonsensical, I've long been amazed by how frequently they're ignored.

Treat employees with dignity, fairness, and respect – the way you want to be treated. Reducing a workforce is painful, but you can do it in such a way that people will someday say, "You know, I once worked for Company X. I didn't like the fact that they shut my plant down, but I still think it's a good company." Here's how:

Address "What does it mean for me?" Employees have a right to be treated as adults. They should be told why they are losing their jobs (whether it's because of a drop in demand, changes in technology, or productivity and quality issues), how the closure will affect them (in terms of timing and severance benefits), what you will do to help them land on their feet, and what you will need from them to help customers through the transition.

Communicate until it hurts. Studies say that people need to hear a message at least six times to internalize it. The shock of the initial announcement



A closure or a downsizing is not an excuse for leaders to go into hiding.

will prevent employees from absorbing everything you tell them at that time. After all, their lives are being turned upside down. So follow up with both written and oral communications. Then keep people constantly informed along the way. Counter the rumor mill with frequent town meetings, and tell people the truth in a forthright fashion.

Also be sensitive to any language barriers. Many members of the workforce at Accellent's Memphis plant were Vietnamese and didn't speak English. We brought in translators to ensure that everyone understood our communications.

Be visible and personal. A closure or a downsizing is not an excuse for leaders to go into hiding. To the contrary, it's an occasion when people need to see their leaders. I've known businesses where the CEO or the division manager was visible when there was something good to say

and hid in his or her office when layoffs were necessary. Such people ended up with zero respect in their organizations.

If the operation being closed or downsized is large or historically important to the company, the CEO should make at least one visit. Other executives – the division manager or the head of the business unit – should be visible from beginning to end.

Employees' accomplishments and contributions should be recognized. Someone might say, "Gee, my factories have thousands of people. There are limits to how personal we can be." That may be true, but it's extremely important to follow a general announcement with smaller group discussions led by members of your management team, who should also make themselves available for individual conversations.

Don't assume that your managers all have the necessary communication

skills. Work with the HR department to train them in advance. Serve as a model yourself, coach the managers who need help, and ask senior managers who are good communicators to do the same.

Set the tone. The leader should take personal responsibility for the organization's behavior. Although the CEO of a major corporation obviously can't do all the nitty-gritty stuff himself, he must be engaged and stay abreast of the discussion and the implementation process. During the integration of Quest and SBCL, for instance, I told everyone at both companies, "Yes, there are going to be layoffs, but we're going to treat everybody – I mean everybody – with dignity, fairness, and respect." I made it clear to the organization, which was not used to a soft-hands approach, that I was taking it really seriously.

Deliver messages that are consistent and positive but grounded in reality. To ensure that employees don't let up during and after the closure or layoff, be as positive as possible and give everyone a purpose. By "everyone" I mean those who know they're going to leave, those who know they're going to survive, and those who don't yet know their fate. Explain that the decision is being made for the sake of the overall business, not because the people who are leaving have done a bad job.

An experience in the early 1990s drove home the importance of providing honest and balanced messages. I was heading most of Corning's corporate administrative staffs when the company launched a major reengineering initiative. The outside consulting firm that helped with the effort focused on how we would reduce costs by \$600 million. I pointed out to the CEO that cost reductions don't motivate people and urged him to promote the initiative instead as a campaign to reduce costs *and* build capabilities for the future. He listened. The program, called Corning Competes, was extremely successful. If it had been only a cost-reduction program, we couldn't have engaged the thousand or more people on the various teams we created

to help identify how to make the company more effective. Although a lot of people ended up leaving the company in the process, it wasn't driven by "Let's cut the head count." That experience told me that you can keep your people engaged as you do the challenging work needed to carry out a tough decision.

Don't summarily throw people out into the street. I cringe whenever I see newspaper photos of newly laid-off employees toting boxes of their personal belongings as they're being escorted off the premises of some company. Remember that the world's a small place and people don't forget.

Concerns about sensitive information are often used as an excuse for such behavior. I don't buy it. You can protect information and treat people humanely at the same time. You may have to cut their access to sensitive information immediately – which means, of course, that they will no longer be able to perform their jobs. But you can always give them

time to say their good-byes and retrieve personal material from their computers. You can explain, "We will work with you to collect whatever you need. But we hope you understand that we have to protect highly proprietary or confidential information, so we can't give you unfettered use of the machine."

Honor company commitments. The company's severance policies regarding health care, retirement, insurance, and outstanding bonuses should be explained when a person is hired and should be included in the employee handbook. The company should feel obligated to adhere to those policies. If any of them are changed, employees should be informed at the time – not when they are told they are losing their jobs.

Treat everyone equitably. Who stays and who goes should be decided on an objective basis. When Quest and SBCL joined together and I was assembling the new management team, senior colleagues who had been with me at Quest

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for three years said, “We won. They lost. We should be in.”

The SmithKline Beecham folks said, “Our company has been in business for more than 100 years. You guys are latecomers. We really should have bought you. We should run this company.”

I said to both groups, “Not so fast,” and then put the top layers – more than 200 people – through an evaluation process. In addition to considering their past performance reviews, I required them to go through an externally conducted assessment of their leadership skills and behaviors. As you might expect, about half

factory floor know as much as or more than anybody else in the company about your customers and how to make things work. If you’re going to shut their facility down or relieve some coworkers of their jobs, everybody has to have a common platform of understanding. If it’s not provided, you’ll create chaos and lose a lot more than you gain.

Treat your customers and suppliers like valued partners during the shutdown process, and they will stick with you. If you’re consolidating operations, you might want your customers to agree to transfer their business from the

mated customers’ needs and can close a facility sooner than you thought.

Of course, you can’t always give customers everything they want. A balanced approach is important. But when you’re calculating the economic impact, be sure to weigh the value of the customer relationship. The higher cost of putting off a closure by a week or even several months may be more than offset by the future business your company gains from an appreciative customer.

After you strike a deal, keep customers informed of progress and any hiccups that occur along the way. Have managers in your organization provide a weekly update.

Don’t reduce the focus on quality. This is one more reason to treat employees of an operation that’s being phased out with respect; you don’t want disintegrating morale to take a toll on quality. Leaders should regularly remind everyone of the importance of quality and keep measuring and celebrating it. They should also practice what they preach. If the company stops cleaning the restrooms, the odds are that workers won’t clean their work areas or strive to provide superior quality and service.

Use appropriate incentives to retain critical employees. Who they are isn’t always obvious. For example, you almost always have employees who know how to run a particular machine or database that is crucial for serving customers. It’s important to make sure you don’t lose that knowledge or capability during the transition.

Work with suppliers to ensure that service and product quality are sustained. If they find out secondhand that you’re closing an operation, they may unilaterally decide how they’re going to cope. Like customers, important suppliers should be treated as partners and be told in advance where you’re heading and why. Then hammer out a joint plan with them.

Take pains to transfer the business smoothly. If a customer intends to transfer its business to a competitor and you will no longer have the capability

Like customers, important suppliers should be treated as partners and told in advance where you’re heading.

of the senior leaders I chose came from Quest and about half from SBCL.

People throughout the organization took notice. They said, “Hey, Ken is taking a very deliberate approach to staffing his senior team, and if he’s doing that, he’s probably expecting us to do something similar.”

Help people find jobs. If conditions warrant it, consider affected employees for opportunities at other locations in your company or offer them contract work. At the very least, hold job fairs and help them write effective résumés and learn how to leverage their personal networks.

Put yourself in their shoes. How can you know whether employees are being treated with dignity, fairness, and respect? Attitude surveys throughout the shutdown or layoff process are one obvious way. In addition, regularly ask yourself how you’d react to various actions or inactions. There are times when managers think, “I have an MBA or a PhD. I’m a really smart guy. So what I would need to know is a little different from what the guy on the factory floor needs to know.” Well, the folks on the

plant being closed to another factory. If a customer conducts business with several units of the same company, it may retaliate against other units if a shutdown leaves it in the lurch. Furthermore, bitter memories linger for years and people move around, taking their resentment with them to new employers.

Here are some ground rules for keeping customers and critical suppliers happy during a shutdown:

Make sure they’re informed and consider their needs. You don’t want your customers learning in the newspaper or on the internet of your plans to close an operation. Before announcing the closure of Accellent’s Memphis plant, we went to our core customer, Medtronic, and said, “We want to shut our plant as soon as we can, but we want to work out a solution that serves everyone’s interests.” We had a good relationship with Medtronic before the Memphis closure, but it strengthened dramatically because of how we handled the closing.

In some cases such an arrangement might mean keeping an operation open longer than you initially wanted. In others you might learn that you overesti-

to serve the customer yourself, offer to work with the competitor. If you're moving the business to another operation of yours, don't assume it will be easy sailing. It can be complex – especially in a heavily regulated industry. The surviving operation may need to be certified or may lack certain equipment or capabilities, which may have to be moved from the facility being closed. This raises the level of complexity another notch. Preventing a disruption in customer service requires disciplined project management, a topic I'll discuss next.

Manage the closure or layoff like a project. If you wanted to expand the capacity of a factory, you'd employ project-management techniques. Why is it that the same kind of discipline is so rarely applied to closures? Considering how much money, credibility, and reputation can be at stake, it doesn't make sense. Here's some advice:

Appoint an experienced, full-time project leader and a strong team. Typically, this assignment is bigger than the plant (or department or functional) manager's role. So although the project manager must work closely with the plant manager, he should report to the CEO or division manager and the plant manager's boss. The role can be an outstanding developmental opportunity for a high-potential performer and provides managers with a chance to watch people grow, to coach them, and to determine what they are really made of.

The project leader should have sufficient experience, authority, and credibility in the organization to address the interests of all constituents: the company, employees, customers, suppliers, and communities. Masonite and Accellent have leaders who bring the full package. Engineers by background, they are people-oriented and good communicators, and have run substantial parts of the company. They have high credibility with the employee base and customers, and they get results.

The project leader should assemble a team of people with the special expertise that's required. I don't mean just

technical skills: Product knowledge, customer sensitivity, disciplined focus, and strong people skills are extremely important, too.

Use the techniques of conventional project management. Define stages from the planning phase through the closure; assign clear responsibilities; establish criteria that must be met to get to the next stage; and conduct regular reviews involving senior leaders.

Use judgment and, if necessary, fight back. Managing a closure or a workforce reduction like a project does not mean mechanically going through steps and checking off all the items on a list. Considerable judgment is involved. If a customer repeatedly asks you to postpone a closing, you will ultimately have to decide when you've gone far enough. Often there's a fine line between doing the right thing and being abused.

At the same time, resist those who would have you go so fast that the wheels fall off. I still remember how Forry Behm pushed back when some Corning executives pressed him to close Bluffton quickly. After the merger of Quest and SBCL, I had to stand up to Wall Street, which looks only at numbers. Analysts told me, "You've got to go very fast, Ken, and get those synergies right away. Just get it done."

I said, "No, we need to have a business when we're through. We'll get the synergies, but it's not going to happen in three months, because we're going to proceed in a deliberate manner, making sure that we take care of our customers and our employees." In the end, the integration took almost three years, and we created much more value than if we'd done it the old-fashioned way. ▢

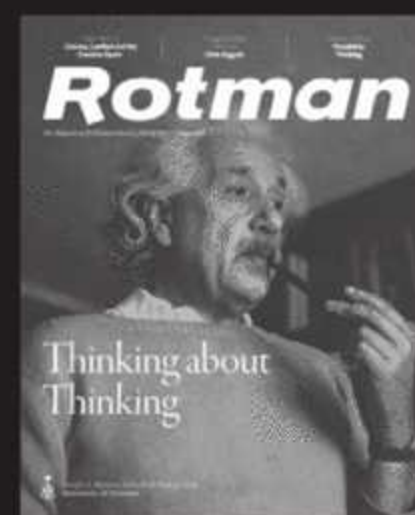
Kenneth W. Freeman (ken.freeman@kkr.com) is an executive at Kohlberg Kravis Roberts in New York. He previously worked at Corning for more than 20 years and served as the chairman and CEO of Quest Diagnostics.

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Managing for High Performance in an Economic Downturn



A natural reaction to an economic downturn is to batten the hatches and ride out the storm. Yet the ability to make smart decisions now may be the key to sustaining high performance or positioning the company to achieve it in the future, according to ongoing High Performance Business research conducted by Accenture, the global management consulting, technology services and outsourcing company.

by Sherree DeCovny

Business leaders face the arduous task of exploiting the ordinary levers that drive operational effectiveness and managing the extraordinary challenges that a downturn brings.

Exploit the Ordinary

Companies are under intense scrutiny from wary investors, impatient regulators and nervous boards. "Managers need to run day-to-day operations better than ever," says Mark Foster, Accenture's group chief executive - Management Consulting & Integrated Markets. "That means executing operations flawlessly despite the need to cut costs, deal with struggling suppliers and appeal to hesitant customers."

Four operational imperatives must be heeded to manage the crisis, he says. Companies must:

- Achieve rapid and sustained cost management by scrutinizing costs, assets and investments.
- Acquire new customers and sustain their current base by revising marketing efforts.
- Develop operational excellence through an effective global model that manages far-flung manufacturing, sales, distribution and other divisions.
- Look for M&A opportunities, but avoid inheriting a demoralized staff or a battered balance sheet.

Finding the Right Strategy for You

Efficiently managing daily operations during a downturn may keep the company afloat, but that won't get the company ahead. Managers must be quick to confront the threats unique to this crisis and quick to assess their companies' current competitive position.

The extent to which a company is positioned to respond effectively to the downturn is a function of three analyses: its relative performance over recent business cycles, its financial strength, and its relative position amid the overarching global trends. Leaders must then execute one of three core strategies:

- If the company is in survival mode, focus primarily on short-term actions to ensure it continues to operate independently until the downturn passes. Take steps to secure cash flow and minimize exposure to risk. Quickly reduce debt, cut costs and renegotiate pension obligations.
- If the company has a strong balance sheet and healthy (if reduced) revenues, look for ways to reposition the company to strengthen its long-term competitive position. One strategy is to embrace a global operating model to compete more effectively in a world of

dispersed economic power. Others include upgrading talent in key areas and focusing on "green" goals.

- If the company is in a strong position now, use the downturn to grow and stretch the lead. For example, build market share through mergers, acquisitions and international expansion or grow organically by investing in customer acquisition and strengthening brands.

Executing the Strategy: Management's Challenge

Once a strategy is chosen, follow it. Don't let the current challenges be a distraction. At the same time, "You can't let the pursuit of your strategy disrupt your ability to execute the current business model," warns Mark Spelman, Accenture's global head of strategy. "The last thing you need is to signal distress to your employees or the markets."

Managers should also pay close attention to their calendars, Spelman says. They should split their time evenly between overseeing everyday operational activities and pursuing a downturn-specific strategy.

Spelman recommends that companies assemble a tight-knit, communicative top-management team that can react quickly. A company whose CEO makes unilateral decisions won't be able to respond rapidly to change because quick, effective action requires a strong sense of shared commitment at the top. An aligned team helps to ensure that both operational excellence and future positioning receive adequate attention.

Finally, the Accenture High Performance Business research shows that companies should take this opportunity to find the next generation of leaders. Managing through a downturn can be a transformational experience, making leaders more able, confident and self-aware. There could hardly be a better time to test the mettle of your rising stars.

Historically, the greatest changes in a company's relative position within its industry has occurred during times of economic turbulence. Seen in that light, the current crisis offers opportunities for all businesses to achieve high performance by delivering operational effectiveness while preparing for the eventual upturn.

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It's rough out there. Economic realities are daunting. And yet, as with every competitive challenge, some businesses will respond proactively and effectively, while others are left behind. The winners will be those who

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What Only the

CEO

*Procter & Gamble's CEO
on the most important things
to focus on, wherever you are
in the business cycle*

by A.G. Lafley

I became Procter & Gamble's CEO in June 2000, in the midst of a crisis. On March 7 of that year the company had announced that it would not meet its projected third-quarter earnings, and the stock price plummeted from \$86 to \$60 in one day, leading the Dow Jones Industrial Average to a 374-point decline.

The price dropped another 11% during the week my appointment was announced. A number of factors had contributed to the mess we were in, chief among them an overly ambitious organizational transformation in which we tried to change too much too fast and which distracted us from running the everyday business with excellence. But our biggest problem in the summer of 2000 was not the loss of \$85 billion in market capitalization. It was a crisis of confidence. Many of P&G's leaders had retreated to their bunkers. Business units were blaming headquarters for poor results, and headquarters was blaming the units. Investors and financial analysts were surprised and angry. Employees were calling

Can Do

Ulla Puggaard



for heads to roll. Retirees, whose profit-sharing nest eggs had been cut in half, were even angrier.

The news media chronicled the drama with headlines ranging from “P&G Investor Confidence Shot” to “Trouble in Brand City: We love their products. But in a tech-crazed market, we hate their stocks.” The most painful one was in a major industry publication: “Does P&G Still Matter?”

At 6:00 PM on my first day as CEO, I stood in a TV studio, a deer in the headlights, being grilled about what had gone wrong and how we were going to fix it. Everyone was looking to me for answers, but the truth was that I did not yet know what it would take to get P&G back on track. Welcome to the job of CEO – a job I’d never done before.

The Work of the CEO

In October 2004 I looked back on that first day and the even more difficult weeks that followed as I sat with Peter Drucker and several other CEOs and management scholars who had come together to ask, “What is the work of the CEO?” (Most of the quotations in this article come from Drucker’s notes for the remarks he made on that occasion.)

It seemed an odd question, because enormous attention has been paid to CEOs, who are alternately revered as corporate saviors and reviled as corporate scoundrels. Yet the question remained: Do we really understand the role and the unique work of the chief executive? Drucker believed the answer was no. He argued that people wrongly view CEOs as coaches and utility infielders who jump in to solve problems as needed, and that CEOs indeed have work that is their own. On his death, in November 2005, Drucker left behind an outline of his emerging thoughts on the role. (The *Wall Street Journal* had published a portion of it as “The American CEO” in January 2005.) In 2004 Drucker said, “The CEO is the link between the Inside that is ‘the organization,’ and the *Outside* of society, economy, technology, markets, and customers. Inside there are only *costs*. *Results* are only on the outside.”

My experience validates Drucker’s observations, and my actions since those early days and weeks have been consistent with them. I’ve gone back to his unfinished draft time and again, reflecting on his central question: What *is* the unique work of CEOs – work that *only* they can do and that they *must* do? Over time I’ve come to see the power in Drucker’s words about linking the outside to the inside. The CEO alone experiences the meaningful outside at an enterprise level and is responsible for understanding it, interpreting it, advocating for it, and presenting it so that the company can respond

IDEA IN BRIEF

» Conventional wisdom suggests that the CEO is primarily a coach and a utility infielder, dropping in to solve problems where they crop up.

» In fact, however, the CEO has a very specific job that only he or she can do: link the external world with the internal organization.

» It’s a job that *only* the CEO can do because everybody else in the organization focuses much more narrowly and almost always internally.

» It’s a job that the CEO *must* do because without the outside there is no inside.

in a way that enables sustainable sales, profit, and total shareholder return (TSR) growth.

It’s a job that only CEOs can do because everybody else in the organization is focused much more narrowly and, for the most part, in one direction: Salespeople are externally focused; just about everyone else is inwardly focused. Integrating the outside and the inside is hard; it’s far easier to pick one. The CEO can see opportunities that others don’t see and, as the one person whose boss isn’t another company employee, make the judgments and the tough calls others are unable to make. The CEO is the only one held accountable for the performance and results of the company – according not just to its own goals but also to the measures and standards of diverse and often competing external stakeholders.

And it’s a job that CEOs must do because without the outside, there is no inside. The sustainable growth of the institution is the CEO’s responsibility and legacy, and inward focus is the enemy of growth. At P&G our goals are 4% to 6% organic sales growth and 10% or better earnings-per-share growth. To achieve 4% sales growth, we need to add the equivalent of a new Tide brand; to achieve 6%, the equivalent of a new P&G Latin American business. Every year. We won’t succeed without a deep understanding of external stakeholders and their competing interests, and how those interests correspond with the capabilities and limitations of the organization.

But if linking the outside to the inside is the role of the CEO, what is the actual work? I think it comes down to four fundamental tasks, drawn from Drucker’s observations:

1. Defining and interpreting the meaningful outside
2. Answering, time and again, the two-part question, What business are we in and what business are we *not* in?
3. Balancing sufficient yield in the present with necessary investment in the future
4. Shaping the values and standards of the organization

The simplicity and clarity of these tasks is their strength, but their simplicity is also deceptive, because the work is more demanding than an observer might suspect. The challenge is to resist getting pulled into other work that is not the unique responsibility of the CEO.

Defining the Meaningful Outside

Years of success combined with the heady dot-com boom had led us to lose touch, to some extent, with why P&G was in business. Employees had been drawn to internal interests. I needed to define the relevant outside – where the results are

most meaningful. Which external constituency mattered most, and which results were the most important? This is uniquely the job of the CEO because people view the importance of various stakeholders according to where they themselves sit. The CEO has both a clear perspective across the organization and accountability to the outside.

Drucker also wrote that the purpose of a business is to create a customer. P&G's purpose is to touch and improve more consumers' lives with more P&G brands and products every day. Of all our stakeholders, both outside and inside, the primary one is the consumer.

Everybody knows that the customer is king; we knew this in 2000 as we know it today. But we were not acting on what we knew. That had become apparent to me in 1998, when, as executive vice president, I returned from an assignment in Asia, where we didn't have reams of research data on consumers and markets. In China, for instance, we had no choice but to visit consumers where they lived and observe them where they shopped. Coming home to our global headquarters, in Cincinnati, I was struck as I walked the office halls by how many employees were glued to their computers and how much of each day people spent mired in internal meetings with other P&Gers. We were losing touch with consumers. We were not out in the competitive pressure cooker that is the marketplace. Too often we were working on initiatives consumers did not want and incurring costs that consumers should not have to pay for.

Everywhere I go, I try to hammer home the simple message that the consumer is boss. We must win the consumer value equation every day at two critical moments of truth: First, when the consumer chooses a P&G product over all the others in the store; and second, when she or a family member uses the product and it delivers a delightful and memorable experience – or not. Almost every trip I take includes in-home or in-store consumer visits. Virtually every P&G office and innovation center has consumers working inside with employees. Our employees spend days living with lower-income consumers

and working in neighborhood stores. At our global headquarters we replaced dozens of paintings by local artists with photographs of everyday consumers around the world buying and using P&G brands. All these efforts keep the two moments of truth foremost in the minds of P&Gers as they work.

Although the consumer is clearly P&G's most critical external stakeholder, others are important as well: retail customers, suppliers, and, of course, investors and shareholders. Over the past decade we have dramatically changed how we work with retail customers and suppliers, both of which help P&G deliver on its purpose. For too long these relationships were transactional – a series of win-lose negotiations. Beginning in 2000 we tried to make them win-win partnerships. We focused on common business purposes and goals, on joint business plans, and, most important, on joint value creation. These are not soft-sell, feel-good relationships. They are based on hard-nosed sales-, profit-, and cash-building action plans, reviewed quarterly and annually, for which leaders from both sides are held accountable. Our joint business plans are effective because they put the consumer front and center – they deliver better value to shoppers in retailers' stores.

Proof of the power of partnerships is in the consistently strong business and financial results for all partners. The preference for P&G as a partner shows up in annual retailer and supplier ratings of manufacturers.

We have also strengthened our relationships with analysts and investors. We try to understand their needs and wants and to explain P&G's long-term goals and strategies as clearly and simply as we can. These stakeholders are also consumers, of course, and are often personally interested in innovations from P&G brands. Since 2000 P&G's market TSR has outperformed that of the S&P 500 and the Dow Jones Industrial Average. Over the same period, on average, P&G has grown organic sales, diluted earnings-per-share, and free cash flow ahead of long-term targets.

As for employee stakeholders, we believe that P&G people are the company's most valuable assets. Without them we

Virtually every P&G office and innovation center has consumers working inside with employees.

The consumer is
boss.

would have no P&G brands, no P&G innovation, and no P&G partnerships. However, putting employees ahead of external stakeholders, especially consumers, would result in a more internal – and, arguably, more short-term – focus. P&G people are inspired by the company's purpose and motivated by how they can personally touch and improve consumers' lives.

With a clearer view of the outside, we then had to define the results that matter most. Like any other for-profit institution, P&G has primarily financial companywide goals, but at the business unit, category, brand, country, and customer levels, where 99% of employees work and where critical day-to-day business choices are made, our measures are more consumer-centric. Are we winning in the store at the first moment of truth? Are we winning when the consumer uses P&G products at the second moment of truth? Ideally, the consumer will not only try P&G products but also convert to regular use for life. Higher consumer trial and loyalty rates drive P&G's business model.

We know, for instance, that in the 10 years since the Swiffer floor-cleaning system was introduced, only 15% of U.S. households have bought and tried it annually – meaning that we're not reaching 85% of households in any given year. But we also know that people who buy it like it, and a very large percentage become regular purchasers. Therefore, the leaders in the Swiffer business focus on growing by getting new consumers to try the brand. That's an example of linking the meaningful outside to the inside. We've developed our own brand equity measures – along the lines of Frederick Reichheld's Net Promoter Score – which give us insights into how consumers behave and why, and we hold managers and executives accountable for them.

The result of clearly defining the meaningful outside: In 2000 P&G served about 2 billion of the then 6 billion consumers in the world with one or more P&G brands. In 2009 we are serving about 3.5 billion of the 6.7 billion consumers in the world. Touching more consumers and improving more consumers' lives is our overarching purpose as an institution.

The process of clarifying and communicating the priority of external stakeholders is ongoing, because many internal and external stakeholders have important demands. I wouldn't ignore any of them. But if there's a conflict, I make sure we resolve it in favor of the consumer.

Deciding What Business You Are In

The second CEO task is to identify the competitive spaces where you can win. Drucker said, "Equally important – and also a task only the CEO can fulfill – is to decide, What is our business? What should it be? What is *not* our business? And what should it *not* be?"

The second most important decision we made in 2000 – after "The consumer is boss" – was where P&G would play and where it would *not* play. We began by analyzing several

factors: The most important were the structural attractiveness of the businesses we were in or considering; P&G's leadership position relative to its competitors; and the strategic fit of various industries with P&G's core competencies and strengths – consumer understanding, brand building, innovation, go-to-market capability, and global scale.

We decided to grow from P&G's core, which we defined as laundry products, baby diapers, feminine care, and hair care. These were businesses in which P&G was already the global sales and market share leader. We understood them well; our core product technologies and core strengths represented competitive advantage in them; and they sold primarily through our core distribution channels – discount, drug, and grocery stores. We had in some cases been milking these businesses, because we'd assumed they couldn't grow and we'd wanted to invest in new ones. I believed that although they

were more mature, they could still grow – a conclusion I drew not only by analyzing the financials but also by looking more closely at consumer and market trends. We did the math. For example, after assessing the total number of households worldwide that used washing machines and the number of machine loads done in each home every week, we determined that P&G's Tide and Ariel brands

still had significant room to grow through brand and product innovation. Since 2000 P&G's four core businesses have accounted for 58% of the company's total sales growth.

Next we decided to enter more beauty and personal care categories, for three reasons. First, they met our criteria for structural attractiveness by being businesses with low capital intensity, high margins, and relatively high growth. Second, they fit with our strengths, because they presented consumer-led branding and innovation opportunities and could be sold through our discount, drug, and grocery store channels. And third, they made sense in view of demographic data showing that a growing number of consumers were trying beauty and personal care products at an earlier age, using more products throughout their lives, and using them at a later age. From 2000 through our FY2008, 49% of P&G's total growth has been in the beauty and personal care businesses. Some of this growth was acquired – through brands such as Clairol, Wella, and Gillette – but organic growth was up by double digits. By 2009 Pantene had reached \$3 billion in net sales annually, and Olay had reached \$2 billion.

We also chose to focus more on low-income consumers and developing markets. Here demographics were the primary factor. Because more babies are born, more households are formed, and incomes rise faster in developing markets, they were a significant white space opportunity for household and personal care products and for P&G. China and Central and Eastern Europe provided a level playing field as they opened up to all manufacturers at the same time. Since 2000, sales in developing markets have grown from 21% to 31% of

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The Four Tasks of the CEO

The CEO has a unique external perspective to bring to his or her real work, which is to link the outside to the inside. This involves four tasks.

1

Defining the Meaningful Outside

Of all your external stakeholders, which are the ones that matter most?

What results are the most meaningful?

EXAMPLE At P&G we believe that the consumer is boss. Without consumers, there is no P&G. Therefore, our meaningful results come at two critical moments of truth: first, when a consumer chooses to buy a P&G product over all others in the store, and second, when she or a family member uses the product at home. Although other external stakeholders have important demands, when there's a conflict, we resolve it in favor of the one who matters most: the consumer.

2

Deciding What Business You Are In

Where should you play to win? Where should you not play at all? These are dif-

ficult decisions that require thorough evaluation and discussion. However, only the CEO has the enterprisewide perspective to make the tough choices involved.

EXAMPLE We decided to focus on P&G's core businesses – laundry products, baby diapers, feminine care, and hair care – businesses in which P&G was clearly the industry leader, and businesses that fit strategically with P&G's core strengths. As for industries where we won't compete, pruning isn't as sexy as acquisition, but it's just as important and perhaps more difficult. For instance, we let go of a sentimental favorite, Jif, because it didn't play to our strength of creating brands on a global scale. Only Americans eat peanut butter.

3

Balancing Present and Future

Learning to strike the right balance between the short and the long term comes

more from experience and judgment than from facts. Defining realistic growth goals is the first step toward getting the balance right; determining what goals are "good enough" to deliver in the short term is critical to gaining credibility and momentum for the longer term. And the CEO's personal involvement in leadership development may have the single biggest long-term impact on the company's future.

EXAMPLE We had been treating internal stretch goals as external commitments. Shortly after I became CEO, we took the stretch out of financial goals to make them more realistic – not a popular decision on Wall Street, but one that made sense for the longer term. And on the organizational development side, I'm involved in the career planning of approximately 150 P&G leaders with the potential to become line presidents or function heads. They are the future of our business.

4

Shaping Values and Standards

Values establish a company's identity; they are about behavior. If the company

is to win, these values must be connected to the meaningful outside and relevant for the present and future. Standards are about expectations; they define what winning on the outside looks like. They are best established by answering two important questions: Are we winning with those who matter most? Are we winning against the very best?

EXAMPLE P&G's values had been in place for generations, but over time they had become internally focused and interpreted in a way that put employees' needs ahead of consumers'. We reoriented our values toward the outside. For instance, trust had come to mean employee reliance on the company for lifetime jobs. Now it means consumers' trust in P&G brands. Our standards, too, have been reoriented externally. We measure consumer household penetration – that is, the percentage of households that buy a P&G brand – and consumer loyalty, meaning the percentage of consumers that convert to regular users. That's how we know if we're winning with those who matter most. We also compare P&G's performance with that of our strongest competitors to ensure that we win against the very best.

Determine the optimal balance.

Resolving the tension of sometimes divergent short-term and long-term priorities is a challenge as old as business itself.

P&G's total sales and have accounted for nearly 40% of sales growth.

While considering the first part of Drucker's question – What businesses are we in? – we also struggled with the second part, which is just as important: What businesses are we *not* in? Only the CEO has the enterprisewide perspective to make these tough choices, because although most business leaders are motivated by growth opportunities, they find it exceedingly hard to recommend shutting down or selling a business they're a part of. Often a leader will instead step up to the challenge of turning a business around – whether or not it's a strategic fit for the enterprise.

Answering the question of where not to play involved just as thorough an evaluation, using the same criteria of structural attractiveness, core strengths, competitive position, demographic trends, and the potential to globalize and grow. We've since exited most of the less strategic food and beverage businesses: We sold the Crisco, Jif, and Folgers brands to Smucker's (for which they are a better fit). We sold weak household and beauty brands such as Comet and Noxzema. We're exploring the sale of P&G's pharmaceutical business.

Determining which businesses we should not be in is an ongoing effort that calls for continual pruning and weeding. Disposing of assets is not as sexy as acquiring them, but it's just as important. Drucker said, "On these two decisions – 'What is our outside?' and 'What is our business?' – [rest] all the other work and all the other decisions inherent to being a CEO."

Balancing Present and Future

Resolving the tension of sometimes divergent short-term and long-term priorities is, as Peter Drucker reminded us, a challenge as old as business itself. Drucker said, "The CEO decides on the *balance* between yield from the *present* activities, and investment in an unknown, unknowable and highly uncertain *future*....it is a *judgment* rather than [a decision] based on 'facts.'"

I've taken the liberty of expanding on Drucker's theme by saying that we must work on the present to earn the right to invest in the future. It's a balance that the CEO alone can strike, because he or she alone is exposed to all the external *and* internal interests – while being accountable for the long term.

Determining the optimal balance between yield from present activities and investment in a highly uncertain future entails the riskiest choices a CEO can make. It's as much art as science. The pull will always be to the present, because the interests of most stakeholders are short-term; few are deeply invested in a company's performance for more than a year or two. In times of financial crisis and global recession, CEOs feel even more pressure to focus on this week, this month, and this quarter. Understandably, such pressure can result in a significant reduction of investment in the middle and long terms, including the slashing of capital projects and R&D innovation.

First-time chief executives rarely have much experience with weighting the balance toward a long-term future. Typically, they've been accountable for results only a few months out. Their careers have not depended on bets placed a decade or more into the future. Their instincts for investing for long-term growth have not been honed. Those instincts often arise from on-the-job training. My own experience suggests that a few critical choices must be made to manage this balance.

The first is to *define realistic growth goals*. At P&G we had gotten into the habit of treating internal stretch goals as external commitments. Once a company starts pursuing unrealistic growth objectives, it will rarely, if ever, create the capability and flexibility to invest in long-term growth. Instead it will borrow from the future to sustain the present – pulling volume from the next quarter to deliver in the current quarter, for example. The result is fewer resources and increasingly limited latitude to make investments in the future.

Before establishing P&G's long-term goals, I had to decide what would be "good enough" to deliver in the short term. Early on as CEO, I announced that we were reducing our goals.



The stock price increased more than 8% as investors recognized that our lower goals were realistic and we were making the right decision for the long term. Although we've often exceeded our targets, we've resisted pressure to raise them above what makes sense.

The second choice is to *create a flexible budgeting process*. We have a rolling budget forecast with flexible short-term and sustainable long-term goals. We have clear portfolio roles for each business based on a realistic and sustainable sales and profit growth and operating TSR (the cash flow return on investment). In other words, not all businesses are created equal. Moreover, a slow-growing business isn't necessarily less valuable than a fast-growing one. As long as each fulfills its role, we can deliver on total company goals. We have complementary short-term, midterm, and long-term focuses in our innovation programs, with planning horizons ranging from three-to-five years to 10-to-15 years.

What's most important in budgeting is our rhythm in managing the business: We deliver in the short term, we invest in and plan for the midterm, and we place experimental bets for the long term. Over the past 20 years, for instance, we placed a bet on compact laundry detergents, which allowed us to meet our goal of regularly making discontinuous product innovations while also reducing unnecessary packaging for consumers and the environment. Bets don't always pay off, of course. Our concentrated liquid detergents are a huge success, but our heavy investment in developing a tablet designed to simplify the laundry process wasn't. We learned that consumers wanted more control over how much detergent they used in a load, depending on the kind and quantity of clothes and how dirty the clothes were. As long-term bets are qualified, they become midterm priorities and then, on a rolling basis, the short-term results we focus on delivering consistently year after year.

The third choice is to *allocate human resources* in a way that identifies and develops good people for today and tomorrow. Drucker said, "Effective CEOs make sure that the perform-

ing people are allocated to opportunities rather than only to 'problems.' And they make sure that people are placed where their strengths can become effective."

Allocating human resources in a strategic manner is a key aspect of the CEO's role, because it involves not only considering what we know today but also anticipating what skills and experiences leaders will need to run businesses that may not yet exist. There is no substitute for personal involvement with the people who are being groomed for the future. I know the top 500 people in the company and I am personally involved in career planning for the 150 who are potential presidents or function heads. I review their assignment plans at least annually, assess their strengths and weaknesses, and put them in front of the board at meetings, lunches, and other company events. Little if anything else that I do as CEO will have as enduring an impact on P&G's long-term future.

Shaping Values and Standards

Values establish a company's identity; they're about behavior. If they don't help move the business forward, they are nice to have but not essential for the future. Standards are about expectations; they guide our decisions. Standards are the measuring stick for values. Drucker said, "CEOs set the values, the standards, the ethics of an organization. They either lead or they mislead."

The fourth task of the CEO is to interpret the organization's values in light of change and competition and to define its standards. This was a top priority in my first year as P&G's chief executive, after setting goals but ahead of strategy. At P&G we're purpose driven and values led. Focusing first on what would *not* change – the company's core purpose and values – made it easier to ask the organization to take on what I knew would be fairly dramatic changes elsewhere. The challenge was to understand and embrace the values that had guided P&G over generations – trust, integrity, ownership, leadership, and a passion for winning – while reorienting

them toward the outside and translating them for current and future relevance.

I realized that over time the company's values had evolved to implicitly place employees' needs ahead of consumers', leading to an internal focus. Today we embrace powerful external interpretations of our values. Trust had come to mean that employees could rely on the company to provide lifetime employment; we redefined it as consumers' trust in P&G brands and investors' trust in P&G as a long-term investment. A passion for winning was often a matter of intramural competition; we redefined it as keeping promises to consumers and winning with retail customers.

After defining an external context for our values, it was time to make our standards relevant to the outside as well. In the absence of explicitly defined standards, people will develop their own; that's human nature. Autonomous standards tend to measure progress incrementally and internally – as in "This year is better than last." A more effective way to reset the standard is to ask simply, "Are we winning with those who matter most and against the very best?" Those who matter most and those who are the very best are on the outside.

We reinforced the external shift by setting a new standard for business performance: Each business was expected to be in the top third of its industry according to operating TSR. O-TSR focuses on value creation, which is driven primarily by sales growth, margin improvement, and asset efficiency. This internal measure is closely correlated with the stock market TSR. O-TSR had been a metric at P&G for several years, but it had not been broadly embraced. By making it our primary performance measure and linking it to leadership compensation, we established a value-creation mind-set and also brought the shareholder's perspective to important business decisions.

We defined standards for winning with consumers – who matter most – by specifying what winning looks like at the first and second moments of truth. Is the number of households that buy a given P&G brand or product increasing? What percentage of consumers who buy a P&G product once buy the same product again? Do consumers consider a specific P&G brand a good value? How do P&G brands compare with their best competitors in the hearts and minds of consumers? We also set clear standards for new initiatives to improve our batting average – which resulted in doubling their success rate.

The CEO is uniquely positioned to ensure that a company's purpose, values, and standards are relevant for the present and future and for the businesses the company is in. The CEO can and must make the interventions necessary to keep purpose and values focused

on the outside. To sustain competitive advantage and growth, he or she must create standards to ensure that the company wins with those who matter most and against its very best competitors.

...

In *Management Challenges for the 21st Century*, Peter Drucker wrote,

One cannot *manage* change. One can only be ahead of it.... In a period of upheavals, such as the one we are living in, change is the norm. To be sure, it is painful and risky, and above all it requires a great deal of very hard work. But unless it is seen as the task of the organization to *lead change*, the organization...will not survive.

The outside changes inevitably, sometimes very fast, and often unpredictably. Regardless of the dynamics, the same work must be done: linking the outside to the inside. The CEO is the only person who can appreciate both the inside *and* the outside. This work will never go away.

The majority of a CEO's time should be spent on the four tasks outlined here. Yet this is not the reality for many – perhaps most – CEOs. I give more attention to internal demands than I should; I constantly fight the gravitational pull from the inside. But it has become clear to me that the CEO's real and unique work draws on a uniquely external perspective that is inaccessible to the rest of the organization unless the CEO makes it accessible through choices and actions every day. ▢

A.G. Lafley is the chairman and chief executive officer of Procter & Gamble in Cincinnati.

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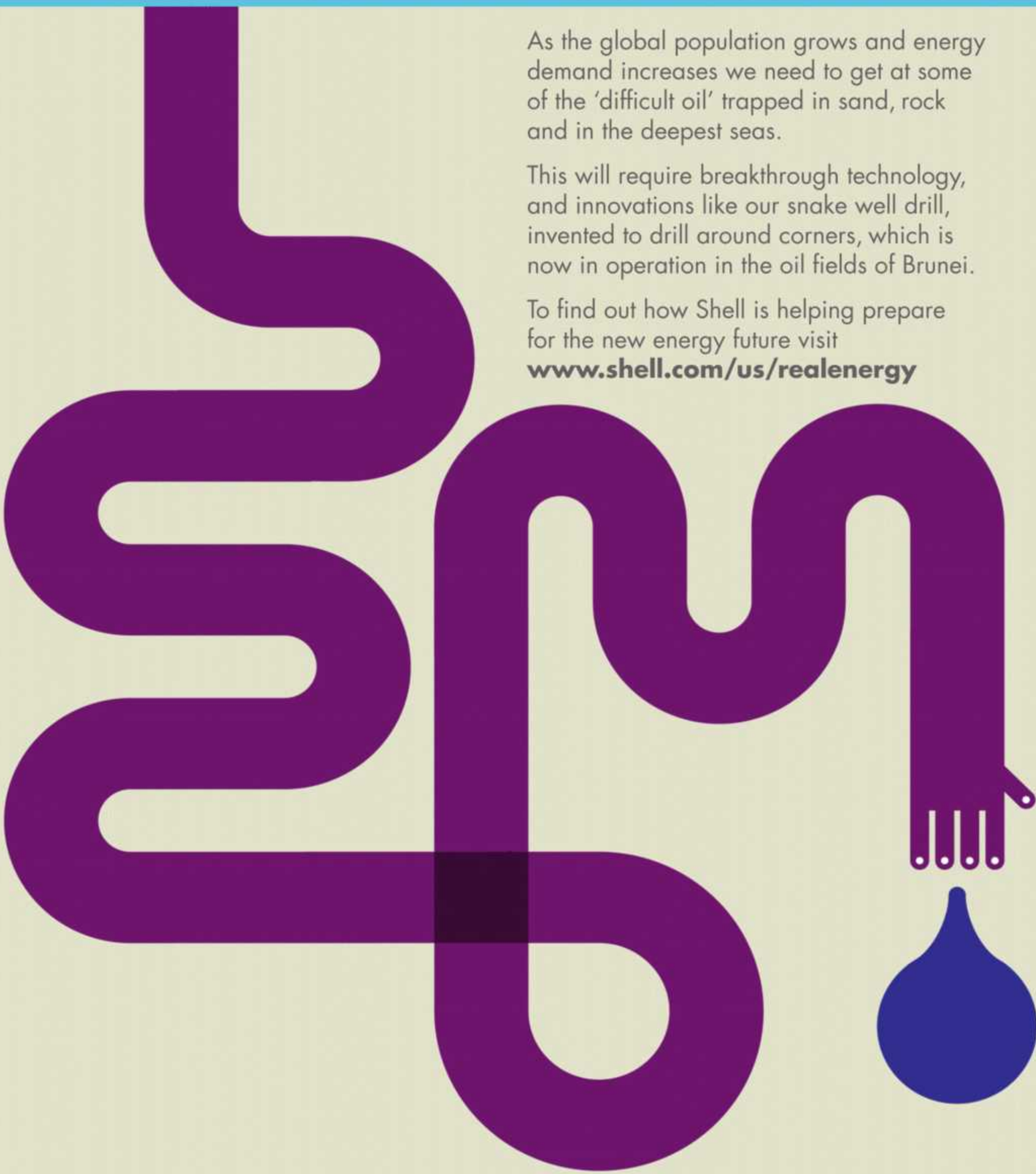
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NEED CASH?

Look Inside Your Company

Thanks to the credit crisis, companies are scrambling for cash. Time to take a cold, hard look at the way you manage working capital.

BY KEVIN KAISER AND S. DAVID YOUNG

THE BOOM YEARS made businesses careless with working capital. So much cash was sloshing around the system that managers saw little point in worrying about how to wring more of it out, especially if doing so might dent reported profits and sales growth. But today capital and credit have dried up, customers are tightening belts, and suppliers aren't tolerating late payments. Cash is king again.

It's time, therefore, to take a cold, hard look at the way you're managing your working capital. It's very likely that you have a lot of capital tied up in receivables and inventory that you could turn into cash by challenging your working-capital practices and policies. In the following pages, we'll explore six common mistakes that companies make in managing working capital. The simple act of correcting them



could free up enough cash to make the difference between failure and survival in the current recession.

MISTAKE 1 Managing to the Income Statement

The first favor you can do your company in a downturn is throw any profitability performance measures you may be using out the window.

Suppose you are a purchasing manager and your performance is judged largely by your contribution to reported profits. Chances are, a supplier will at some point propose that you buy more supplies than you need in return for a discount. If you accept the offer, you will have to lock up cash in holding the extra inventory. But since inventory costs do not appear on the income statement, you will have no incentive to turn your supplier's offer down, even if you take the trouble to calculate those costs and find that they are greater than the gains from the lower prices. In fact, if you do turn the discount down, your compensation, which is linked to the income statement, is likely to suffer, even though your decision may be good for the company.

Whether they're in manufacturing or in services, companies that hold managers accountable for balance sheets and not just profits are less likely to fall into that trap. Managers will have every incentive to explicitly measure and compare all costs and gains in order to determine the best course of action.

The same argument applies to all the components of working capital. Take receivables. Let's assume that you are contemplating reducing your terms of payment from 30 days to 20 days. You assess the likely impact on customers and estimate that you will have to reduce prices by 1% to compensate for the tighter terms and you will sell 2% fewer units, which will lead to a drop in after-tax operating profit of \$1 million this year. On the other hand, if the company generates \$2 million in sales per day, shortening receivables by 10 days would free up \$20 million in capital. Assuming an opportunity cost of capital of 10% (that is, you could make alternative investments that would generate a 10% return), you should be willing to sacrifice up to \$2 million in profit per year to get your hands on this capital. The decision, then, is quite clear: If you estimate that profits will fall in future years in excess of that \$2 million, you probably should not reduce your payment terms. But if

IDEA IN BRIEF

- » In the hard times we're experiencing, companies are scrambling for cash. Fortunately, many have a lot locked up in their operations because the recently ended boom encouraged sloppy working-capital management.
- » Companies typically make some or all of six common mistakes in managing working capital: they manage to the bottom line; they reward the sales force only for growth; they overemphasize production quality; they link receivables to payables; they manage to current and quick ratios; and they benchmark competitors' practices.
- » Simply correcting those mistakes will release a lot of cash. Longer term, though, companies need to create a culture in which everyone takes responsibility for the balance sheet.

you estimate that the profit loss will be less than the return on your \$20 million, you definitely should.

A metals refining firm that had extraordinarily high levels of receivables in its Japanese business illustrates precisely this calculus. Following the company's acquisition by a private equity firm, managers started requiring salespeople to call customers a week before their payments were due to remind them. The salespeople were predictably horrified. "This is going to drive customers to the competition for sure," they protested.

The incoming senior vice president countered their objections by asking a simple question: "How would your customers feel if we deliberately delayed shipping their products until after the agreed-upon date? Would they hesitate to call us?" "Of course not!" the salespeople responded. "So then why should customers that consistently pay late be surprised when we call to remind them that their payments are coming due?" With this perspective, the sales force enthusiastically started calling customers

to encourage on-time payment. As a result, receivables fell from 185 days to 45 days, putting the equivalent of \$115 million in recovered capital back into the bank account and reducing capital costs by \$8 million a year. Sales did decline, but the resulting loss in margin was only about \$3 million. The reduction in receivables clearly outweighed the loss in sales from demanding faster payment. This is the sort of trade-off that we urge all companies to consider.

MISTAKE 2 Rewarding the Sales Force for Growth Alone

Although most general managers are rewarded to some extent for controlling costs – even if only for those savings that appear on the income statement – cost discipline is very seldom applied to people on the front lines. Salespeople's compensation plans in particular tend to be linked to unit or dollar sales generated. There are several downsides to this.

Most obviously it encourages sales folks to book sales at any cost. It also makes concessions in the terms of trade more likely, as salespeople look for ways to get customers to buy. They grant customers long payment delays and are unwilling to chase down late payments. Fearful of sales-destroying stock-outs, they insist on larger than necessary finished-goods

inventories. High receivables and high inventories mean that a lot of cash is locked up in working capital.

This is a pity, because a properly motivated sales force can do wonders to wring more cash out of your sales. And you don't necessarily have to go to the length of completely changing the comp system. Sometimes all you need to do is make people aware that there's more to sales than booking the deal.

That's precisely what happened when the metals refining company instituted the more aggressive policy on receivables. The additional contact that the policy necessitated between sales staff and customers ended up shining a spotlight on each customer's financial condition. Customers with potentially bad receivables could be identified earlier and shifted to pay-on-delivery terms, even before they exhibited the full symptoms of financial distress. When one of those customers did begin to default, the impact was minimal, because the company had already instituted pay-on-delivery terms. The overall result was a decline in the percentage of overdue or bad receivables from 12% of the total to less than 0.5%, yielding annual cash gains of nearly \$3 million.

Or consider the case of a global electrical component manufacturer that catered to utilities, power generation, and distribution companies. A large portion of its sales came from emerging markets, especially China. However, sales in China generated receivables that had painfully long payment terms and were often of dubious quality. When challenged to improve on this performance, the sales force argued that the Chinese way of doing business imposed "flexible" payment terms and that a stricter policy would result in a big loss of market share.

When sales results were disappointing despite the flexible terms, a task force was assembled to analyze the underperformance in the Chinese market. It turned out that the main issue was incorrect price positioning; extended payment terms were often rebates in disguise. In addition, salespeople often had the wrong documentation, which prevented the

The six "don'ts" of working-capital management:

1. Don't manage to the income statement. Many important cost items don't appear on the income statement, which often encourages managers to tie capital up in stock and receivables.

EXAMPLE One metals refining firm reduced its level of receivables from 185 days to 45 days. This caused a fall in sales but allowed the company to save \$8 million a year in reduced capital costs, which more than compensated for the lower operating profit.

2. Don't reward the sales force for growth alone. When salespeople are rewarded only for booked sales, they have no incentive to help you manage customer payments.

EXAMPLE At the same metals refining firm, the sales staff was directed to help manage receivables. The percentage of overdue or bad receivables fell from 12% to less than 0.5% of the total, generating annual cash flow of nearly \$3 million.

3. Don't overemphasize production quality. Rewarding production people primarily on quality metrics encourages them to gold-plate and slow down production.

EXAMPLE One European producer of drive systems for power generation had a manufacturing cycle nearly three times longer than those of its competitors, but the company was unable to pass associated costs along to customers. By scaling back on non-value-added quality, the

firm reduced cycle times and cut inventory by 20 days, freeing up €20 million in capital.

4. Don't tie receivables to payables. The power balance in your supplier relationships may be very different from that of your customer relationships.

EXAMPLE When a French small-appliance manufacturer introduced different terms of trade for each of its supplier and customer segments, it freed up capital of around €35 million, for a business with annual revenues of less than €450 million.

5. Don't manage by current and quick ratios. Bankers use current and quick ratios in making credit decisions, and many companies consequently try to maximize those numbers.

EXAMPLE A French consumer goods company proudly announced that its current ratio had risen from 110% to 200% and its quick ratio from 35% to 100%. The company declared insolvency six months later.

6. Don't benchmark competitors. Managers become complacent when their working-capital metrics are in line with industry norms.

EXAMPLE It was only when Michael Dell compared Dell Computer's working-capital management with retailers' rather than with other computer companies' that he realized what his company could potentially achieve.

company from collecting invoices on time. Once the processes were fixed, payment terms converged on the industry standard, and the product/price grid was corrected. The result of this modest effort was a sharp reduction in receivables, which

freed up more than \$10 million in cash for a company with sales of \$400 million. Meanwhile, receivables quality improved without harming market share.

MISTAKE **3** **Overemphasizing Quality in Production**

On the production side, the chief source of working-capital mismanagement lies in the structure of incentives – essentially the same story we saw on the sales side. Production people are often evaluated on quality metrics, such as the number of defects in finished goods. This is understandable given concerns about warranty costs and the reputational harm that quality problems can cause.

But although quality control reduces those costs, it tends to slow down the production cycle, locking up capital in work-in-process (WIP) inventory. At one European producer of drive systems for power generation, which has annual revenues of about €1 billion, production managers were given bonuses on the basis of their ability to reach or exceed agreed-upon reductions in product defects each year. Managers were also rewarded for incorporating an ever-increasing array of new features into products. The firm had a strong reputation for quality, which allowed it to secure some valuable long-term sales contracts, but over the years, its increasingly complex production processes led to a manufacturing cycle nearly three times as long as those of its competitors.

When we asked whether customers appreciated this extra care, senior managers were quick to point out that their products were recognized as being of the highest quality. But, we asked, were they able to pass along the extra cost to customers? They admitted that customers often lacked the engineering sophistication to appreciate the incremental quality built into the products and were therefore unwilling to pay a higher price for them. Gradually the executives came around to the idea that they should stop trying to convince customers that the added quality was worth the difference in price and instead focus on reducing WIP inventory to keep costs down. After a determined effort to speed up production and scale back on non-value-added quality, the firm was able to

cut WIP inventory by 20 days. Although cycle times were still longer than industry averages, the inventory reduction freed up €20 million in cash.

For an Italian food manufacturer we studied, a significant share of its product portfolio consisted of items that were aged between 12 and 24 months. These products commanded a price premium and represented almost a quarter of total sales, but they also generated below-average returns compared with the rest of the portfolio. The disappointing results were due to the high WIP inventory levels associated with maintaining product quality. Management insisted that the contribution to profit was highly significant, that these products were must-haves in the portfolio, and that they enhanced the prestige of the brand.

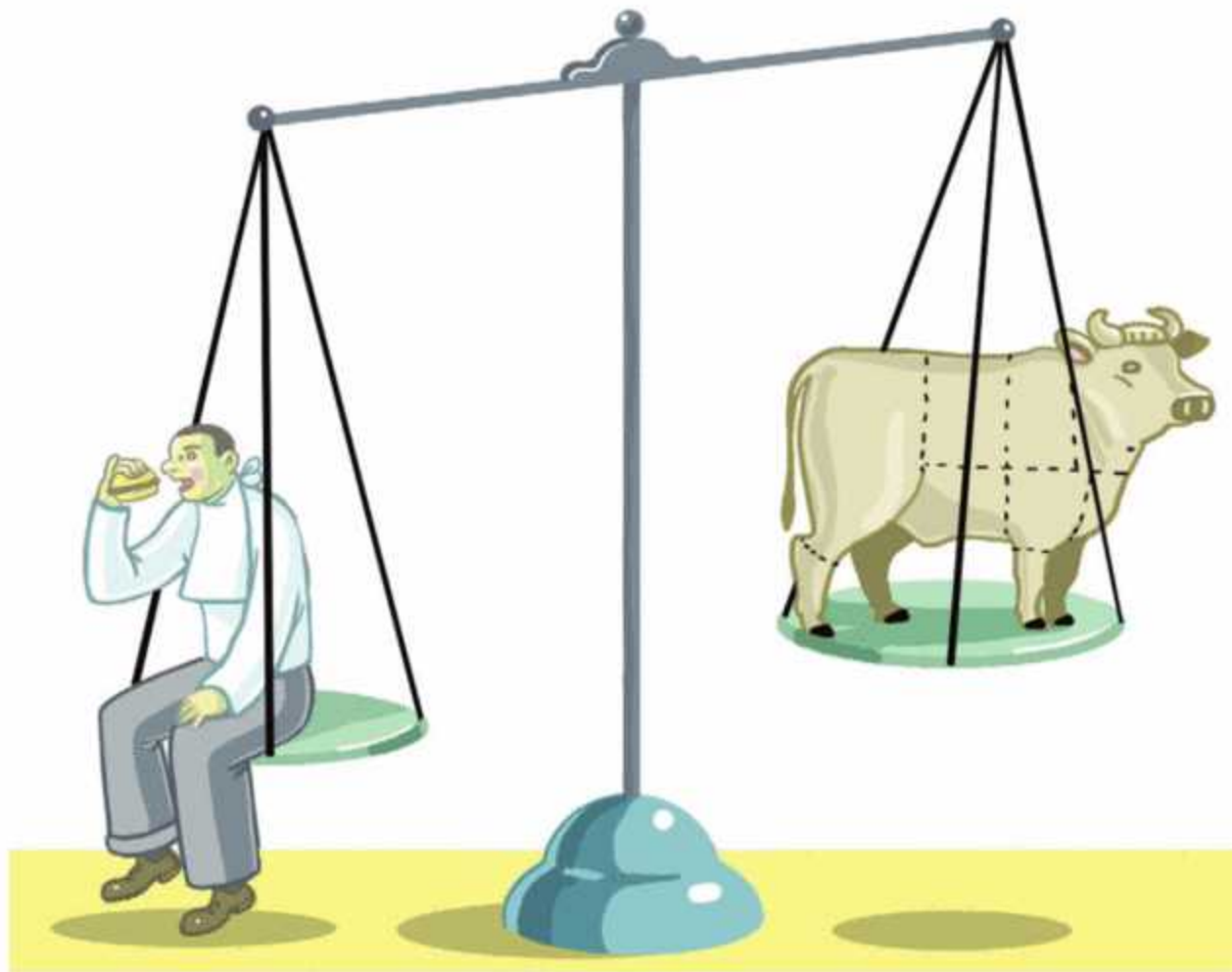
Only after the economic environment worsened did management concede that the quality advantage conferred by their aging process was no longer defensible. Through a comprehensive redesign of the manufacturing process, including outsourcing arrangements, the company was able to free up tens of millions of euros in capital previously tied up in inventory. Although quality dipped, the change was imperceptible to customers, and thus the impact on margins was negligible. Because the company was able to maintain margins with much less capital, the return on invested capital dramatically improved. An important takeaway here is that although the customer may be willing to pay for high quality, companies should take careful notice of what that quality really costs. By sacrificing a small amount of quality to make a notable improvement in efficiency, a firm can maintain its reputation while freeing up large amounts of cash.

MISTAKE **4** **Tying Receivables to Payables**

Many companies relate the terms they are given by their suppliers to the terms they offer their own customers. If their suppliers tighten terms, they try to cover the resulting cash call by tightening their own credit policies.

But this implicitly assumes that a company's relationship with customers mirrors its relationship with suppliers. Just look at the retail business to see how false that assumption

Customers often lack the engineering sophistication to appreciate incremental quality built into products.



Receivables and payables are entirely separate sets of relationships, and should be managed as such.

is: A hamburger chain like McDonald's takes between 30 and 45 days to pay its suppliers. Does this mean that it gives the customers in its restaurants 45 days to pay for their meal?

The truth is that receivables and payables represent entirely separate sets of relationships, which need to be managed according to their own conditions and imperatives. Relative bargaining power, the nature of competition, industry structure, and switching costs will ultimately determine the terms that a company can dictate to its customers or must accept from its suppliers. In nearly all cases these factors will differ across the two sets of relationships. A firm may, for example, have less bargaining power with suppliers than with customers, and its customers' switching costs may be quite different from those the firm contemplates when considering a change in suppliers.

The auto industry provides an example of why this distinction is so important. Excess capacity and low switching costs for car buyers have prompted many automakers to offer customers five-year payment terms with no money down and no interest. But because of far higher switching costs on the other end of the value chain, carmakers have been unable to extract

similar terms from their suppliers. Even if they could, it would be a bad idea – they would most likely end up bankrupting their suppliers.

In recessionary times the practice of linking receivables to payables is even more prevalent as companies look for ways to make up shortfalls. Imagine a hypothetical company in the machine tools business. Although it operates in a competitive business-to-business industry, the company has built up a loyal set of customers to which it offers a unique value proposition. Part of that proposition involves 30-day terms of trade. Suppose the company sources a large share of its supplies from one major steel manufacturer, which suddenly and unilaterally reduces its terms of trade by 10 days. This move leaves our company scrambling for new cash to plug the resulting \$20 million hole in its capital.

To find the cash, the company succumbs to the temptation to reduce its customers' grace period by 10 days as well. The problem is that, unlike its supplier, the ma-

chine tools company does not enjoy market power over its customers. Competitors' offerings now look more attractive since our company has shortened its payment times. As its salespeople predicted, the company experiences an almost immediate 20% drop in business, from \$100 million to \$80 million, leading to a decline in after-tax profit of \$6 million for the year.

Although the change in supplier terms was unfortunate and costly, it should in no way have been a reason for revisiting the customer relationship. If the company could have shortened the collection period without destroying value, it should have already done so. Tightening terms with customers allowed the firm to capture \$3.8 million from receivables reductions – but that drop of \$6 million in after-tax profit caused it to lose cash in the first year. If this profit decline were to persist, and assuming a 10% cost of capital, \$60 million in value would be destroyed. Had the company not tied receivables terms to payables terms, it wouldn't have destroyed this value.

We recently worked with a French small-appliance manufacturer on working-capital management. The company was applying exactly the same terms of trade to all its counterparties;

we immediately suggested that senior managers analyze all relationships on both ends of the value chain. In doing so, they discovered big differences in the balance of power not only between suppliers and customers but also between different types of suppliers and different types of customers. As the largest player in its industry segment globally, the company enjoys a strong bargaining position relative to its suppliers. However, a huge percentage of its sales are distributed through giant retailers, such as Wal-Mart, Carrefour, and Metro.

Acting on this analysis, the company introduced new terms of trade for each supplier and customer segment. For example, after it acquired a financially distressed competitor and negotiated with the new customer segments, management reduced customer payment terms by more than 20 days and increased the company's own payment terms to suppliers by about eight days. That put €35 million in capital back in the bank, a significant sum for a business with annual revenues of just under €450 million.

MISTAKE 5 Applying Current and Quick Ratios

When bankers assess their customers' creditworthiness, they often think in terms of current or quick ratios – indicators of how much cash or cash-equivalent a company can count on to meet its obligations. The current ratio is simply a company's short-term assets (cash, inventory, debtors) divided by its short-term liabilities (creditors, taxes, and deferred dividends). The quick ratio subtracts inventory from short-term assets and divides the result by short-term liabilities.

Although current and quick ratios are popular with many bankers and some managers, they can be misleading. Worse, their use encourages companies to manage according to a "death scenario." Bankers want to ensure that companies have enough liquid assets to repay their loans in the event of distress. The irony is that the more closely a company follows its bankers' guidelines, the greater the likelihood that it will face a liquidity crisis and possible bankruptcy. That's because a higher (which to bankers means "better") current ratio value is achieved by having higher levels of receivables and inventories and a lower level of payables – all quite at odds with sound working-capital practices.

Alternatively, suppose that the quick ratio is your main yardstick for determining working-capital levels, and you manage operations carefully to maximize that measure. To the extent that it discourages high inventory levels, this approach has some merit. Unfortunately, it also encourages you to build up your levels of receivables indiscriminately – which, as we have already seen, is usually not a good idea. As long as credit is easy, this approach, though value destructive, will not cause a liquidity headache. But when a credit crunch takes hold, the company will quickly run out of cash. Experts in structured and leveraged finance therefore tend to ignore current and

quick ratios, focusing instead on cash flow generation as a sound measure of short-term liquidity.

Managing to the bankers' ratios has gotten many company executives into trouble. Perhaps the best example comes from a French consumer goods company whose CEO announced in 2001 with considerable pride, "Our working capital has increased from €1 million to over €4 million with our current ratio rising from 110% to 200% and the quick ratio rising from 35% to 100%." The company declared insolvency six months later.

MISTAKE 6 Benchmarking Competitors

Common management practice is to benchmark a set of metrics – a scoreboard of sorts – in comparing a company's performance with industry competitors. The trouble with this approach is that companies become complacent when the scoreboard indicates that their metrics are above industry norms.

The best companies strive to improve radically on industry norms, often looking outside their industry for benchmarks. Consider Dell Computer in the early 1990s. Michael Dell knew that his company was already best in its class in terms of key working-capital metrics (days of inventories, receivables, and so on). A comprehensive consultants' report showed him that his company had little to learn from other computer companies, but his satisfaction was short-lived. When he started comparing Dell Computer with retailers, he very quickly realized that his company's performance wasn't so special after all, and he resolved to completely overhaul the company's working-capital practices.

Or consider the example of the metals refining company cited earlier. The incoming senior vice president traveled to Japan to examine why the business there was accepting those receivables terms of 185 days and maintaining three to four months' worth of finished-goods inventories. He learned in his initial discussions with the sales force and key customers that these figures were norms for the industry and was advised to leave them alone.

But as he pressed harder with customers, he came to realize that his company's product quality and reputation were such that he did not need to stick to these norms. He managed to convince customers that the company could ensure delivery with only one month's worth of inventory, and to prove his point he offered to accept stiff penalties for late delivery. He also offered discounts for early payment, leading to the drop in receivables from 185 days to 45 days. Other avenues for value creation opened up in the course of his Japanese tour: Customers turned out to be less price sensitive than the company had long assumed, which left room for price hikes of 3% to 52% across the product line, more than making up for the early-payment discounts.

None of these improvements would have been possible if the company had relied entirely on the standard industry


benchmarks to guide its working-capital practices. To be sure, such studies are a logical and necessary exercise for companies seeking to improve, but real breakthroughs come from the willingness to shed the straitjacket imposed by benchmarking. Difficult times require creativity, and creativity doesn't come from comparing yourself with competitors. It comes from an intimate knowledge of your customers, suppliers, and production processes, and the opportunities such knowledge offers to do more with less.

Creating a Culture of Value

The stories we've related illustrate the same larger point. Motivating managers by numbers alone never works, because when managers focus on maximizing a particular performance indicator, they almost always end up destroying value. A far better approach is to foster a culture in which managers from all functions engage in a dialogue with one another, with suppliers, and with customers about value creation. Incentives and performance metrics certainly play a role, but a company's leaders must always be alert to the danger that their managers will end up optimizing their performance metrics at the expense of the company's balance sheet. CEOs should think back to the early days of their careers. They must have frequently encountered managers who said, "I know that doing this is dumb, but my bonus will suffer if I don't do it, and it's not my responsibility to fix the system."

But getting people at all levels to help fix the system is precisely what you must do if you're to have a consistently

Real breakthroughs come from the willingness to shed the straitjacket imposed by benchmarking.

healthy business. Toyota is perhaps the best place to look for a model of the culture you need to create. In their influential 1999 HBR article, "Decoding the DNA of the Toyota Production System," Harvard academics Kent Bowen and Steven Spear argue that just-in-time production is not about applying a particular set of tools and practices; it is about creating an environment in which all workers are rewarded for and guided in constantly experimenting with their work processes, asking questions, and testing hypotheses. In such an environment, performance indicators certainly play a role, but they are not blindly and unquestioningly followed. The result is a participative culture in which all employees feel responsible for creating value. It's precisely the kind of attitude that will ensure that the capital in your company is working as efficiently as it can. 

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THE DEFINITIVE GUIDE TO **RECRUITING** *in Good Times and Bad*

BY CLAUDIO FERNÁNDEZ-ARÁOZ,
BORIS GROYSBERG, AND NITIN NOHRIA

WHEN ECONOMIC CRISIS HITS and companies focus on cutting costs – or on their very survival – they slash hiring. But if history is any guide, in the first few months after the upheaval subsides, hiring quickly becomes a front-burner issue.

Consider the period following the terrorist attacks of September 11, 2001, when the economic outlook appeared dire. In rapid succession, the U.S. initiated the war in Afghanistan, Enron's house of cards fell, other corporate scandals ensued, the SARS scare struck Asia, and the Iraq War began. The economy was in recession, and struggling firms retained only their strongest people. But even before things turned a corner in 2003, the smarter and abler companies – having cleaned house and discovered what was missing from their talent pools – took advantage of the buyer's market and began staffing for the future. By June 2003, the war for talent was on again in full force, and companies hired aggressively until the economy went into a tailspin in 2008.



History will again repeat itself. Even now, before the recession lifts, our research suggests that most global companies are running into staffing problems in emerging markets, and they are also having a difficult time finding talented younger managers to replace baby boom retirees. These problems will be made all the worse because, we've found, current hiring practices are haphazard at best and ineffective at worst. And even when companies find the right people, they have difficulty retaining them.

This article offers our best thinking about the most effective way to hire top-level managers, based on a combination of our own and established research about the relationship between recruiting and long-term corporate performance (see the research sidebar). The following is, to our knowledge, the first time that an end-to-end set of best practices has been put forward in one place. Our compendium comprises seven steps, which cover the full recruitment spectrum: anticipating the need for new hires, specifying the job, developing a pool of candidates, assessing the candidates, closing the deal, integrating the newcomer, and reviewing the effectiveness of the hiring process.

The focus of our research was on recruiting at the top three levels of organizations – C-level executives, their direct reports, and the layer below that. We call this the “top-*x* group,” where *x* is the number of senior executives constituting the critical leadership pool in the company. The size of this pool can vary from 20 to 50 people in a midsized organization to as many as 1,000 in a large multinational. We are primarily concerned with external recruiting, although our findings can be applied to internal hiring efforts as well.

Of course, any leader currently faced with the unhappy prospect of downsizing may find it difficult to think about staffing right now. But whatever the future brings, firms that learn to hire talent and retain it successfully will have a distinct advantage in the years ahead.

Hiring Gets a Failing Grade

Most companies react to hiring situations as emergencies; that might explain why so many do it so poorly. When we surveyed 50 CEOs of global companies, along with a pool of executive search consultants who rated about 500 firms, we found hiring practices to be disturbingly vague: Respondents

IDEA IN BRIEF

» Recessions are recruitment bonanzas, and smart companies use them to prepare for post-recessionary growth. Unfortunately, most firms are ill-equipped to take advantage of this golden opportunity because their recruitment procedures range from scattershot to nonexistent.

» To fill this void, this article offers an end-to-end set of best practices for recruiting in seven steps: anticipating the need for new hires, specifying the job, developing a pool of candidates, assessing the candidates, closing the deal, integrating the newcomer, and reviewing hiring-process effectiveness.

» With a proactive hiring process, companies can not only acquire the best talent but retain their stars longer than less-prepared competitors.

relied heavily on subjective personal preferences or on largely unquestioned organizational traditions, often based on false assumptions.

The executives we surveyed held widely differing views regarding the desirable attributes of new hires. They emphatically disagreed on whether it was best to hire insiders or outsiders, on who should be involved in the recruiting process, on what assessment tools were most suitable, and on what the keys were to successful hiring and retention.

Furthermore, 43% of the executive search consultants reported that their client companies considered the number of years of relevant work experience to be one of the top reasons for hiring a particular candidate, whereas only 24% gave similar weight to the ability to collaborate in teams – and an alarmingly small 11% factored in a candidate's readiness to learn new things. In today's increasingly turbulent business and economic landscape, in which, as one of us likes to put it, “even the past has become unpredictable,” we find this neglect of a potential candi-

date's adaptability mystifying.

Assessment practices were equally variable (even within the same company). On one end of the scale, in 32% of companies, candidates for senior positions went through only one to five interviews; at the other end, 12% of firms subjected candidates to 21 or more. Shockingly, only half of the top-*x* managers recruited were interviewed by anyone in the C-suite. Fully half the companies relied primarily on the hiring manager's gut feel, selecting a candidate believed to have “what it took” to be successful in any job. What's more, we found that companies based their hiring decisions mainly on interview performance, paying relatively little attention to careful reference checks.

Given the ad hoc quality, lack of specified criteria, and inconsistency of practices among the companies we studied, it's no wonder that usually about a third of promising new hires depart within three years of being recruited.

It's one thing to take a poor approach to hiring. But what really stuns us is that many CEOs do not recognize their recruiting situation for what it is; some are even ignorant of their company's own demographic projections mandating aggressive hiring to replace soon-to-be-retiring managers. Even those who recognize the loom-

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ing shortage of talent are ill-prepared to fill it.

So what it comes down to is this: Despite a universal acknowledgment that hiring good people is a key source of competitive advantage, we could find only a few companies that excel at one or more aspects of the hiring process and just a handful – most notably Southwest Airlines, McKinsey, Intuit, TCS, and ServiceMaster – that come anywhere close to a hiring “gold standard.” On the whole, there is neither a generally accepted code of best practices for hiring for senior-level positions nor a single company that demonstrates true best practices along each step of the process.

Clearly, organizations need to take a serious look at the challenges facing them. They need to stop treating recruitment as a big surprise. They have to approach hiring from a rigorous, strategic, and objective point of view. They must develop best practices, which in many cases will mean drastically revamping their hiring processes. They need to educate their line managers so they can hire effectively. And they have to ensure that their HR managers provide the right support. Let’s walk through each step of the process, with challenges and best practices in mind.

STEP 1 Anticipate the Need

When we asked the CEOs in the 50 major global companies to forecast their revenues for the next three years, most had little trouble. Some even broke down projected revenues from as-yet-undeveloped products and services by geographic region. But these same executives had difficulty making similar predictions for the size and composition of their top-x groups, even with the help of their HR heads. Although most reported that they’d like to see a broader diversity of nationality, gender, and entrepreneurial experience in their senior managers, few had translated these aspirations into a concrete and proactive hiring plan. In fact, few had any strategic talent plan to complement their admirably detailed business plan.

The first step in establishing a sound recruitment process is to recognize that your firm’s existing top-x pool is probably

» **Think about future staffing needs.** Internal succession plans are supposed to proactively maintain a slate of candidates that can step into new openings, but most firms search for senior managers only when there is an opening. Organizations should, at the very least, review their high-level leadership requirements every two to three years and develop a staffing plan for top-level jobs.

EXAMPLE The software firm Intuit conducts a deep analysis of its hiring-pipeline, attrition, and business-unit budget data to predict how many people – including top executives – it will need throughout the organization. As a result, the company has over the years been able to correctly anticipate more than 90% of its talent needs.

» **Develop a large pool.** Contact people in your network who are likely to know of several high-quality candidates. But don’t just stop at the usual suspects. Look, too, at “inside-outsiders” – internal candidates (say, from an international branch) who have an objective view of the firm – and “outside-insiders” – trusted former employees, customers, suppliers, or firm advisers.

EXAMPLE Rather than waste time calling too many irrelevant pros-

pects, Amgen CEO Kevin Sharer puts out an “all points bulletin” whenever he’s looking for senior talent – reaching out to recruiting firms, consultants, industry associates, and board members. This strategy has helped him not only identify great candidates but make new contacts who can help him down the road.

» **Conduct probing candidate assessments.** Getting the wrong people involved in your hiring process increases the risk of a bad hire. The best interviewers are deeply familiar with the range of experiences and competencies relevant to the position – and are also good sleuths.

EXAMPLE Instead of engaging in unstructured Q&A sessions, smart managers learn how to conduct “behavioral event interviews.” In them, a skilled interviewer asks candidates to describe situations similar to the ones they’ll be facing – like a time they worked under an intense deadline or managed competing interests. Assessors try to uncover details about the candidates’ exact actions and reasoning at the time. Likewise, reference checkers probe for specific details about the candidates’ actions, tactics, and results.

inadequate. Despite your best efforts, some top talent will leave to pursue other opportunities. And certain kinds of talent – like experienced executives in emerging markets – may not be available, so you may need to hire and then develop promising people.

Organizations should, at the very least, review their high-level leadership requirements every two to three years and develop a plan that can answer the following questions: How many people will we need, in what positions, in the next few years? What qualities are we looking for in those people, and how will we know when we find them? What will the organizational structure look like? What does our pipeline need to

contain today to ensure that we can find, develop, and support the leaders of tomorrow?

One firm that excels in this area is Intuit – the software company best known for products like QuickBooks and TurboTax. Taking a page from the best analytics practices of Harrah’s (see “Diamonds in the Data Mine,” HBR May 2003), Intuit has built a proprietary database that combines information from various hiring pipelines (such as internal-mobility figures, employee-referral programs, and external-recruiting yields) with additional data on anticipated attrition and business unit budgets to predict how many people, including top executives, will be needed annually throughout the organization. In this way, Intuit has been able to correctly predict more than 90% of its talent needs, which has greatly reduced its recruiting costs and smoothed its employee transitions.

STEP 2 Specify the Job

Most companies rely on a leadership competency model to help define the attributes they want in their managers. These models typically emphasize generic leadership skills, such as strategic thinking and articulating a vision, as well as abstract character traits like courage, humility, and drive. Combine these ideals with industry experience and a proven track record, so the thinking goes, and you have a perfect leader.

The problem, of course, is that there’s no such thing. If a new high-level executive is to be more than a flash in the pan, a company must define the particular job skills it needs, and recruit and judge candidates accordingly. The May 2006 HBR article “Are Leaders Portable?” laid out a systematic way to consider the full range of skills that a high-level job would require, called the “portfolio model of human capital.” Our research suggests that hiring is greatly improved if companies employ the model’s basic tenets as a template:

Job-based competencies. What specific capabilities will this job require over the next few years? Will the focus be on growth or on engineering a turnaround? Does it require someone who is fundamentally an entrepreneur, a manager, or a leader? If this is a stretch opportunity, can the candidate grow into the job? What are the next jobs he or she is likely to move into, and what capabilities may be required for those positions?

Team-based competencies. Does the candidate have the skills to lead his or her prospective team, and how do they overlap with other members’ skills? How will the applicant manage resistance or political dynamics? Will the individual need to hire additional people to build out the team? If so, can he or she bring in other talented executives?

Firm-based competencies. How well will the candidate fit into the organizational culture? Will this person flourish with the resources (supporting talent, technology, organizational reputation, and so on) the organization can provide? If the

person comes from a more resource-rich environment, can equivalent support be provided, or at least can the candidate be helped to adapt to less?

STEP 3 Develop the Pool

You’d think it would be obvious that the wider you cast your net, the greater the likelihood of finding the right person for the job. But in fact, research from the Center for Creative Leadership has shown, nearly a quarter of the time (one in four cases!) the executive selected was the only candidate considered. That’s a pity, for in talking to many prospects companies gain valuable information about ways different people would tackle the job, and they benefit from thinking afresh in each case about which skills the job truly calls for.

In casting that net, it’s important to include a group that Joseph Bower in a November 2007 HBR article called “inside-outsiders.” These are internal candidates who are nevertheless not bound by corporate tradition and ideology and so may have a more objective view of the organization. A likely prospect might come from an international branch or may manage a line outside the company’s main field. The CEO of a multinational bank told us that he was particularly proud of having promoted some expatriates who had been “forgotten” by the organization.

By extension, another category of candidate to include is the “outside-insider” – that is, a former employee; a customer, supplier, or adviser to the firm; or someone who has worked closely with a trusted insider. Any top-x search, then, needs to contain a mix of insiders, inside-outsiders, outside-insiders, and true outsiders.

The most effective strategy for sourcing is to think not only about candidates themselves but also about people who may know the best ones. Rather than waste your time calling too many irrelevant prospects, talk to individuals who are likely to suggest several high-quality candidates right off the bat. The best leads will come from suppliers, customers, board members, professional service providers, and the like. Amgen CEO Kevin Sharer puts out an “all points bulletin” whenever he’s looking for senior talent – reaching out to recruiting firms, consultants he has used, industry associates, and board members. This strategy helps him identify great candidates and also find further contacts who can connect him with new prospects. As effective as this approach is, we’ve found few CEOs and senior executives who get as systematically and personally involved as Sharer does in the generation of candidates.

This network-sourcing strategy is equally powerful for internal candidates. Research studying the career paths of middle-management executives at one *Fortune* 100 firm, for instance, found that 14% of the people ranked by their peers as being in the top 30% (in terms of potential) rose to become corporate officers. Conversely, only 2% of those ranked in the bottom 70%

Hiring Top Executives: A Comprehensive End-to-End Process

	POOR PRACTICES	BEST PRACTICES	IMPLEMENTATION CHALLENGES
1 Anticipate the Need	<ul style="list-style-type: none"> Hiring only when you have an opening Having an ad hoc succession plan Overlooking the skills your organization will need in the future Indulging in irrational optimism about attrition, succession depth, and recruiting yields 	<ul style="list-style-type: none"> Conducting ongoing, proactive analysis of future needs Continually evaluating the pool of potential talent Developing rigorous periodic forecasts of the company's talent needs 	<ul style="list-style-type: none"> Linking your talent plan to your strategic plan Incorporating input from HR professionals into the strategic-planning process
2 Specify the Job	<ul style="list-style-type: none"> Relying on generic competency models Looking primarily for charisma, general ability, and track record 	<ul style="list-style-type: none"> Defining the specific demands of the job Specifying which skills and experience are relevant Identifying the team the candidate will need to work with or recruit Considering how company culture and context affect the role 	<ul style="list-style-type: none"> Ensuring a close dialogue between HR and top management Building up-front consensus among key decision makers about job requirements
3 Develop the Pool	<ul style="list-style-type: none"> Taking a scattershot, ad hoc approach to finding candidates Limiting the pool Looking for only external candidates or only internal candidates 	<ul style="list-style-type: none"> Developing a large pool Including insiders, outsiders, inside-outsiders, and outside-insiders Considering people on the periphery of the organization (employees in remote offices, consultants, suppliers, customers) Tapping your networks and involving the right external partners Asking candidates' peers for nominations 	<ul style="list-style-type: none"> Transcending organizational silos Encouraging open discussion at the top about when and how to conduct external talent searches
4 Assess the Candidates	<ul style="list-style-type: none"> Settling on the first adequate choice Looking endlessly for the perfect choice Going with your gut only Using the wrong interviewers Including too many unreliable filters and bureaucratic steps Employing unstructured or generic interviews Conducting inadequate (or no) reference checks 	<ul style="list-style-type: none"> Using a small number of high-caliber, well-trained, properly motivated interviewers Employing rigorous behavioral event interviews Conducting detailed reference checks Including top stakeholders in candidate assessment 	<ul style="list-style-type: none"> Educating and training senior line managers in interview techniques Ensuring the right level of involvement of both HR and the relevant line managers
5 Close the Deal	<ul style="list-style-type: none"> Assuming money is everything Showing too little commitment to the candidate's success Discussing only the positives of the job Failing to involve C-level in discussions 	<ul style="list-style-type: none"> Demonstrating active support for the candidate's interests Describing the job realistically Involving the hiring manager personally, not just HR, in closing the deal Ensuring that compensation is fair to other employees Involving C-level for top positions 	<ul style="list-style-type: none"> Ensuring commitment of top managers to closing the deal Ensuring compensation equity
6 Integrate the Newcomer	<ul style="list-style-type: none"> Assuming the new hire is "plug and play" Providing inadequate support and mentoring 	<ul style="list-style-type: none"> Using veteran top performers as mentors Making sure the newcomer checks in regularly with boss, mentor, and HR, even when no problems have arisen 	<ul style="list-style-type: none"> Providing adequate ramp-up time Rewarding mentors
7 Audit and Review	<ul style="list-style-type: none"> Hanging on to bad hires Failing to review hiring practices and institutionalize the best ones 	<ul style="list-style-type: none"> Removing bad hires within the first year Regularly reviewing recruiting practices Identifying and rewarding excellent interviewers Holding all assessors accountable for the quality of their evaluations 	<ul style="list-style-type: none"> Institutionalizing audit and review Being willing to admit mistakes, learn, and move on

did so. In other words, those ranked as high potentials by their peers were seven times more likely to make it to the top.

Additionally, we have observed that organizations are often extremely poor at promoting high-potential candidates across divisions, so it's important to make a special effort to break through silos to identify promising inside-outsiders working in other units.

How do you know when to stop looking for candidates? Surprising as this may sound, it has been demonstrated both empirically and theoretically – whether one is searching for

CFO or a mate – that the simple decision rule of “meeting a dozen” will work well, even when you are sampling candidates from a very large population. Once you have 10 to 12 carefully generated, high-quality candidates, you should move to the next step.

STEP

4

Assess the Candidates

A few decades ago, a number of consumer goods companies applied mathematical models to quantify the expected value of their advertising investments. These same models can be applied to assess the effectiveness of the recruiting process. They allow you to quantify the expected profitability of investing in generating more candidates, improving your assessments, reducing the compensation of hired candidates, and reducing the operating costs of your recruiting practices.

The most important finding from the application of these models is that improving the quality of assessments is three times more profitable than increasing the size of the candidate pool – and six times more profitable than getting the chosen candidate to accept a lower compensation package. A good assessment yields more than a good candidate – it can actually improve the company's bottom line and market value in a very significant way. Specifically, a company can increase its yearly profits and market value by about a third through the disciplined generation and assessment of candidates for a CEO position. The typical cost of a search (with or without professional external recruiters) is negligible when compared with the expected return on investment in candidate assessment. Even for a small company – say, one with a market value of \$100 million – a 10% improvement in the quality of candidate assessments would have an expected return of almost \$2 million in additional profits per year and mean an increase in market value of \$30 million to \$40 million.

Of course, if judging people accurately were an easy task, there would be no need for executive search consultants (or, perhaps, divorce lawyers). Assessing people for complex positions is inherently difficult for several reasons, including the unique and changing characteristics of many jobs, the challenge of assessing intangible traits, and the time constraints of many candidates.

To complicate things even further, what is usually called the “assessment process” is in reality three separate practices, with three different objectives. One goal is to evaluate the candidates. A second is to sell the position and the organization to highly attractive candidates, especially those who may be wary. A third is to build organizational consensus on the suitability of the new candidate, particularly if he or she is external.

Each of these objectives can conflict with the other two. Too stringent a focus on assessment can leave a candidate feeling

OUR RESEARCH is based on two major studies. The first, conducted throughout 2007, included interviews with 50 CEOs of major global companies, followed by interviews with their HR managers and a quantitative survey of their current HR practices. Participating companies collectively employed about 3 million people, earned more than \$1 trillion in yearly revenues, and had a market cap of about \$2 trillion. All major sectors were represented, including industrial, high-technology, life sciences, financial services, consumer products, and service businesses. Likewise, all relevant geographic regions were covered, including North America; Latin America; the UK, Germany, and France; the Middle East; India and China; and Australia.

The second study was a survey of executive-search consultants, conducted in the summer and fall of 2008. Respondents rated the talent-management practices of about 500 companies. Sixty-seven percent of those who responded had over 10 years of experience in recruitment, and 59% had specialized in a given industry for 10 years or more. The survey was designed to create a broad-based view of the state of the art in selection, hiring, integration, and talent management practices.

The article is also built on the research conducted by Claudio Fernández-Aráoz for the book, *Great People Decisions* (Wiley 2007) and by Boris Groysberg, Andrew N. McLean, and Nitin Nohria for the May 2006 HBR article “Are Leaders Portable?” Finally, we conducted a major review of academic articles about selection and hiring.

judged and unenthusiastic about the firm. Too great an emphasis on selling may make candidates feel that you are desperate and that they are in a position to drive a tough bargain. Too hard a push toward consensus by involving layers and layers of people and many interview stages invites internal politicking – and may also drive away attractive candidates whose schedules, or need for confidentiality, won't allow for a lengthy decision process. Avoiding these pitfalls requires the following four elements:

The right interviewers. A robust assessment process follows a sequence of steps. We believe that the first is to select a small number of individuals – typically the hire's prospective boss, the boss's boss, and the top HR manager – to conduct the interviews and check references. It's critical to note that *it's more important to choose the right assessors than to focus on the assessment technique*. Getting the wrong people involved in your hiring process increases the risk not only of hiring an unsuitable candidate but also of rejecting a good candidate. The worst interviewers actually have a slightly *negative* effect – that is, following their recommendations will lead to a worse decision than simply hiring a candidate from the pool at random.

There are a host of reasons why this might be so. Interviewers may enter into the process with the wrong motives: Some people, for example, don't like to surround themselves with strong, high-potential colleagues. Interviewers may also be subject to a whole series of unconscious psychological biases, including a bias toward people like themselves. Interviewers who are themselves weak managers, for instance, may rate highly candidates who are weak in the same way they are and, worse, rate strong managers as poor simply because they are different.

The best interviewers are deeply familiar with the range of experience and skills the position requires and are sufficiently self-confident to look for the best possible candidates, even those they may deem more talented than themselves. They possess a high level of emotional intelligence and the ability to decode nonverbal behavior. They are masters of self-control – and great listeners. Of course, it's difficult to find individuals who can fit this bill, so companies have a choice. They can “empower the knowledgeable” – those who already demonstrate some of these skills and have been educated and trained in assessment (possibly because they work in HR). Or they can follow an even more promising strategy, which is to “educate the powerful” – that is, make sure senior managers and executives are properly educated in making great people decisions.

The right number of interviewers. Given the importance and difficulty of assessments, you may naturally be tempted to

involve a large number of interviewers. That, however, would be the wrong strategy in today's world, where exceptional talent has become scarce. The greater the number of filters you include in an interview process (in which, for example, each successive interviewer can eliminate a candidate), the more you reduce your risk of hiring the wrong person – but

The worst interviewers may very well recommend a candidate who's less qualified than one hired at random.

also the more you increase your risk of rejecting the right one. Probabilistic analysis shows that three independent top-caliber interviewers are enough. With the right skills and motivation, they will help you reach a high level of accuracy in your assessments while still maintaining a low probability of losing exceptional talents.

The right techniques. Properly structured interviews and reference checks will help you achieve reliable assessments. We recommend a particular type of structured interview, called a “behavioral event interview,” followed by thorough reference checks that fill out the picture.

Behavioral event interviews are far more effective than unstructured interviews or those in which standard and general questions are asked about a candidate's strengths or weaknesses. With some training and practice, even an intelligent novice can master the basics. The interviewer should ask candidates to describe specific experiences they've had that are similar to situations they'll be facing in your organization. For example, you might say, “Describe a time when you needed to work under an intense deadline,” or “Tell me about a situation in which you managed conflicting interests among your colleagues,” or “Explain how you saw a new product through to completion.” The assessor should probe for details of the candidate's exact actions and reasoning at the time. The candidate should not be allowed to discuss hypothetical scenarios or make vague statements about what “we” did. The objective is to find out whether the individual's past reveals the specific competencies you're looking for.

After the assessments have been completed, it's important for the interviewers to come together and have a rigorous, disciplined conversation about the evidence. This conversation should not be allowed to veer off into vague discussions of overall impressions or of how well everyone hit it off with the candidate. Some companies that excel at recruiting require all interviewers to score candidates on a matrix of specific attri-

butes. They then tabulate the data and gather to review their combined ratings, explore differences in their judgments, and arrive at a consensus on which candidates should be finalists. This process naturally results in a bias against including any candidate about whom a strong consensus cannot be reached.

Given the fallibility of memory and the human tendency to overestimate one's own ability and achievements while being interviewed, it's important to balance interviews with formal reference checks once the initial pool has been reduced to a few strong finalists. In general you will want a broad spectrum of references. A boss in a former job can attest to how well a candidate can think strategically or get results. Former peers can discuss the candidate's ability to influence and collaborate. And former direct reports can reveal leadership traits. Again, ask about specific things the candidate did, particular tactics chosen, and actual results achieved, so you can put his or her attributes and achievements into a day-to-day context. You should go out of your way to get permission from the finalists to speak with truly relevant people, not just their friends. At this later stage, a candidate risks less and has more to gain in giving permission for such assessments.

There is an art to getting referees – who may be loath to say disparaging things about their colleagues – to speak frankly. Asking specific questions is one safeguard. In addition, you should point out that it does no one any good if the candidate gets hired but then fails. You could also add that of course no one is perfect, and honest replies will help in integrating the successful candidate into the job. Finally, if the position is senior and the reference is critical, a top executive should meet in person with the referee.

The right organizational support. Once you are convinced that you have one to three highly qualified candidates, it's time to start exposing the finalists to a few key stakeholders who have been properly briefed about the position's requirements. It's important here to ensure that these people hold no conflicts of interest and can evaluate the candidates objectively. They should review each prospect's relevant skills, as well as the detailed assessments, to avoid rejecting the right candidates for the wrong reasons.

How does that happen? First of all, people commonly assume that an impressive educational background or years of experience in senior positions at a great company are almost a guarantee for success on the job. GE alumni, for instance, are usually thought to do very well as CEOs elsewhere. They all have great academic credentials, and of course GE is a factory of senior talent. But when they didn't have the right mix of competencies needed for the specific jobs they were hired to do, a number have actually destroyed significant value when becoming CEOs of other companies.

Second, many people fall into the first-impression bias and very rapidly (in a matter of minutes, or even seconds) reach a conclusion, pro or con, about the candidate, based on snap judgments. As a result, during most of the interview they just



seek selective confirmatory information from the candidate's background rather than keeping an open mind. And, third, it's possible that an interviewer does not conduct the search in good faith for political reasons.

Ideally, once they're satisfied that the finalists have been selected for the right reasons, the three principals (the boss, the boss's boss, and the HR executive) should reach a consensus on who is the best of the finalists. Ultimately though, the direct boss is the one who should make the final decision. Every manager should have the right to hire and fire – and of course be accountable for his or her decisions.

STEP 5 Close the Deal

Having found the candidate of their dreams, too many companies fail to close the deal. If you are ambitious enough to try to attract the best candidates, at least one out of five will be likely to turn down your offer. And the situation is even more intense in the most attractive growth markets, such as China and India, where the talent pools are extremely limited for their size and growth rates. There, candidates are blessed with options; we frequently hear of individuals receiving three, and even four, job offers.

What factors determine whether or not the top candidate will accept your offer?

The organization's commitment. Many executives in our survey think financial compensation is the linchpin in recruiting. But closing the deal is not just about money; it's also about demonstrating to candidates that the organization is committed to their success. No high performer wants to take a new job only to be demoted, downsized, or left to flounder in organizational quagmires. A personal show of commitment by the CEO is essential: By taking the time to share his or her passion about the company and the position with the candidate, by expressing a sincere interest in the project and the person, and by genuinely understanding the candidate's motivation, concerns, and long-term fit with the organization, the CEO can send a powerful message that the company cares.

The job. In their desire to close the deal, many managers present only the positive aspects of the job. This is a mistake, for research shows that a realistic presentation of both the opportunities and the challenges of a prospective position results in higher offer-acceptance rates, better post-employment job satisfaction, and lower turnover. Candidates want to decide for themselves whether they will be able to cope with the challenges they may face. This doesn't mean dwelling on the downside. To communicate the positives, a successful hiring manager could borrow a page from John F. Kennedy's playbook and ask not only what the candidate can do for the job but what the job can do for the candidate – and then take whatever steps are necessary to make sure the job holds that potential. Managers should also clearly differentiate the opportunities at their firm from those of competitors. The value proposition might range from flexible job design and job rotation to nonfinancial benefits, advantages in the culture, and growth and development opportunities.

The boss. It's well known that employees do not leave jobs; they leave their managers. Inept managers not only do their own jobs badly, they also destroy the performance (and potential) of the people around them. In their book *Hard Facts, Dangerous Half-Truths & Total Nonsense*, Jeffrey Pfeffer and Robert Sutton review the research on organizational climate over the past half century. They found that "60% to 75% of the employees in any organization – no matter when or where the survey was completed and no matter what occupational group was involved – report that the worst or most stressful aspect of their job is their immediate supervisor."

"Abusive and incompetent management," Pfeffer and Sutton continue, "create billions of dollars of lost productivity each year." And study after study, they conclude, "demonstrates that

bad leaders destroy the health, happiness, loyalty, and productivity of their subordinates." Because of this, the hiring manager must demonstrate commitment by being heavily involved in the closing stage of the hiring process, rather than delegating this last, critical step to HR.

Compensation. How much should you pay to get the best candidate? Aside from considering the comparable market rate for the position and the prospect's past salary, there is another important benchmark – the current state of compensation within the company. If you break the bank on an outside person and the amount is discovered, existing staff can feel devalued and demotivated. It's also important to structure the

Talented new hires should not be given the freedom to sink or swim; more often than not, they sink.

new employee's compensation with an eye not only to immediate effort but also to sustained performance. This goal usually calls, of course, for striking a creative balance among salary, bonus, and long-term incentives, such as restricted shares.

STEP 6 Integrate the Newcomer

The recruitment process doesn't end after the deal has been closed, although most companies think it does. Our research shows that many firms take no steps at all to ensure that new employees are integrated into the company's culture. Many hire experienced professionals, expecting them to be "plug and play." Typically, the entire integration "strategy" consists essentially of signing up the promising candidate, making the necessary introductions, and hoping for the best.

But talented new hires should not be given the freedom to sink or swim; more often than not, they sink. We found that 40% of new C-level hires who departed within two years did so because of integration difficulties. Turnover was highest in positions requiring the greatest level of integration. (The COO, for example, is far more dependent on establishing relationships throughout the company than is either the CTO or the CFO.) Similarly, a fall 2007 survey of 2,000 HR and training executives conducted by Novations Group found that a third of employers lost between 10% and 25% of all new employees within the first year. The main reasons respondents gave for employees' departures were (in order of importance):

the company's unrealistic expectations, failure to grasp how things get done around the organization, poor communication with immediate supervisors, failure to develop a sense of belonging and purpose, inadequate technical skills, not understanding the link between their job and the organization, and failure to connect with key employees.

In general, organizations that systematically integrate new employees enjoy lower turnover, and the recruits report greater commitment and job satisfaction. The most successful firms move quickly on several fronts to orient newcomers to their own departments and to other parts of the firm. Such companies begin integrating new hires during the interview stage, before they ever come to work. In the first few months, these organizations make sure the boss and HR manager check in regularly with each new recruit, just to see if everything is going well. In some organizations, detailed integration plans are developed similar to those used for acquisitions, complete with specific milestones and backed up by regular progress reports.

The best firms assign each new top-x a mentor, usually an established star in the organization. A veteran of the company's culture can serve as a valuable reality check until the newcomer becomes fully culturally literate. We recommend that companies identify and secure commitment from strong potential mentors before a new hire is brought on board. The mentor's role should be understood to be ongoing, not just a quick "buddy" fix to make the newcomer feel at home. Organizations should mandate that new leaders formally check in quarterly with their mentors, their bosses, and HR for the first year or so, no matter how well they're performing. They should analyze progress against expectations by asking four basic questions: Is the new hire getting adequate support? Is he or she developing the right relationships within the organization? Does the new manager understand the business model? Is there evidence of progress? In the absence of regularly scheduled check-ins, a new hire might be reluctant to ask for help, for fear of losing face. It's important that mentors be trained to give feedback and handle difficult conversations appropriately – that is, to be coaches rather than cheerleaders.

STEP 7 Audit and Review

A great recruiting and integration process will minimize, but can never eliminate, the chances of making a hiring mistake. When that happens, best-practice firms act quickly to remove bad hires – that is, within the first year. One year may not be enough time for a new executive hire to forge any great successes – but it's plenty of time to demonstrate ineptitude.


To improve what might be called your "hiring batting average," it's important to regularly au-

dit and review your recruiting practices. Some of the best IT-software companies – including the Indian firms Infosys, TCS, and Wipro – take auditing and review of all their recruiting practices as seriously as they do oversight of their financial systems.

In addition to evaluating your new hires, try to find out what happened to the other internal and external finalists. Though it's hard to tell how the candidates who were not hired might have fared had they come on board, it's still instructive to see how well they're performing in their current roles relative to the candidate who got the job. Does this comparison give you confidence in your decision – or give you pause?

Periodic reviews can also help identify those in your organization who are particularly adept at assessing talent. In fact, rewarding your assessors (and, conversely, holding them accountable) for the quality of their evaluations will motivate them to improve next time.

...

Companies can and must do better at filling top executive positions than they have up to now. Our hope is that, by following the recommendations we've laid out in these pages, organizations will be able to set the bar higher, reevaluate their recruiting processes, and make "talent management" a reality rather than an empty phrase. 

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"I like a man with a good, firm fist bump."

Roy Delgado

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Is Your Growth Strategy

Flying Blind?

by Mehrdad Baghai, Sven Smit, and Patrick Viguerie

Sizing up revenues by division or region can be downright misleading. Only a fine-grained view of performance will reveal the most – and least – promising pockets of opportunity.

IN EARLY 2007, U.S. senators asked then-Lieutenant General David Petraeus how much sectarian violence might erupt if U.S. forces withdrew from Iraq. He admitted being uncertain: “It’s hard from this distance,” he said, to understand “the real granularity of what’s going on.”

The Senate questioners sought the big picture – something CEOs are continually told it’s their job to provide. Yet for that big picture to be meaningful, Petraeus needed “granularity” – which few chief executives have the time to pursue.

For most of the past century, CEOs have coped with this tension fairly elegantly by organizing their companies into business units and geographic



regions and then holding those entities accountable for performance. Over the past two decades, however, advances in information technology have made it feasible both to target ever-finer-grained market segments and to measure the sources of growth – market momentum, mergers and acquisitions, and market share gains – in an increasingly detailed way. So far, few organizations have figured out how to turn the oceans of data available to them into islands of insight about their best opportunities for growth. Even fewer have attempted to structure and manage themselves with sufficient granularity to match the texture of the markets in which they play.

Therein lies largely untapped potential for companies to accelerate their growth and separate from the competition. By looking microscopically at their markets and their current performance relative to rivals, companies can develop far better growth strategies. In most cases, the new strategic direction will highlight a need for significant changes in how the company allocates resources, deploys people, and reviews results. This additional granularity becomes especially important during economic downturns because it enables much more nuanced strategies, both in terms of cutting costs and of going on the offensive.

This article describes how the world has become more granular – through, for instance, the global expansion of markets and the impact of advanced information technologies – and the challenge that presents for companies as they try new ways of understanding their growth potential and then wrestle with the organizational implications of their enhanced understanding. It is meant to be a practical road map that builds on our recent book, *The Granularity of Growth*, with new analyses and descriptions of several companies' experiences adopting more granular approaches to growth. It is increasingly clear to us that granularity and economies of scale can – indeed must – coexist, and that mastering this balancing act will confer competitive advantage through the downturn and once the economy begins to recover.

Growth Is Granular, but Most Companies Aren't

During the early twentieth century, a new organizational form emerged in the United States: the multidivisional company, in which business units corresponded to key product lines and

IDEA IN BRIEF

Your company's best growth opportunities may get lost in the big picture. To find them, look at markets and performance under a microscope. For example, one construction equipment and services company suffered stagnant growth until a highly granular market analysis identified pockets with \$10 billion in untapped revenue potential.

To grow your business:

- » Identify microsegments of customers, geographic regions, and products with the strongest market momentum.
- » Invest resources (R&D, advertising, and so on) in those areas, and jettison low-growth areas.
- » Restructure your organization to focus on the expanded number of priorities. For instance, assign each microsegment its own accountable leader. Some companies will need a team of 200 or more executives to head up new product clusters or geographic slivers.

shared a central set of resources. DuPont was an early pioneer, and Alfred Sloan took the form to fruition during the 1920s, when he reorganized a hodgepodge of companies and brands into the General Motors Corporation. By adopting this new structure, DuPont, GM, and many others honed their precision in making decisions, measuring performance, managing their workers, and organizing themselves.

Our research suggests that firms today can benefit from an even more granular approach than Sloan could have imagined possible. A snapshot of one large European manufacturer of personal-care products illustrates how (the unnamed companies in this article are disguised examples). The company has three lines of business and appears at first glance to labor in a number of low-growth markets (growth forecasts for the three divisions range from 1.6% to 7.5%). But a deeper look reveals a prodigious spread in anticipated growth rates among countries and product lines within each division. What's more, some of the most promising segments in the company happen to reside in the division with the lowest overall growth forecast (see the exhibit "Unearthing Hidden Growth Segments").

This is not an isolated phenomenon.

We reviewed growth patterns of global firms from 1999 to 2006 and found that the correlation between overall growth rates and sector growth rates increased dramatically for companies that had taken a granular approach to management and analyzed smaller slices. In other words, companies can get a much more accurate picture of their growth prospects by digging deeply into micromarkets (typically ranging from \$50 million to \$200 million in value) than by looking at the divisions commonly used for measuring, organizing, and managing.

Over the past decade or so, the rapid pace of innovation on the internet, and in the information and communication technology world more generally, has made that more feasible. To understand why, consider the basic economic problem associated with greater granularity. As companies target finer-grained market segments, the sales benefits typically increase quite quickly but then start to taper off as smaller and smaller variations are tried. At the same time, adding complexity by catering to a broader range of customer needs can boost costs sharply. However, as the cost of technology platforms drops, so does the cost of targeting ever-narrower segments of cus-

tomers – as Chris Anderson argued in *The Long Tail*.

A few examples show what we mean. Let's start with a well-known one: Amazon, the online retailer unconstrained by physical storefronts, has a scalable, sophisticated IT platform and infrastructure and delivers many of its books not from its own warehouses but via a virtual supply chain. As a result, Amazon can efficiently indulge the tastes of narrow customer segments, literally down to the individual buyer, at very low marginal cost. Technology also enables companies in emerging markets to build scale rapidly while continuing to take a granular approach. Ping An, one of China's largest insurance companies (with more than 40 million customers), is able to manage a fragmented sales force of about 300,000 agents by using a mobile-based sales management platform, thus overcoming the lack of fixed-line telecom infrastructure in some regions. Similarly, packaged-goods companies in Latin America are increasingly tailoring their product and service offerings, displays, distribution approaches, promotions, and incentives to the needs of microsegments of mom-and-pop retail outlets: Salespeople armed with wireless devices feed information to headquarters in exchange for concise recommendations on tactics.

Despite such possibilities, our experience is that a great many companies continue to measure, manage, and organize themselves on the basis of relatively aggregated data. These companies are likely to miss important shifts in their performance and their markets. Excessive aggregation also leads to unrealistic performance targets, misinformed priorities, and misdirected leadership efforts.

Building Granular Understanding

When companies take a more granular approach, they position themselves for growth by making smarter decisions regarding everything from their R&D investments to their target markets to their advertising mix. Take the following three examples:

- When a construction equipment and services business facing flat growth divided its global markets into thousands

Many companies still steer divisional strategy based on aggregated data. This big-picture practice leaves deeper levels of detail unseen, often giving managers a misleading view of performance. A granular approach can produce more-rational – and more-rewarding – investment decisions.

EXAMPLE One large European manufacturer of personal-care products languishes in a number of low-growth markets. Divisional growth forecasts range from 1.6% to 7.5%, but an aggregated view of performance obscures the fact that the division with the lowest overall projected growth actually houses some of the company's most promising segments. Moreover, within each division there is dramatic variation in performance at the microsector level.

Companies can grow in three basic ways: by gaining market share, by participating in fast-growing markets, and by acquiring or merging with new businesses. The authors' research shows that the strongest contribution to overall performance comes from the vitality of the markets in which the company plays. The weakest contributor is market share – ironically, the area that traditionally commands the most management attention.

EXAMPLE A construction equipment and services business facing flat growth discovered hitherto neglected market-growth pockets by dividing its world into geographic, customer, and product slices. The exercise showed extremely small revenues and market share in the fast-growing market spaces, revealing more than \$10 billion in untapped potential.

The ability to capture the performance of all three kinds of growth at a high level of granularity is neither cheap nor easy. Doing it well requires a significant expansion of the leadership team – in a large enterprise, perhaps hundreds more managers. CEOs can themselves be reluctant to go spelunking into the depths of divisions for which they've made others accountable. But if their conversations with business unit leaders can penetrate beneath the surface view, better strategy decisions will emerge.

EXAMPLE When the CEO of one large semiconductor company structured discussions with division chiefs to focus on performance at a much higher resolution, the company reallocated 30% of its R&D resources to previously unexamined markets where it had the strongest winning play. Two years later, it is growing much faster than the broader market.

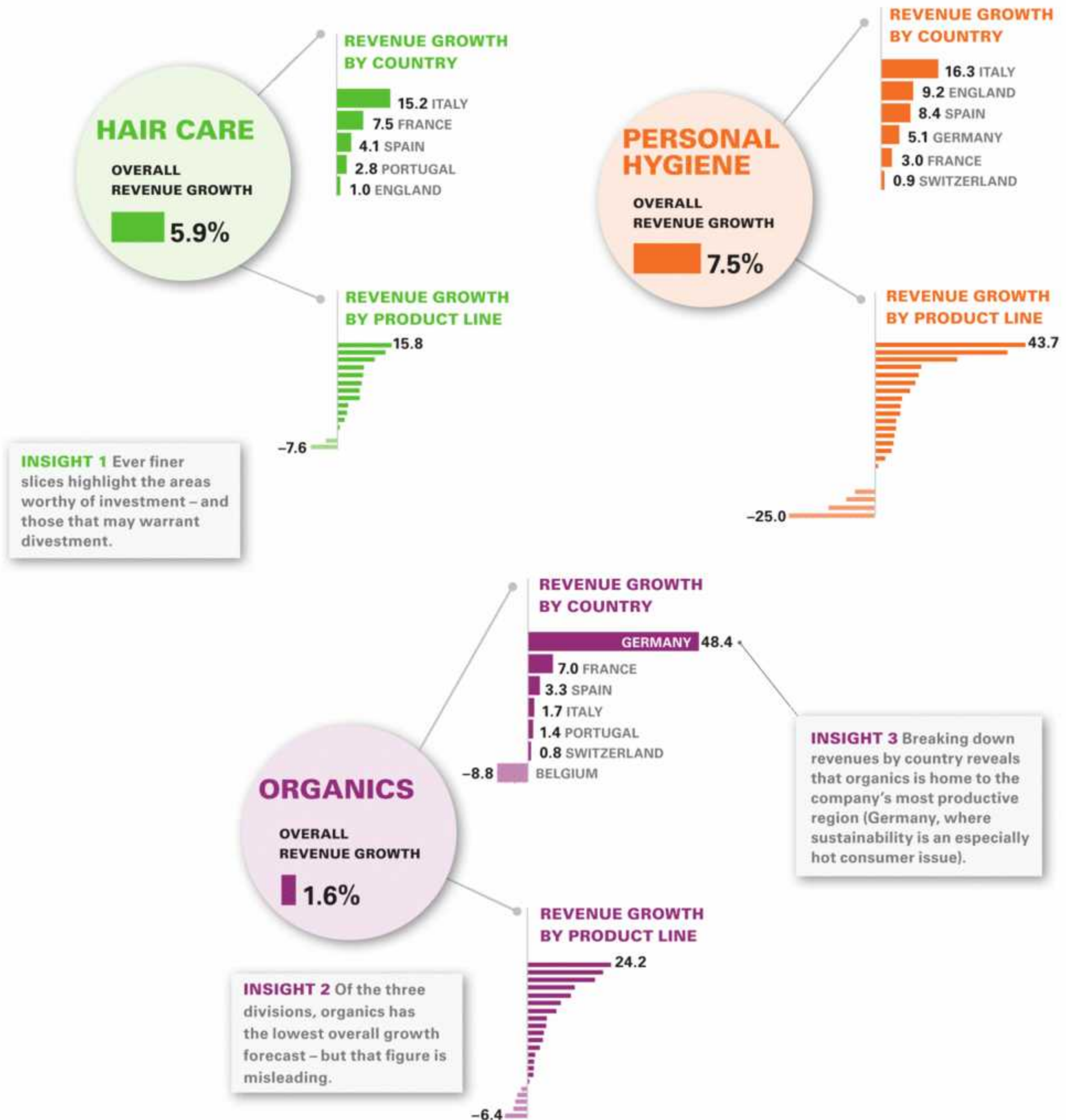
of segments, it recognized several growth opportunities that had been starved of R&D resources because 85% of its investments had gone to support existing business activities.

- A company in a knowledge-intensive industry shifted to more-granular management of its business units, driving its annual compound profit growth over 30% for each of the past five years. The company is adopting a similar approach for business development activities, going from a three-segment to a 150-microsegment view of the market.

- An integrated telecommunications service provider retooled its marketing mix – making fewer roughly calculated

Unearthing Hidden Growth Segments

A large European multinational manufacturer of personal-care products has three divisions: hair care, personal hygiene, and organics (a three-year-old group that develops natural and organic alternatives to traditional offerings). Successively finer levels of disaggregation yield increasingly useful insights about revenue growth forecasts.



For an even more atomized breakdown of performance, see our heat map of a construction equipment and services firm in the exhibit "Backing the Best Bubbles of Market Activity."

media trade-offs (television versus direct mail versus radio) and instead selecting the right media within narrowly defined regions for specific lines of business (wireless versus land lines). As a result, it boosted sales between 10% and 15% in several regions and increased average lifetime customer value by 15%.

To seize opportunities like these, firms must examine both market potential and company performance in greater detail.

Market potential. Our research indicates that building a granular understanding isn't simply about assessing segments and markets at lower levels of aggregation, though this is important. It is also about sizing up the sources of growth in a more precise manner. We see three distinct categories of growth: mergers and acquisitions, plus two types of organic growth – market share gains and portfolio momentum (that is, the growth of the markets in which the company plays).

We used multivariate regression analysis to calculate the relative importance of these three elements. All are meaningful contributors to growth, but the most important at the more than 400 companies we surveyed was portfolio momentum, which accounted for nearly half the total uptick. M&A performance came in second, at roughly one-third. Market share gains, a primary focus of many management teams, accounted for about one-fifth.

Companies trying to understand market potential may look at their overall growth rates in specific customer segments. In our experience, the simplest way of scrutinizing the underlying market momentum of the different parts of a company's business is to create a heat map that shows the momentum and market share levels for the firm in extremely fine detail. To understand what this looks like in practice, let's return to the construction equipment and services company that faced a flat growth outlook as its core markets matured. The sheer size of the company's business and the rate at which the core markets were slowing made it virtually impossible to achieve meaningful growth rates by focusing on market share gains in established segments and regions.

When the company divided the business into geographic, customer, and product slices, it identified nearly 4,000 measurable growth pockets (see the exhibit "Backing the Best Bubbles of Market Activity"). This analysis showed that despite the slowdown in the overall market, fast-growing pockets held more than \$10 billion in revenue potential. Furthermore, the company's actual revenue in many of these intriguing growth pockets was extremely small.

This basic exercise of mapping each \$50 million to \$200 million growth opportunity on the dimensions of market momentum and current market share is enormously powerful. The former gives a feel for the strength of the wind at the back or in the face of each business unit. (It's worthwhile to compare recent portfolio momentum rates with growth forecasts to paint a dynamic picture of the market and understand how a company is performing in light of expectations.) Market share, by contrast, describes the firm's current position relative

to others': Is it chronically underperforming in the market; is it still just wading in; has it achieved a viable foothold and earned the right to grow rapidly; or is it in a strong competitive position, such that maintaining its standing will be a key investment focus?

Company performance. Building an understanding of market potential is a good start, but companies can get far more rigorous by deploying a benchmarking approach that we have named the *growth MRI* (after the high-resolution medical-scanning technology). Anyone who has had a family member diagnosed with cancer will understand the importance of the MRI scan. For an oncologist to simply break the news that there is cancer would not be very helpful. Before deciding on the best course of treatment, the doctor must know what type of cancer it is, where it is, and how advanced it is. The growth MRI provides the same degree of specificity for chief executives seeking to grow their companies.

The conceptual underpinning of this approach is the relationship between shareholder-value creation and the three growth components (market momentum, market share gains, and M&A). When we assessed this relationship in the 400 companies we surveyed, we found that top-quartile performance in one growth component (even if coupled with bottom-quartile performance in another) was associated with greater shareholder-value creation than average performance across all three. Strength in more than one area, though rare, led to even better results for shareholders. Over time we have evaluated alternative ways of looking at growth and found that one figure offers the best correlation with shareholder-value creation. It is the number of components with top-quartile performance minus the number with bottom-quartile performance – or, the *net growth rating*. The growth MRI exposes the relative performance of each part of the business by benchmarking its net growth rating against a relevant industry threshold. Looking at the world in this way allows companies to identify areas of strong and weak growth and quickly point to priorities for investment or divestment.

To grasp the diagnostic value of the growth MRI, consider the following example of one large multinational with a diversified set of businesses. At the corporate level, the company has a net growth rating of zero, which equates with "good" performance. Looking at the company through a geographic lens reveals that two of its five regions are rated as "good." Another, propelled by a tailwind provided by strong market momentum, is achieving "great" performance. On the bad side, two regions exhibit poor market share growth and are rated "poor." It is already clear that the average "good" performance of the company as a whole masks the distribution of performance in the organization.

Cutting the data again, by line of business, reveals even greater variation. Of the company's 16 lines of business, five rate as "poor" and one rates as "great" (the remaining 10 are

Backing the Best Bubbles of Market Activity

THIS DIVERSIFIED MAKER of construction equipment (and, more recently, provider of logistics and project-management services) has four main divisions that operate in the Americas, Europe, and Asia-Pacific. Its offerings range from light to heavy specialized excavation and earth-moving equipment and cranes; it also provides support services such as site lighting, power generation, and mobile offices.

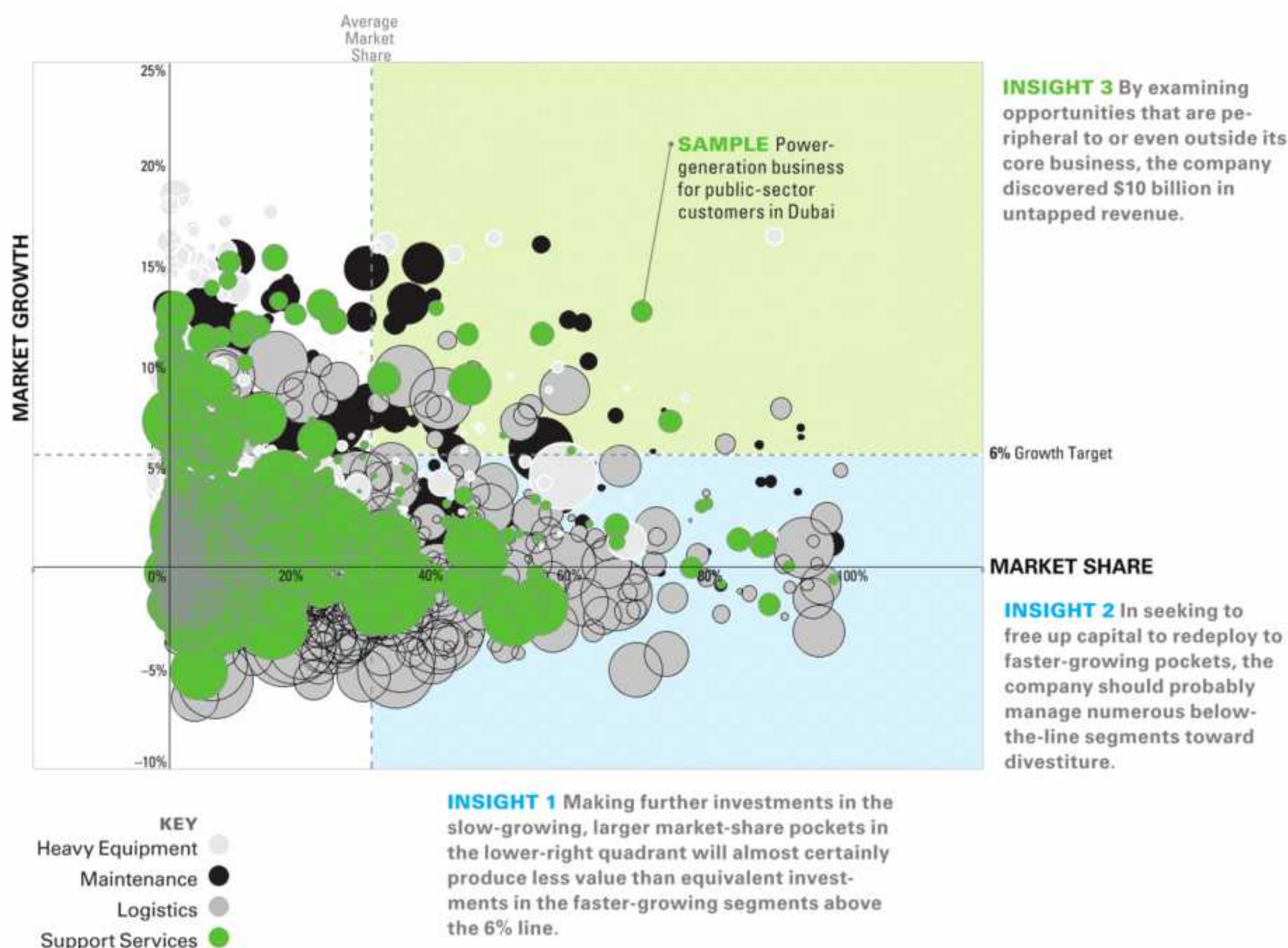
Because the highly competitive construction industry is hard hit by the economic downturn, the firm's growth expectations of 6% will be

challenging to meet. When performance numbers are rolled up to the division level, it is difficult to identify either promising market segments to pursue more energetically or those from which the company could profitably withdraw. Only by taking a granular view of the entire portfolio of activities (by individual product lines, customer segments, and regions) does management get a telling picture of both opportunities and liabilities.

That's why the firm created this heat map, which shows roughly 4,000 pockets of the business. The

bubbles are colored to correspond to the company's four divisions and sized to represent the relative value of the business the company currently does in each pocket. The placement of a pocket along the horizontal axis indicates its market share; placement on the vertical axis indicates the segment's momentum growth rate – how much wind is at its back.

It's easy to see that more pockets fall below than rise above the company's aggressive 6% growth target. What other insights can leadership draw from this highly granular view?



“good”). This additional resolution was also lost by averaging up the data.

The real power of the MRI comes at the next level of granularity. It’s possible to push the analysis to several hundred or even a thousand cells in order to get an extremely fine-grained look at which areas have tended to succeed and whether there are patterns by region or type of business. Without making things too complex, let’s look at the exhibit “The Full-Growth MRI.” Nine of the 80 cells (the ones shaded black or dark gray) exhibit “exceptional” or “great” growth performance. Forty-nine of the 80 cells (the ones shaded light gray) are rated “good.” The remaining 22 “poor” cells impose a heavy performance burden on the company, accounting for low overall growth relative to competitors.

The MRI can help companies go further in identifying their growth challenges and opportunities. For example, only 15 of the company’s 80 cells exhibit at least top-quartile market momentum. The rest of the business – including cells with strong M&A or market share performance – doesn’t benefit consistently, as it should with a growth-sustaining wind at its back. To address this, the company is now investing resources in the areas with strong market growth and seeking to shed some of its low-growth holdings.

This company’s CEO seems to be in charge of three different businesses: one that’s performing brilliantly and creating shareholder value, one that’s average, and one that’s struggling. The trouble is that these three intermingled organizations are difficult to discern without the benefit of granular management techniques – which CEOs must learn to apply.

Managing Your Business in a More Granular Way

When a company takes a more detailed view of its activities, it shines a spotlight on areas that senior management has never before seen clearly. As aggregation and consolidation give way to precision, it becomes easier to identify previously hidden parts of the organization that are performing strongly – as well as those that are not. This can be an uncomfortable experience for senior executives, as it often has profound implications for the organization’s structure, people, and processes.

The impact on structure is the most apparent effect (though not necessarily the most important): More-granular management can lead to changes in how business units are grouped and the lenses used to view their growth potential. It also is likely to influence how many layers of management are needed, and which functions are shared and which have devolved to the business units. A question executives must al-



Resource reallocation must be derived from insights about where growth pockets will be, not where they are now.

ways ask themselves is whether the benefits of centralization genuinely outweigh the benefits of focus and unambiguous accountability. This isn’t a new question – Alfred Sloan wrestled with it, too – but it’s one that companies may answer in new ways with a granular approach to strategy.

We’ve observed that the people and process issues are more important than structural challenges – and frequently take more time to get right because they are the guts of how most companies run. CEOs need to evolve how they lead and manage the increasingly granular organization. This means developing the ability to quickly reallocate resources as needed. It often requires CEOs to expand their concept of “top leadership” to encompass not dozens but hundreds of executives across the relevant performance cells. And it calls for overhauling how CEOs review and discuss results with those managers – whose own performance, when seen in a more granular way, may be revealed as exemplary or deficient.

Reallocating resources. A more-precise understanding of company performance and market potential will lead to resource reallocation, both within and across businesses. The goal, of course, is to target pockets of higher market momentum, thus increasing the growth rate for the company as a whole.

We have found that two guiding principles are imperative for effective resource reallocation. First, it must be derived from insights about where growth pockets will be, not where they are now. Take, for example, General Electric CEO Jeff Immelt's announcement a few years ago that by 2010 the company would be investing \$1.5 billion annually in renewable energy businesses. Second, it's helpful to use zero-based budgeting (requiring managers to justify each expense rather than incrementally increasing the budget year after year) to unfreeze and correct past misallocations.

Zero-based budgeting was crucial for the construction company that had previously devoted just 15% of its R&D resources to growth-related activities. Taking a clean-sheet approach allowed management to make tough choices and

free up resources for three major thrusts: investing in the more rapidly growing product areas, regions, and customer segments; trying to boost the underlying market growth of a large business that would be unwieldy to divest but could easily drag down the company's growth prospects; and re-deploying resources to fund acquisitions in an entirely new market area with the potential to equal or exceed in size the company's existing business.

Acquisitions and divestments will be an important part of resource reallocation at most companies. Our research indicates not only that M&A is a critical source of growth for large organizations but also that taking a granular view will help them spot more situations where the only way to move quickly into a high-growth market space is through a targeted acquisition. Businesses revealed as poorly performing, in unattractive market spaces, should be jettisoned.

As firms begin to manage in this way, they will need to scale up their M&A capabilities. This means building the capacity to screen more deals, getting better at looking beyond purely financial criteria to growth potential and strategic fit, know-

Fighting Gravity in a Downturn

CORPORATE LEADERS have a choice as they work their way through a global downturn: Pull in their horns and ride out the storm, or look for opportunities to go on the offensive and get ahead of their competition. If past is prologue, most will follow the first course – and that will be a mistake.

To be sure, it's an understandable mistake. As revenues slow and margins are squeezed, management naturally switches focus. The company protects its balance sheet, leading to the deferral of growth and low-priority investments, the shelving of large acquisitions, and the sale of assets. Many firms simply freeze under pressure: In the last downturn, the companies in our database with decreased revenues in a major business segment were one and a half times more likely than those with increased revenues to make no portfolio moves at all.

The best growth companies take the opposite tack, treating a recession as a time to increase their lead. They leverage the advantage created by their more-

granular management approaches in at least three important ways:

FIRST, they cut discriminately. One client of ours, rather than reduce costs 20% across all business units, asked some "cells" within the organization to cut more than that so other especially high-performing pockets could be spared altogether. The same logic should apply if divestments are needed to free up capital; granular analysis can identify key assets to retain. Done thoughtfully, cost cutting can actually improve the company's portfolio momentum and enhance the likelihood of outperforming peers in the future.

SECOND, such firms pounce on acquisition opportunities the downturn creates – and do so with an alacrity that is the stuff of legends (think of General Electric's speedy dispatch of an army of deal makers to Asia after the financial markets took a dive in 1997–1998). Potential deals that may have been off the table might suddenly be viable again as asset prices fall. This is especially true for small- and mid-cap targets where

drops in market capitalization threaten not just their growth strategies but their very survival.

THIRD, the best growth companies view a downturn as an occasion to take advantage of the competition's weaknesses. As rivals cut costs and staff, they expose themselves to attack. We worked with one client to identify the 30 most attractive micromarkets where competitors became vulnerable through broad cost-reduction initiatives. The client formed special "blitz teams" to pursue aggressive market share gains in exactly those places.

We're not saying companies should go on a spending spree in a downturn and tighten their belts in an upturn. Nor are we naive to the fact that some firms simply aren't in a financial position to exploit the opportunities presented by downturns. But for large numbers of healthy, resilient companies and their CEOs, we hope our findings are a useful counterweight to their natural tendencies, which can lead to missed opportunities.

ing when to integrate and when to leave an acquisition alone, and enhancing coordination between corporate M&A teams and business unit leaders who understand the nature of the growth opportunity. Companies that build their muscle in these areas raise their odds of quickly and effectively reallocating resources to their best possibilities for growth.

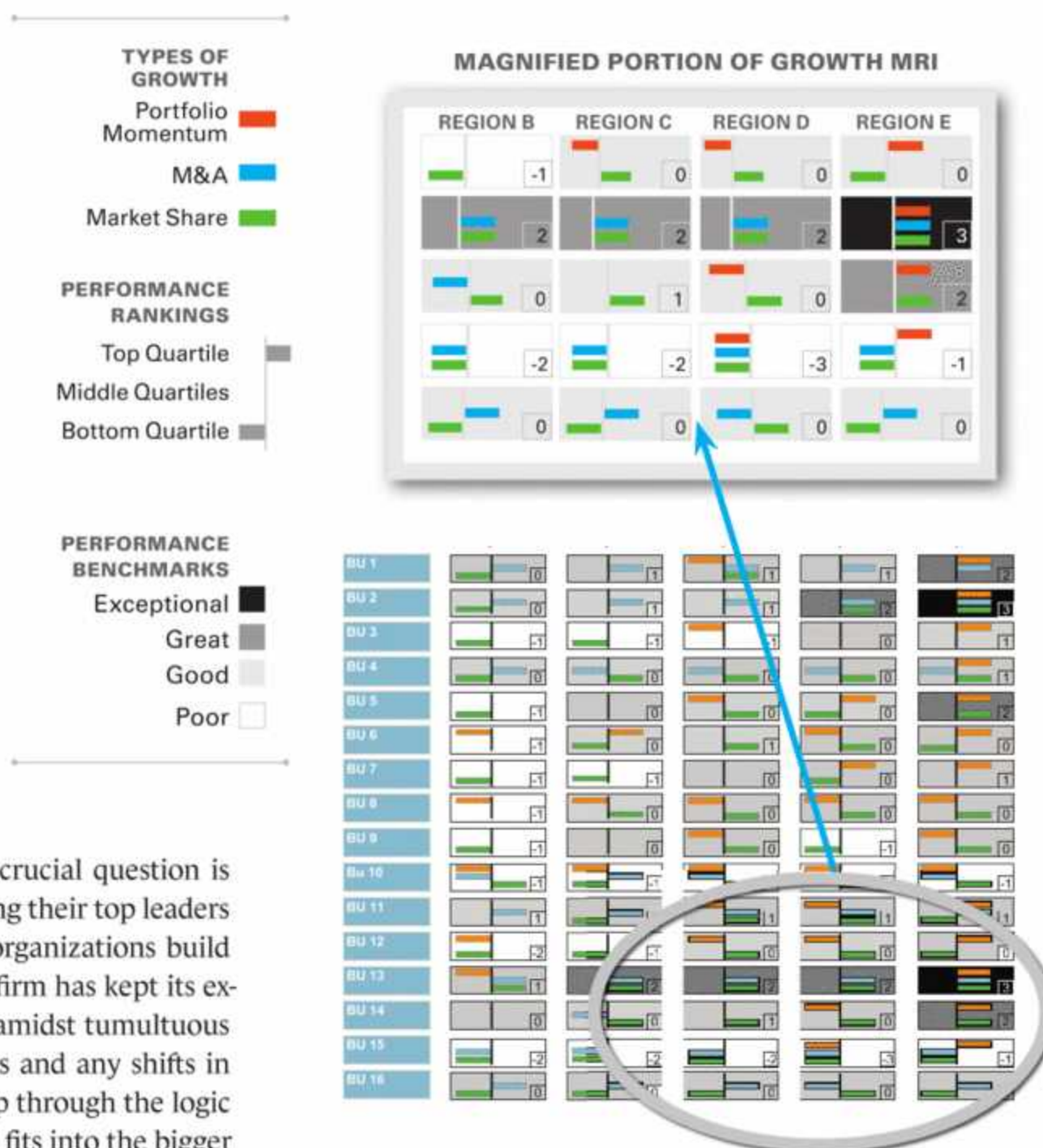
Assembling a big leadership team. At most companies, the leadership team can fit around a large conference table. Members of this group might include, in addition to the CEO, the heads of a half-dozen business units, one or two executives with major sales responsibilities, and a few critical functional leaders such as the chief financial, marketing, technology, and strategy officers. Most organizations can't function without an inner circle like this. But this inner circle is not well positioned to make all the where-to-compete choices that arise on a day-to-day basis. Large companies need to devolve responsibility for the pursuit of fine-grained opportunities to its 200-plus top leaders. Those executives – who might lead product clusters, geographic slivers, or special initiatives – can focus the organization on important growth priorities while inspiring and motivating relatively small teams. In doing so, they will build a sense of ownership and personal involvement among their subordinates, thereby helping to overcome classic big-company people problems such as managers' denying below-the-radar subordinates the opportunity to lead or "free riding" on the efforts of other executives.

There's an obvious danger in expanding the leadership team to 200 or so people: Management complexity grows exponentially, causing a loss of control as executives and teams inadvertently work at cross-purposes. To avoid that pitfall, the members of the extended leadership team need to fully understand how their individual goals fit with the company's strategic priorities and must also be well versed in the systems and processes the company is creating to bring that strategy to life. These include measurement approaches such as the growth MRI, as well as conceptual frameworks that assess growth opportunities in terms of different strategic purposes.

Since strategies are always evolving, a crucial question is how effective companies can be at exhorting their top leaders to adopt changes in real time. How can organizations build this alignment? One professional services firm has kept its extended leadership team moving together amidst tumultuous change by explaining strategy refinements and any shifts in direction in 15- to 20-page memos that step through the logic of what is new and different and how it all fits into the bigger

The Full-Growth MRI

Scanning an organization's overall growth requires looking at three components: mergers and acquisitions, market share, and the momentum of markets in which the company plays. This chart depicts one company's performance in all three categories, broken down by its five regions and 16 business units. (The absence of a bar for one or more components means its performance ranks in the middle quartiles – neither particularly good nor bad.) The overall growth rating, expressed as a number from 3 to -3 in the small box at the lower right of each cell, is derived by subtracting low-performing components (to the left of the vertical line) from high-performing ones (to the right). By including additional data cuts – product lines, customer segments, smaller geographic regions – this relatively simple 80-cell chart could grow to include hundreds or even a thousand cells.



picture. These memos are then shared with as many as 500 top leaders, who are each asked to e-mail the CEO personally to vouch that they have reflected on the update and to confirm their support or voice any concerns. At subsequent management off-sites, the CEO poses questions designed to reveal how much managers understand and support the overall strategic direction, and – using an anonymous electronic voting system – gets an immediate sense of where things stand with his extended leadership team and what aspects of the new strategic story he and other senior executives will need to emphasize, reinforce, or reconsider.

Reviewing performance. Many CEOs have reservations about increasing the size of their leadership team to pursue more-granular growth opportunities: “I simply don’t have the time to give this level of attention to so many units,” they might say, or “Don’t I employ managers to look after the business units so I can concentrate on the big picture?” We agree that all CEOs need breadth of vision, but they also need a clear view down through the organization.

Periodic operations reviews are a natural time for CEOs to get this view. Typically, though, managers arrive well armored with PowerPoint slides that explain their business only at a fairly aggregate level. The unit head will struggle to run through the high-level financial and operating numbers for most or all of the business’s multiple product lines, markets, R&D projects, and marketing programs. The CEO will seek to pierce management’s armor, often while simultaneously tackling critical talent issues. A crowded agenda prevents discussion of the outlook and the risks from getting beyond “what you should expect from my business unit next quarter, and why we may not meet that expectation.” Hardly any time is devoted to talking about the underlying texture of the market, or the drivers of growth and profitability in the different component businesses, or how these drivers are changing.

At one large semiconductor company, for example, quarterly operations reviews focused on four business units. But these encompassed more than 50 portfolio segments, each running four or five major R&D programs and generating very different rates of return. In effect, there were nearly 250 individual performance cells. However, because the discussion was focused on the four business units, decisions that drove overall growth – such as the program-by-program allocation of R&D – were lost in the aggregate figures and rendered invisible to the CEO, as were any market insights revealed at the cell level.


The CEO solved that problem by structuring management dialogues to reflect the company’s markets and important decisions at a sharper resolution. This has helped the busi-

Large firms should devolve responsibility for growth opportunities not to dozens but to hundreds of leaders.

ness units focus their energy and investments more productively over time. Performance conversations now go beyond static measures to address key questions: How likely is each cell to win in the market? Do resources need to be reallocated? Is it time to exit a market altogether? These discussions require deeper understanding of the markets, the nature of competitors’ sources of advantage, and the performance of the 250 or so separate cells. After restructuring its performance reviews, the company reallocated 30% of its R&D resources to markets where it had a strong winning play. Two years later, it is growing significantly faster than the broader market.

Some executives worry about the amount of time that this management approach demands. But thoughtful application of greater granularity in reporting, through the use of such tools as the growth MRI, can actually save executives time. The hidden issues affecting growth are brought to light immediately, making the dialogue between the CEO and the business unit much more specific and thus much closer to the reality of both the market and the internal organization. The dialogue can focus on solving the unit’s problems and executing agreed-upon solutions. In most cases, the number of issues discussed doesn’t increase, but the quality of discussion is greatly improved.

...

Becoming more granular isn’t necessarily about dividing the organization into more business units (though it could be). Nor is it about collecting more data (many companies have all they need) or requiring more meetings (busy executives don’t have the time). Rather, greater granularity is about infusing existing structures and processes with better information and then refining them on the basis of that information. The IT and connectivity revolutions of the past 20 years have made it possible for companies to extract and act on meaningful insights at a more detailed level than ever before without massive investments or ongoing expenses. The growth leaders of the future will embrace the power of that possibility. 

Mehrdad Baghai is the managing director of *Alchemy Growth Partners*, a boutique advisory firm in Sydney, and a coauthor (with Stephen Coley and David White) of *The Alchemy of Growth* (Orion Business, 1999). **Sven Smit** is a director in McKinsey’s Amsterdam office and the global knowledge leader of the firm’s Strategy practice. **Patrick Viguerie** is a director in McKinsey’s Atlanta office and leads the firm’s Strategy practice in the Americas.

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Why Teams DON'T Work

A leading organizational psychologist explains the five critical conditions that make the difference between success and failure.

Interview by Diane Coutu

OVER THE PAST COUPLE OF DECADES, a cult has grown up around teams. Even in a society as fiercely independent as America, teams are considered almost sacrosanct. The belief that working in teams makes us more creative and productive is so widespread that when faced with a challenging new task, leaders are quick to assume that teams are the best way to get the job done.

Not so fast, says J. Richard Hackman, the Edgar Pierce Professor of Social and Organizational Psychology at Harvard University and a leading expert on teams. Hackman has spent a career exploring – and questioning – the wisdom of teams. To learn from his insights,

HBR senior editor Diane Coutu interviewed Hackman in his Harvard office. In the course of their discussion, he revealed just how bad people often are at teamwork. Most of the time, his research shows, team members don't even agree on what the team is supposed to be doing. Getting agreement is the leader's job, and she must be willing to take great personal and professional risks to set the team's direction. And if the leader isn't disciplined about managing who is on the team and how it is set up, the odds are slim that a team will do a good job.

What follows is an edited version of that conversation.

You begin your book *Leading Teams* with a pop quiz: When people work together to build a house, will the job probably (a) get done faster, (b) take longer to finish, or (c) not get done?

That multiple choice question actually appeared on a standardized fourth-grade test in Ohio, and the obvious "answer," of course, is supposed to be *a* – the work gets done faster. I love that anecdote because it illustrates how early we're told that teamwork is good.

People tend to think that teams are the democratic – and the efficient – way to get things done. I have no question that when you have a team, the possibility exists that it will generate magic, producing something extraordinary, a collective creation of previously unimagined quality or beauty. But don't count on it. Research consistently shows that teams underperform, despite all the extra resources they have. That's because problems with coordination and motivation typically chip away at the benefits of collaboration. And even when you have a strong and cohesive team, it's often in competition with other teams, and that dynamic can also get in the way of real progress. So you have two strikes against you right from the start, which is one reason why having a team is often worse than having no team at all.

IDEA IN BRIEF

» Teams are often seen as safe places where people can be highly creative and productive. However, research consistently shows that teams underperform their great potential.

» Teams need to be set up carefully to ensure that they have a compelling direction. Small teams whose members stay together for long periods of time perform best.

» Perversely, organizations with the best human resource departments sometimes have less effective teams. That's because HR tends to focus on improving individual rather than team behavior.

» Leading a team requires enormous courage because authority is always involved, which arouses great anxiety in the team. Great team leaders often encounter resistance so intense it can put their jobs at risk.

You've said that for a team to be successful, it needs to be real. What does that mean?

At the very least, it means that teams have to be bounded. It may seem silly to say this, but if you're going to lead a team, you ought to first make sure that you know who's on it. In our recent book *Senior Leadership Teams*, Ruth Wageman, Debra Nunes, James Burruss, and I collected and analyzed data on more than 120 top teams around the world. Not surprisingly, we found that almost every senior team we studied thought that it had set unambiguous boundaries. Yet when we asked members to describe their team, fewer than 10% agreed about who was on it. And these were teams of senior executives!

Often the CEO is responsible for the fuzziness of team boundaries. Fearful of seeming exclusionary – or, on the other end of the spectrum, determined to put people on the team for purely political reasons – the chief executive frequently creates a dysfunctional team. In truth, putting together a team involves some ruthless decisions about membership; not everyone who wants to be on the team should be included, and some individuals should be forced off.

We worked with a large financial services firm where the CFO wasn't allowed on the executive committee because he was clearly a team destroyer. He was disinclined toward teamwork, he was unwilling to work at finding collective solutions, and every team he was on got into trouble. The CEO invited the CFO to stay in his role because he was a truly able executive, but he was not allowed on the senior executive team. Although there were some bruised feelings at first, in the end the CFO was much happier because he didn't have to be in "boring" team meetings, and the team functioned much better without him. The arrangement worked because the CEO communicated extensively with the CFO both before and after every executive committee meeting. And in the CFO's absence, the committee could become a real team.

I have no question that a team can generate magic. But don't count on it.



You also say that a team needs a compelling direction. How does it get one?

There is no one right way to set a direction; the responsibility can fall to the team leader or to someone in the organization outside the team or even to the team itself in the case of partnerships or boards of directors. But however it's done, setting a direction is emotionally demanding because it always involves the exercise of authority, and that inevitably arouses angst and ambivalence – for both the person exercising it and the people on the receiving end. Leaders who are emotionally mature are willing and able to move toward anxiety-inspiring situations as they establish a clear, challenging team direction. But in doing so, a leader sometimes encounters resistance so intense that it can place his or her job at risk.

That point was dramatically brought home to me a few years ago by a participant in an executive seminar I was teaching. I'd been talking about how leaders who set direction successfully are unafraid to assume personal responsibility for the mission of the team. I mentioned John F. Kennedy and Martin Luther King, Jr., and I got carried away and said that people who read the New Testament knew that Jesus did not convene little team meetings to decide the goals of the ministry. One of the executives in the class interrupted me and said, "Are you aware that you've just talked about two assassinations and a crucifixion?"

What are some common fallacies about teams?

People generally think that teams that work together harmoniously are better and more productive than teams that don't. But in a study we conducted on symphonies, we actually found that grumpy orchestras played together slightly

better than orchestras in which all the musicians were really quite happy.

That's because the cause-and-effect is the reverse of what most people believe: When we're productive and we've done something good together (and are recognized for it), we feel satisfied, not the other way around. In other words, the mood of the orchestra members after a performance says more about how well they did than the mood beforehand.

Another fallacy is that bigger teams are better than small ones because they have more resources to draw upon. A colleague and I once did some research showing that as a team gets bigger, the number of links that need to be managed among members goes up at an accelerating, almost exponential rate. It's managing the links between members that gets teams into trouble. My rule of thumb is no double digits. In my courses, I never allow teams of more than six students. Big teams usually wind up just wasting everybody's time. That's why having a huge senior leadership team – say, one that includes all the CEO's direct reports – may be worse than having no team at all.

Perhaps the most common misperception about teams, though, is that at some point team members become so comfortable and familiar with one another that they start accepting one another's foibles, and as a result performance falls off. Except for one special type of team, I have not been able to find a shred of evidence to support that premise. There is a study that shows that R&D teams do need an influx of new talent to maintain creativity and freshness – but only at the rate of one person every three to four years. The problem almost always is not that a team gets stale but, rather, that it doesn't have the chance to settle in.

So newness is a liability?

Absolutely. The research confirming that is incontrovertible. Consider crews flying commercial airplanes. The National Transportation Safety Board found that 73% of the incidents in its database occurred on a crew's first day of flying together, before people had the chance to learn through experience how best to operate as a team – and 44% of those took place on a crew's very first flight. Also, a NASA study found that fatigued crews who had a history of working together made about half as many errors as crews composed of rested pilots who had not flown together before.

So why don't airlines stick to the same crews?

Because it isn't efficient from a financial perspective. Financially, you get the most from your capital equipment and labor by treating each airplane and each pilot as an individual unit and then using an algorithm to maximize their utilization. That means that pilots often have to dash up and down the concourses just as passengers do, and sometimes you'll have a pilot who will fly two or three different aircraft with two or

What if we looked at the thing backwards or turned it inside out?" That's when people say, "Oh, no, no, no, that's ridiculous," and so the discussion about what's ridiculous comes up. Unlike the CFO I mentioned before, who derailed the team by shutting down discussions, the deviant opens up more ideas, and that gets you a lot more originality. In our research, we've looked carefully at both teams that produced something original and those that were merely average, where nothing really sparkled. It turned out that the teams with deviants outperformed teams without them. In many cases, deviant thinking is a source of great innovation.

I would add, though, that often the deviant veers from the norm at great personal cost. Deviants are the individuals who are willing to say the thing that nobody else is willing to articulate. The deviant raises people's level of anxiety, which is a brave thing to do. When the boat is floating with the current, it really is extraordinarily courageous for somebody to stand up and say, "We've got to pause and probably change direction." Nobody on the team wants to hear that, which is precisely why many team leaders crack down on deviants and try to

Every team needs a deviant, someone who says, "Why are we even doing this at all?"

three different crews in the course of a single day – which is not so wise if you look at the research. I once asked an operations researcher of an airline to estimate how long it would take, if he and I were assigned to work together on a trip, before we could expect to work together again. He calculated that it would be 5.6 years. Clearly, this is not good from a passenger point of view.

The counterexample, by the way, is the Strategic Air Command, or SAC, which would have delivered nuclear bombs had that become necessary during the Cold War years. SAC teams performed better than any other flight crews that we studied. They trained together as a crew, and they became superb at working together because they had to. When you're working together in real time and there can be no mistakes, then you keep your teams together for years and years rather than constantly change their composition.

If teams need to stay together to achieve the best performance, how do you prevent them from becoming complacent?

This is where what I call a deviant comes in. Every team needs a deviant, someone who can help the team by challenging the tendency to want too much homogeneity, which can stifle creativity and learning. Deviants are the ones who stand back and say, "Well, wait a minute, why are we even doing this at all?"

get them to stop asking difficult questions, maybe even knock them off the team. And yet it's when you lose the deviant that the team can become mediocre.

What makes a team effective, and how can a team's leader make it perform better?

A good team will satisfy its internal or external clients, become stronger as a unit as time passes, and foster the learning and growth of its individual members. But even the best leader on the planet can't make a team do well. All anyone can do is increase the likelihood that a team will be great by putting into place five conditions. (See the sidebar "How to Build a Team.") And the leader still will have no guarantees that she will create a magical team. Teams create their own realities and control their own destinies to a greater extent, and far sooner in their existence, than most team leaders realize.

In 1990 I edited a collection of essays by colleagues who had studied teams performing diverse tasks in 27 organizations – everything from a children's theater company to a mental-health-treatment team to a beer-sales-and-delivery team. In those studies, we found that the things that happen the first time a group meets strongly affect how the group operates throughout its entire life. Indeed, the first few minutes of the start of any social system are the most important because they establish not only where the group is going but

also what the relationship will be between the team leader and the group, and what basic norms of conduct will be expected and enforced.

I once asked Christopher Hogwood, the distinguished conductor for many years of the Handel and Haydn Society in Boston, how important the first rehearsal was when he served as an orchestra's guest conductor. "What do you mean, the first rehearsal?" he asked. "All I have is the first few minutes." He went on to explain that there's nothing he pays greater attention to than the way he starts the first rehearsal. That's because he knows that the orchestra members will make a very quick assessment about whether or not they're going to make great music together, or whether he is just going to get in their way.

I do think there is one thing leaders such as Hogwood and others can do to improve the chances that a team will become something special, and that is to embrace their own quirkiness. You shouldn't try to lead like Jeff Bezos, because you are not Jeff Bezos. Each leader brings to the task his or her own strengths and weaknesses. Exploit the daylight out of the stuff you're great at, and get help in the areas where you're not so good. Don't try to ape any leadership model or team, because there's no one right style for leading a team. There are many different ways to create the conditions for effectiveness, sustain them, and help teams take full advantage of them. The best team leaders are like jazz players, improvising constantly as they go along.

How good are companies at providing a supportive context for teams?

Perversely, the organizations with the best human resource departments often do things that are completely at odds with good team behavior. That's because HR departments tend to put in place systems that are really good at guiding, directing, and correcting individual behavior. Take a personnel system that has been honed by industrial psychologists to identify the skills of a particular job and test individual employees on those skills. In such a system, the HR department will set up training to develop the "right" people in the "right" way. The problem is this is all about the individual. This single-minded focus on the individual employee is one of the main reasons that teams don't do as well as they might in organizations with strong HR departments. Just look at our research on senior executive teams. We found that coaching individual team members did not do all that much to help executive teams perform better.

For the team to reap the benefits of coaching, it must focus on group processes. And timing is everything. The team leader needs to know how to run a launch meeting, so that members become oriented to and engaged with their tasks; how to help the team review at the midpoint what's functioning well – and what isn't – which can correct the team's performance strategy; and how to take a few minutes when the work is finished to reflect on what went well or poorly, which can help mem-

How to Build a Team

In his book *Leading Teams*, J. Richard Hackman sets out five basic conditions that leaders of companies and other organizations must fulfill in order to create and maintain effective teams:

1 Teams must be real. People have to know who is on the team and who is not. It's the leader's job to make that clear.

2 Teams need a compelling direction. Members need to know, and agree on, what they're supposed to be doing together. Unless a leader articulates a clear direction, there is a real risk that different members will pursue different agendas.

3 Teams need enabling structures. Teams that have poorly designed tasks, the wrong number or mix of members, or fuzzy and unenforced norms of conduct invariably get into trouble.

4 Teams need a supportive organization. The organizational context – including the reward system, the human resource system, and the information system – must facilitate teamwork.

5 Teams need expert coaching. Most executive coaches focus on individual performance, which does not significantly improve teamwork. Teams need coaching as a group in team processes – especially at the beginning, midpoint, and end of a team project.

bers make better use of their knowledge and experience the next time around. Team coaching is about fostering better teamwork on the task, not about enhancing members' social interactions or interpersonal relationships.

There's a lot of talk about virtual teams these days. Can they work, or are they falling victim to what Jo Freeman once called the "tyranny of structurelessness"?

Virtual teams have really come into their own in the past decade, but I don't believe they differ fundamentally from traditional teams. There was a fantasy in the beginning that everyone would be swarming around on the internet, that the wisdom of crowds would automatically prevail, and that structureless groups would come up with new and profound

OFF AND RUNNING Barack Obama Jump-Starts His Team

by Michael Beschloss

IF THE LAUNCH of a team is as critical as Professor J. Richard Hackman says, then Barack Obama has done pretty well. He appointed his administration's top officials much faster than most presidents do. Given the monumental crises that faced him the moment he was elected, he had to move quickly. The downside of speed was that some of his choices didn't work out – notably Bill Richardson and Tom Daschle. Obama has certainly brought onto his team people of strong temperaments and contrasting views, starting with Hillary Clinton at the State Department and Jim Jones at the National Security Council. This suggests that we have a president who is unusually sure of his own ability to absorb differing opinions. Appointing people like Clinton also shows his eagerness to harness the talent of his former opponents. Compare that with the record of George W. Bush; his people told many job seekers who had supported John McCain in the 2000 Republican primaries, "Sorry, you backed the wrong horse!"

Of course, Obama is taking a risk by hiring so many strong and contentious personalities. He will inevitably have to spend a lot of time and energy serving as referee. This is what happened with Franklin Roosevelt, who also brought strong-minded figures into his government. One difference with Obama, however, is that FDR temperamentally loved the infighting. He liked to pit people against one another, believing that competition evoked the best performance from everyone. At times FDR actually enjoyed making his underlings suffer. I don't think Obama does.

Most presidents prefer a happy ship, and in some cases their definition of loyalty includes not rocking the boat on major administration programs. Richard Nixon fired his interior secretary, Walter Hickel, for opposing his Vietnam War policies. There was a dissenter (what Hackman calls a deviant) on Lyndon

Johnson's team – Undersecretary of State George Ball, who strongly opposed the Vietnam War. Johnson would cite Ball when people complained that he surrounded himself with yes-men, but in fact Ball had little influence when LBJ met with top officials on Vietnam. Everyone in the group knew that Johnson didn't take Ball's antiwar arguments very seriously. If you really want dissenting views, better to use the Roosevelt-Obama model, where they can come from almost any member of the team – and not just from one designated rabble-rouser.

The reappointment of Bush's defense secretary, Robert Gates, also reveals Obama's self-confidence. He's clearly willing to concede that there are things he doesn't know, so he appointed someone with more than three decades of national security ex-

perience. This decision has the historical echo of John Kennedy's near-reappointment in 1961 of Dwight Eisenhower's defense secretary, who coincidentally was named Thomas Gates. Like Obama, Kennedy was a young president with little national security background and thought it might reassure people to have the previous defense secretary stay on at the Pentagon. Like Obama, JFK also suspected that a number of things might go wrong with national security during his first year as president. He felt that Americans might be less likely to blame the Democratic president if a Republican secretary of defense was there at his side. In the end Kennedy did not have the

stomach for the risk of keeping a Republican appointee at the Pentagon. Obama did.

Obama's first months in office prove the importance of having a president who can convey his view of the country and the world and why he thinks his plans will work. One of Hillary Clinton's biggest criticisms a year ago was that Obama gave great speeches but that it didn't have all that much to do with being a strong president. Obama argued that it did, and he was right. Like Roosevelt's addresses in 1933 and Reagan's in 1981, his public utterances – especially his speech to Congress in February – have done a lot to gain acceptance for his programs from skeptical Americans. However jaded they may be about government, Americans – even those who didn't vote for him – are still inclined to turn to their president to explain foreign and domestic crises. Imagine how much more anxious they might feel now if Obama did not do this so effectively. Unfortunately for us all, it's likely that he'll have to call more on that skill as the crisis mounts in the months ahead.

Michael Beschloss has written nine books about presidential leadership, most recently *Presidential Courage* (Simon & Schuster, 2007).




things that face-to-face groups could never have generated. But nirvana never materialized; virtual teams need the basic conditions for effectiveness to be in place just as much as face-to-face teams, if not more so. That said, we are seeing that we can make do with much less face-to-face contact than we ever thought possible. Today's technology, for example, lets you have a chat window open during a web conference so you can type in the word "hand" to signal that you want to talk next. People don't need to see your face to know that you want to speak up. But even well-structured virtual teams need to have a launch meeting with everyone present, a midpoint check-in that's face-to-face, and a live debriefing. I don't think for a minute that we're going to have effective online teams if we don't know who's on the team or what the main work of the team really is, and so far that's still a problem with virtual teams.

Given the difficulty of making teams work, should we be rethinking their importance in organizations?

Perhaps. Many people act as if being a team player is the ultimate measure of one's worth, which it clearly is not. There are many things individuals can do better on their own, and they should not be penalized for it. Go back for a moment to that fourth-grade question about working together to build a house. The answer probably is that teamwork really does take longer or that the house may not get built at all. There are many cases where collaboration, particularly in truly creative

endeavors, is a hindrance rather than a help. The challenge for a leader, then, is to find a balance between individual autonomy and collective action. Either extreme is bad, though we are generally more aware of the downside of individualism in organizations, and we forget that teams can be just as destructive by being so strong and controlling that individual voices and contributions and learning are lost.

In one management team we studied, for example, being a team player was so strongly valued that individuals self-censored their contributions for fear of disrupting team harmony. The team, in a spirit of cooperation and goodwill, embarked on a course of action that was bound to fail – for reasons that some members sensed but did not mention as the plans were being laid. One wonders if the crisis in the financial world today would be quite so catastrophic if more people had spoken out in their team meetings about what they knew to be wrongful practices. But again that brings us back to the hazards of courage. You'd like to think that people who do the courageous right thing and speak out will get their reward on earth as well as in heaven. But you don't always get your reward here on earth. While it's true that not being on a team can put your career on hold, being a real and committed team player – whether as a team leader, a deviant, or just a regular member who speaks the truth – can be dangerous business indeed. 

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To order, see page 131.



"Never mind the screaming and weeping next door. That's just how we get things done here. Now, tell me more about your qualifications for this job."

Tool Kit

BY TED LONDON



Making Better Investments at the Base of the Pyramid

Managers of business ventures that work with the world's poor need more than financials and feel-good stories to measure success. They need to know exactly who's benefiting and how.

RAMA WAS A SEAMSTRESS by trade, not an optician. Before she connected with VisionSpring, a venture providing vision care to the poor, she sold hand-sewn clothes and blankets from her home and used her earnings to help support her husband (a farm worker who was often between jobs) and their two children. She took home about \$44 a month – not nearly enough to make ends meet. Despite Rama's outgoing personality and strong work ethic, she was unable to drum up increased demand for her handiwork. Then, several years ago, she was trained to be one of VisionSpring's "vision entre-

preneurs." Now she is selling eyeglasses and offering vision screenings in her rural Indian community, consistently earning around \$100 a month.

Rama's economic turnaround is featured on the website of VisionSpring, which, like a growing number of ventures doing business with the base of the economic pyramid (BoP), shares success stories to demonstrate its results to funders and other stakeholders. These ventures often use anecdotes to highlight how they're helping families build houses in Latin America, providing health-related products to children in

Caroline Hwang

Africa, or linking farmers in rural Asia to new markets.

Feel-good stories aside, however, it's been nearly impossible to gauge the efficacy of these ventures. Businesses, nonprofits, and other organizations that deliver products to and purchase goods from the base of the pyramid usually don't have robust-enough systems to accurately assess how well they're reaching the people they set out to serve – or they simply look at the wrong measures. They judge their success at alleviating poverty on the basis of tasks completed and milestones achieved – amount of money invested, quantity of products distributed, number of interventions initiated, and so on – rather than on how well their activities translate into changes on the ground.

While such metrics are potentially useful indicators, they fail to capture the complete picture of a venture's impact. Managers of BoP ventures need to take a more holistic, learning-oriented approach to assessing performance – one that factors in dimensions beyond economic well-being. Consider Rama's situation: Her experience with VisionSpring not only increased her income but also prompted changes within her family. Her husband, who was at first reluctant to support his wife's work outside the home, decided to join the program once he saw how successful and self-confident Rama had become. Both say their marriage has improved as a result of their working together as a sales team.

After several years of field research, I've developed a framework to help BoP ventures assess the impact their initiatives are having locally, in the short term and over time. It measures how a venture affects the well-being of its critical constituencies in three important dimensions: their economic situation, their capabilities, and their relationships. Whereas traditional monitoring-and-evaluation metrics generally serve to track preestablished milestones and justify past results, this framework can be used as a forward-looking tool. It helps managers identify and enhance the posi-

IDEA IN BRIEF

- **Businesses serving the base of the pyramid (BoP) may have basic data on financial outcomes and milestones achieved and some success stories to share, but they still lack a reliable method for assessing and enhancing their poverty alleviation performance.**
- **This framework gives managers a detailed look at the impact a BoP venture has on the economics, capabilities, and relationships of three critical groups: local buyers, local sellers, and local communities.**
- **The tool can help managers identify what's working and what's not – and can give them a better understanding of how to increase the value the venture is creating for itself, for funding sources, and for the people it has set out to serve.**

tive effects of a venture's products and services, understand and mitigate the negative effects, and more clearly articulate current performance and prospects for improvement. With this information in hand, they can create more successful, sustainable business models serving the base of the pyramid. Perhaps most important, the framework can amplify for a venture's management team the voices of those living in poverty.

You Are What You Measure

In some ways, the anecdotes about thriving entrepreneurs and other positive outcomes that many ventures tell are akin to the tall tales told by corporations that manipulated their economic returns to present better financial results. That is, by reporting mostly upbeat results, the venture managers fail to present the full range of promises and perils that their activities generate. On the upside, for example, a venture might help local entrepreneurs not only add to their income but also develop new skills and relationships. On the downside, it might promote ineffective or so-

cially inappropriate products, or prompt people to overuse or mistreat community assets, such as arable land or fishing waters. The bottom line: The supporting development agencies, potential funders, and other critical stakeholders of BoP ventures – and even their own managers – usually aren't getting the whole story.

The Base of the Pyramid Impact Assessment Framework keeps the whole story in mind. Over the past three years, I've implemented and refined this framework with partners in corporate, nonprofit, and development sectors in Africa, Asia, and Latin America. It provides a comprehensive process for collecting and analyzing information about the "who" as well as the "how." (See the exhibit "Getting the Complete Picture.")

Who is being affected? Any BoP venture potentially affects three groups of local stakeholders: sellers, buyers, and the communities in which it operates. Some ventures use local distributors (sellers) to offer products or services to local consumers (buyers). An example is the Mexican company CEMEX's Patrimonio Hoy initiative, which provides home-building materials to low-income families in Latin America. Other ventures, such as ITC's e-Choupal agricultural initiative in India, rely on local agents (buyers) to act as intermediaries between BoP producers (sellers) and the venture.

How are they being affected? It obviously makes sense to focus on an individual or a community's economic well-being (gains or losses in income, assets and liabilities, and so on) when evaluating the effects of a venture. Consumers may get cheaper prices and greater access to needed products and services; producers may enjoy expanded markets and higher productivity; and communities may see a rise in the number of jobs available and companies interested in serving their needs. On the flip side, however, an entrepreneur who decides to invest his own hard-earned capital in a new business may open up himself and his family to unanticipated shocks, such

Getting the Complete Picture

The Base of the Pyramid Impact Assessment Framework offers managers of ventures serving the poor a systematic process for measuring – and enhancing – the effects their activities are having on the ground. It involves examining the positive and negative impact those activities have on the well-being of three constituencies: sellers (local distributors or producers), buyers (local consumers or agents), and communities. As a starting point, managers can consider the potential changes listed below, though each organization may have its own unique effects.

Sellers and Buyers	Community
POTENTIAL CHANGES IN ECONOMICS	
Income and income stability	Incomes of existing businesses as a result of competition
Debt levels; access to credit	Number/type of new businesses serving the community
Productivity (buyers)	Jobs and economic opportunities
Product pricing, availability, and choice (buyers)	Infrastructure
Prices received for products and services (sellers)	
Opportunity costs of not pursuing other livelihoods	
Vulnerability to economic or household shocks	
POTENTIAL CHANGES IN CAPABILITIES	
Skills and knowledge through training and education	Access to free information and educational opportunities
Health and morbidity as a result of involvement with venture or use of product or service	Perceptions about and awareness of opportunities (such as health care and education)
Self-esteem, self-efficacy, and contentment	Sense of dignity and respect
Aspirations and goals	Collective aspirations and goals
POTENTIAL CHANGES IN RELATIONSHIPS	
Access to individuals and networks	Relationship with government and other institutions
Dependence on intermediaries and partner organizations	Gender equity, or views about castes, races, or religions
Reputation, levels of trust, and respect	Social cohesion
Household roles and relationships	Values regarding traditional customs, consumption, and consumerism
Community roles and relationships	Relationship with natural environment (ecosystems, land and water quality)
Social status	

as those generated by health- or crop-related crises. Even when local entrepreneurs do succeed, their actions can still negatively affect the community's economic well-being – for instance, when indigenous businesses suffer because of increased competition.

Ventures focused on the base of the pyramid also affect local capabilities – the skills, health, and confidence individuals and communities need to help themselves and influence the world around them. These capabilities include access to intellectual resources, such as training and education; physical resources, such as clean water and quality medical care; and psychological resources, such as opportunities to influence self-esteem, contentment, and aspirations.

BoP-focused initiatives also shape the relationships of their stakeholders. Indeed, social exclusion and geographic isolation are often components of poverty. BoP ventures can help individuals and communities develop new partnerships and access new networks. They can give individuals and communities a greater voice, which can increase responsiveness and service from the public sector. But they can also encourage greater use of natural resources, damaging the relationship the community has with its local ecosystems.

Additionally, these ventures can prompt people to reconsider their views about gender, ethnicity, and culture. If local women play an important role in the venture, for instance, their status in the family or community may rise. Conversely, ventures serving the base of the pyramid can sometimes significantly disrupt traditional family norms and community perceptions about social structure – and, particularly in the case of gender issues, breed not only discontent but even verbal and physical abuse.

Taking It All In

Implementing the impact assessment tool is a two-stage process. Established ventures, as well as those still in the design phase, can initially use it to conduct a strategic analysis of how their activities

can (or will) directly alleviate poverty. Then the venture can use that analysis to develop a set of performance indicators to track the results of initiatives over time, thereby establishing a solid process for continually evaluating what kinds of business models and activities work best and under which conditions.

The strategic analysis: understanding the impact. Conducting a strategic analysis does not involve an inordinate amount of data crunching. It does require, however, that the venture's assessment team rigorously and collaboratively fill in the cells of the framework. This team, comprising central members of the venture plus any important partners, must list all the expected effects of the venture – both positive and negative – on local stakeholders. How will buyers' personal capabilities be affected – will they be healthier and more self-confident? Will sellers' incomes become more stable? How will critical relationships in the community change as a result of the venture's activities? To avoid double counting, teams should log only direct effects in the framework – noting an increase in, say, buyers' incomes but not how the additional income will or could be spent to improve other aspects of well-being.

The team's ability to fill in all the cells is, of course, contingent upon its ability to listen to and respect the opinions of a variety of stakeholders – field staff, development professionals, academics, and local community members. Those stakeholders should include successful and unsuccessful sellers, happy and disgruntled buyers, aggressive participants in the program and quiet nonparticipants, and pleased and dissatisfied representatives of the community. The team should use a variety of methods to collect data – such as semistructured surveys, focus groups, in-depth discussions, and group forums.

Once the assessment team has a detailed understanding of all the venture's effects, it needs to evaluate each one along two dimensions: its expected magnitude, and the relative likelihood that

it will occur. High-magnitude and high-likelihood outcomes should clearly be considered the most important factors in measuring the venture's performance, while low-magnitude and low-likelihood outcomes deserve the least amount of management's attention. The other two categories are less clear-cut, but in general it probably makes sense for venture managers to pay close attention to potentially high-magnitude outcomes even

The India team of New York-based VisionSpring used the framework to get a better view of its impact. As alluded to earlier, the venture's microfranchising model helps address the widespread problem of presbyopia, a medical condition most people face as they age, which results in blurry up-close vision. The company recruits "vision entrepreneurs" and gives each a kit – dubbed a "business in a bag" – that contains an

How will buyers be affected – will they be healthier? Will sellers' incomes become more stable?



when the likelihood that they will happen is relatively small. Of course, the decision about which critical effects to pay attention to first will depend on the context – which is why it's imperative to consult with the people who face poverty on a daily basis and use their feedback to help set your priorities.

initial inventory of 40 pairs of reading glasses of different magnifications and styles, eye-screening materials, marketing resources, and accounting and sales forms. VisionSpring also offers the entrepreneurs several days of training in how to conduct vision screenings, determine the proper power of the glasses needed,

One Microfranchisor Takes Inventory

VisionSpring, a venture that employs a microfranchising model to provide eye-glasses and vision screening to the base of the pyramid, used the framework to get a fuller and more accurate picture of the effects it was having locally in India. Here's its assessment of its impact on the well-being of its sellers, buyers, and communities. (Effects are categorized as major or minor on the basis of their expected magnitude and likelihood.)

Sellers (vision entrepreneurs)	Buyers (local consumers)	Communities
POTENTIAL CHANGES IN ECONOMICS		
MAJOR EFFECTS: Increased income Income instability (lack of guaranteed income) Opportunity costs of not pursuing alternative livelihoods MINOR EFFECTS: Increased synergy with existing businesses Drop in assets (due to investment in business)	MAJOR EFFECTS: Consumer surplus (lower prices and greater convenience) Increased productivity Increased income MINOR EFFECTS: Savings used or debt incurred (the cost of the glasses)	MINOR EFFECTS: Increased interest from other businesses in serving the community Drop in existing businesses' income because of increased competition Fewer apprentices enter certain trades because established artisans regain productivity
POTENTIAL CHANGES IN CAPABILITIES		
MAJOR EFFECTS: Increased communication skills Better management skills If successful, increased self-efficacy and contentment If unsuccessful, decreased self-efficacy and contentment MINOR EFFECTS: Increased eye-care skills	MAJOR EFFECTS: Improved vision health Increased contentment MINOR EFFECTS: Treatment for other eye problems through referrals Failure to receive proper diagnosis (eye problems not solved)	MINOR EFFECTS: Heightened awareness of eye care Greater sense of dignity and respect Higher aspirations of women in the community
POTENTIAL CHANGES IN RELATIONSHIPS		
MAJOR EFFECTS: Improved role in family Increased access to networks Stress on family relationships MINOR EFFECTS: Improved relationships within community Stress on relationships within community	MINOR EFFECTS: Better relationships with community and family (less dependent on others) Improved professional reputation	MAJOR EFFECTS: Greater gender equity MINOR EFFECTS: Improved caste relations Conflict over gender equity issues

make referrals to hospitals if additional eye care is necessary, and manage their inventory. Each entrepreneur is then assigned a cluster of local communities within which to market glasses.

The financial information collected from the entrepreneurs – how many pairs of glasses they sold, the earnings they reported, and so on – showed VisionSpring's management team that the venture was taking hold in the community. But to expand operations and attract the capital necessary to solve a problem that affects hundreds of millions of individuals globally, VisionSpring's senior leaders knew they would need to develop a more rigorous approach to assessing performance as well as a more robust feedback loop that would help them make better-informed decisions.

So, to get beyond anecdotal evidence, they filled in the cells of the framework. (See the exhibit "One Microfranchisor Takes Inventory.") The group's strategic analysis provided a much clearer articulation of the value VisionSpring created, in particular for buyers. In one district of Andhra Pradesh, for instance, locally produced weavings and other handicrafts were in high demand. Many of the artisans, though, were aging and could no longer see well enough to do the intricate work required. As a result, their incomes declined. Previously, this had been the accepted nature of this occupation; the older you were, the less productive you became. By providing glasses that improved their near vision, however, VisionSpring allowed these aging artisans to return to a higher level of productivity – and regain their sense of dignity and self-respect. So whereas VisionSpring tended to promote to stakeholders the economic and status gains that its female entrepreneurs were making, the strategic analysis reminded the management team of all the ways that buyers and community members were affected by the venture.

The analysis also helped uncover VisionSpring's potentially negative effects on individuals and the commu-

nity. For instance, using the framework, the management team was able to recognize the potential for strife and jealousy in families and communities that weren't used to seeing women in nontraditional roles – such as that of an entrepreneur selling wares outside the home and village. Taking those local dynamics into account, VisionSpring offered training to the women's spouses and encouraged them to become more involved in distributing the product – as Rama's husband did. This helped promote the sellers' well-being with regard to relationships and reduced the risk that VisionSpring would lose some of its most successful distributors.

The performance analysis: tracking the impact. Once the assessment team has completed its strategic analysis, it should have enough information to generate a set of short- and long-term performance metrics to track the activities that are creating the most significant local changes (positive or negative).

The findings made it easier to demonstrate to potential partners the value of investing in the organization.

The findings can also help managers as they work to continually refine the business model to enhance their venture's success.

The process isn't as complicated or expensive as one might think. It involves identifying and collecting baseline as well as post-intervention data on the local buyers, sellers, and communities most affected by the venture's activities, and, whenever possible, on a comparable unaffected group to better account for what would have happened had the venture never launched. The assessment team will have to design data collection approaches that will yield the most useful information, focusing on the "biggest magnitude" and "most likely to occur" indicators revealed by the analysis.

VisionSpring's management team followed up its strategic analysis by working with me and my colleagues at the University of Michigan to develop performance measures. In consultation with a variety of local stakeholders, we created a set of indicators, survey instruments, and a data collection process to track the most relevant effects the venture was having on the three central constituencies. We based some of our survey questions on ones that were previously developed by the World Health Organization and other organizations; we also tailored some to the local situation. We came up with the following:

Sellers. The team members agreed that changes in the sellers' economic situations, capabilities, and relationships could be effectively captured by measuring their incomes (a positive effect), income instability (a negative effect), and opportunity costs of not pursuing other livelihoods (a negative effect); their skills development, self-efficacy,

and contentment with life; their perceptions of respect and conflict within the family; and their interactions with individuals and organizations outside their local communities.

Buyers. To measure economic well-being, the team decided it would more closely monitor consumers' incomes, their savings due to product affordability and convenience, and the effect that eyeglasses and vision care had on work productivity. To measure changes in capabilities, the team focused on the role VisionSpring's products and services played in improving buyers' contentment with life and eye health.

Community. The team recognized the importance of changing communities' attitudes toward women who

worked as entrepreneurs and took on nontraditional roles outside the home and village.

These measurements helped VisionSpring's management team establish not a selected, anecdotal snapshot of the venture's activities but a holistic and fact-based view – one that clearly showed whom it was helping and how. The framework's findings made it easier for VisionSpring to demonstrate to potential partners the value of investing in the organization.

Missed Opportunities

While VisionSpring used the assessment tool to get the whole story, other ventures – even organizations that have substantial experience working with the base of the pyramid – still rely on less-systematic means to assess the efficacy of their activities, missing out on opportunities to have even greater impact. Consider the initiative piloted in India by Pioneer Hi-Bred International (a subsidiary of DuPont), the Peoples Action for Creative Education (PEACE), and CARE. The program, based near the city of Hyderabad, allowed Pioneer to distribute its seeds to village farmers through PEACE, a local nonprofit. CARE, an international relief and development nonprofit, facilitated the relationship between the two other organizations.

Agriculture is the primary source of local income in rural India and the predominant work activity, but productivity is low in some communities – in part because farmers have limited access to high-quality supplies and equipment. Take seeds: Farmers in India had traditionally set aside the seeds harvested from one year's crop to plant the next year. These days farmers increasingly buy their seeds from local traders who specialize in selling a wide range of farming supplies – albeit sometimes counterfeit or low-quality goods. The traders obviously can be a risky channel for the farmer; bad seeds translate into a bad harvest. Because the farmers are rarely able to save much income from previous years, they must take out expensive

loans at the beginning of each planting season to pay for supplies.

The partnership set out to provide farmers with high-quality, high-yield maize seeds resistant to waterlogging. The seeds cost more per acre to plant initially, but expected productivity gains justified the added expense. Recognizing that the outlay for seeds might be relatively expensive, PEACE didn't ask the farmers to pay for them until after the harvest.

The partners knew it would take time for the seeds to be accepted and had figured the pilot would be more of a learning experience than a profit-making one. Yet after the first harvest, the initiative had gained only limited traction with local farmers. If the partners had undertaken a strategic analysis of the venture's effects on poverty alleviation, specifically looking at economics, capabilities, and relationships, they might have gained the following insights about its initial business model. (See the exhibit "A Farming Initiative's Business Model Shows Holes.")

Economics. Through the partnership, the farmers got a higher-quality product under payback terms that were sensitive to the seasonality of their business – but they still had to deal with indebtedness. In fact, doing business with the venture put them at greater economic risk, given the larger initial investment required. If the monsoons were late or flooding occurred, all or a portion of their crops would be lost – sure disaster for rural farming families, who often don't have a financial safety net. The partnership's business model also didn't address the challenges that farmers face in selling what they harvest. They have to accept whatever price the market sets for their produce, after all, and are vulnerable to changes in demand.

Capabilities and relationships. Pioneer's seeds at first were an unknown in the eyes of the local community; the farmers weren't sure how best to use them to maximize their yields. And the farmers still faced a relationship with monopolistic local intermediaries. If

A Farming Initiative's Business Model Shows Holes

Working with local development partners CARE and PEACE, Pioneer Hi-Bred International set up a venture designed to serve the needs of poor farmers, focusing in particular on providing them with high-quality seeds. However, its business model didn't account for some important constraints the farmers, or buyers, faced – as shown by the major negative effects on well-being in the framework below. (Since PEACE is the distributor/agent, the effects on sellers are not included in the framework.)

Buyers (farmers)	Community
POTENTIAL CHANGES IN ECONOMICS	
<p>MAJOR EFFECTS:</p> <ul style="list-style-type: none"> Increased productivity (from high-quality, high-yield seeds) More income stability (protection from water damage) Uncertain crop prices (especially if increases in supply are not met with increases in demand) Increased debt and greater vulnerability to economic or household shocks <p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Improved cash flow (loan repayment tied to harvest season) Improved cost of capital (interest rates) 	<p>MAJOR EFFECTS:</p> <ul style="list-style-type: none"> Drop in income of local traders <p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Increased interest by other businesses in serving the community
POTENTIAL CHANGES IN CAPABILITIES	
<p>MAJOR EFFECTS:</p> <ul style="list-style-type: none"> More dignity and respect (from having increased choice) Improved aspirations (if harvest goes well) Uncertainty and stress (from relying on a new product) Drop in aspirations (if harvest is poor) <p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Time and energy savings (from using high-quality seeds) 	<p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Openness to innovations and new farming techniques Improved aspirations of all community members
POTENTIAL CHANGES IN RELATIONSHIPS	
<p>MAJOR EFFECTS:</p> <ul style="list-style-type: none"> Increased status in family (women receive the seeds) Retaliation by local traders Conflicts within families <p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Increased networking with others outside the community Increased dependence on outside products and suppliers 	<p>MAJOR EFFECTS:</p> <ul style="list-style-type: none"> Greater gender equity <p>MINOR EFFECTS:</p> <ul style="list-style-type: none"> Less use of indigenous seeds harvested from prior year's crop Effect of planting hybrid seeds on local ecosystems Conflict over gender equity issues

the farmers were too selective about the products they were buying – getting their seeds from PEACE instead of the local traders, for instance – they could find themselves cut off, unable to procure the rest of their farming supplies from traders bearing grudges.

The framework makes it clear: Until these concerns are addressed by the venture's business design – something Pioneer and its partners, to their credit, have continued to work on – adoption of the seeds will most likely remain modest, thus limiting the venture's prospects for creating value for itself and for farmers at the base of the pyramid.


...

Anecdotes can capture our imagination. Data from monitoring and evaluation efforts can be used to track specific milestones and financial outcomes against plan. But the lack of a systematic and holistic approach to assessing and enhancing the performance of BoP ventures does a great disservice not only to

those living in poverty but to the ventures themselves. After all, the better a business understands its target market, the better it should perform.

The primary purpose of the BoP Impact Assessment Framework is to give managers a standardized approach for understanding the whole story. For managers, development groups, and funders, it can also generate some important insights into the types of organizational designs that are most likely to succeed with the base of the pyramid. Indeed, the framework could be a powerful new lens for organizations that have tough decisions to make about how and where to invest. They can use the framework to evaluate a management team's understanding of a venture's on-the-ground impact, for instance, or to make the case for supporting carefully targeted ventures that are in line with their own philosophies about alleviating poverty – those that, say, are best at empowering women or connecting

previously isolated communities to the outside world.

For far too long now, the lack of a dynamic and inclusive process for hearing and responding to the voices of the base of the pyramid, coupled with a lack of humility from many organizations and ventures at the top, has limited the effectiveness of initiatives serving the poor. It is time for a change. 

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How Emerging Giants Are Rewriting the Rules of M&A

MERGERS AND ACQUISITIONS, the stuff of newspaper headlines, quite often fail. Around 50% of mergers don't achieve their business objectives, and takeovers cause the shareholders of most acquirers to lose money, according to several studies conducted over the past four decades. Yet, in an ironic twist, companies from developing countries such as China, India, Malaysia, Russia, and South Africa are using M&A as their main globalization strategy today.

Even after the economic crisis engulfed the world in the last quarter of 2008, the Indian technology major Tata Consultancy Services picked up Citigroup Global Services (the North American bank's India-based outsourcing division) for \$505 million in October 2008; another Indian technology company, HCL, bought Britain's Axon Group for \$672 million in December 2008; and China's Minmetals made a \$1.7 billion bid for the Australian company OZ Minerals in February 2009. In fact, emerging giants clinched 26% of the previous year's takeover deals between developed countries and developing ones, a recent A.T. Kearney study shows.



Fueling the trend is the fact that many emerging giants are cash rich. Economies like China and India grew at near double-digit rates over the past 15 years, and that, along with corporations' restructuring, resulted in profit margins of 10%, twice those in the developed world. Reflecting those companies' bloated balance sheets, a survey conducted by HBR and the World Economic Forum in 2008 found that 50% of CEOs from developing economies plan to finance their bids with internal resources and 46% by issuing fresh equity. They aren't worried about diluting shareholdings: Business families or founder-promoters hold large stakes in companies in developing nations. Those majority shareholdings also ensure that CEOs won't lose control if stock prices fall, so smart ones can focus on generating long-term value. Moreover, suitors from developing countries are finding the valuations of companies more attractive after the recent stock market crashes in the United States and Europe.

Cash isn't the only factor behind the M&A wave. My research indicates that emerging giants can also create value from takeovers more easily than corporations from developed countries. U.S. and European companies, inhibited by slow-growing home markets, acquire rivals primarily to become bigger and thus create economies of scale. After every merger, executives try to identify synergies, fashion efficient processes,

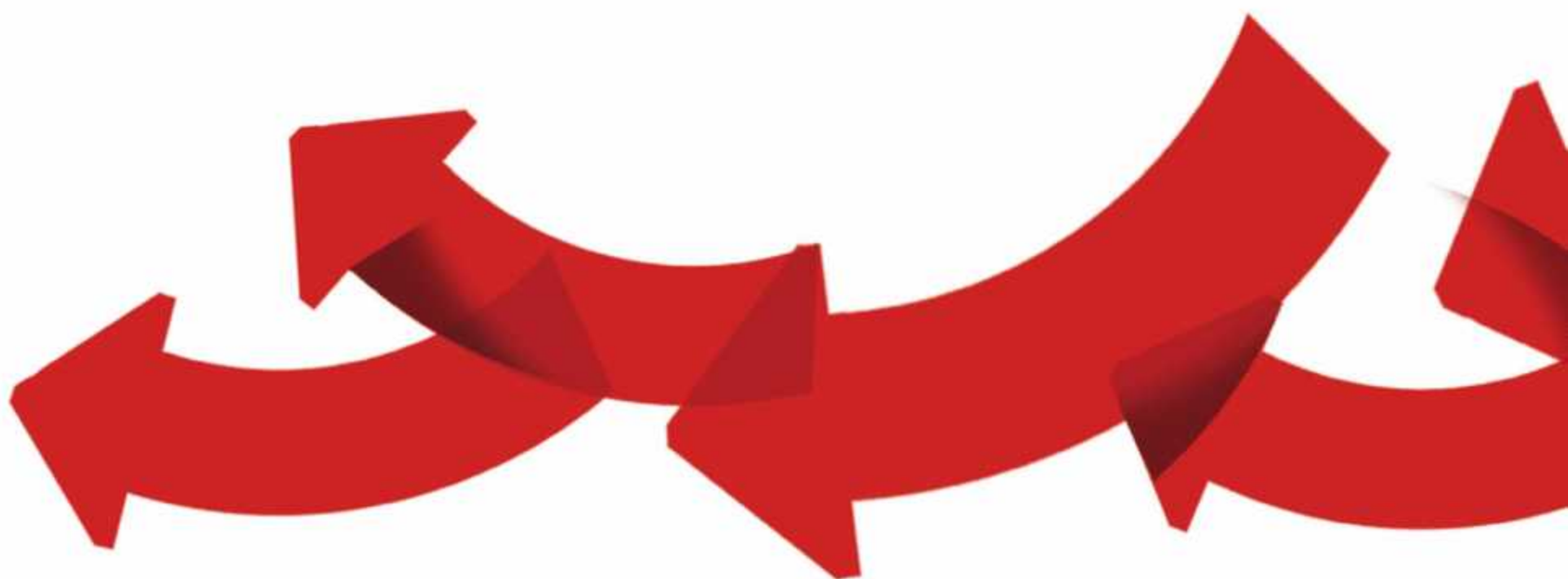
and reduce head count so that costs will fall. In a slow-growing market, lowering costs to enhance margins is the only way to boost profits. This storyline is easy to sell to investors; a CEO can describe a merger's benefits beforehand and demonstrate some of them soon afterward.

IDEA IN BRIEF

- **Half of mergers don't deliver their hoped-for business value. Yet companies from developing countries are defying that statistic, using M&A as their main globalization strategy and generating more value from takeovers than their counterparts from developed nations.**
- **Unlike Western companies, which use M&A primarily to increase size and efficiency, emerging giants acquire firms to obtain competencies, technology, and knowledge essential to their strategy. They avoid overturning acquisitions' management structures and people, ensuring smoother integration. And they have a clear long-term vision guiding their actions; they are willing to wait for a takeover to pay off.**
- **By applying these M&A principles, Indian aluminum producer Hindalco became one of the world's largest aluminum manufacturers.**

By contrast, when emerging giants pursue cross-border acquisitions in particular, they don't search for traditional synergies or try to lower their costs. They buy Western companies to gain complementary competencies – that is, to learn to deploy assets such as technologies and brands, and capabilities such as new business models and innovation skills – that will help them become global leaders. Operating costs aren't an issue; the emerging giant knows it can transform an acquisition's economics simply by switching to the low-cost resources and business processes in its home country. In addition, developing countries will increasingly absorb Western companies' output of technologically superior products. Many slow-growing companies with low margins can be turned into fast-growing, high-margin enterprises by their acquirers in developing countries, the logic of "reverse" M&A suggests.

To realize their objectives, companies from developing countries are using new techniques to identify targets and integrate them. They acquire only to meet strategic goals; they don't completely assimilate acquisitions; and CEOs focus on the long term while planning takeovers and evaluating results. One company showing the way is India's Hindalco, which has used M&A to become one of the world's largest manufacturers of aluminum. In the process, the Indian commodities player turned into an integrated



global major and boosted revenues by 30 times, from \$500 million to \$15 billion, in just seven years. Although the current recession is hurting Hindalco, its strategies are a harbinger of how emerging giants will increasingly approach M&A in the global market and gain an advantage over companies that use more traditional acquisition strategies.

Hindalco's Global Ambitions

Unknown outside India until recently, Hindalco is the flagship company of the \$28 billion Aditya Birla Group, one of the country's oldest and most diversified family business houses. Set up in 1857, the group went overseas in the 1970s when the founder's great-great-grandson, Aditya Birla, established 19 joint ventures in Egypt, Indonesia, Malaysia, the Philippines, and Thailand. It was unusual for Indian entrepreneurs to operate abroad in those days, and the experience laid the foundations of the group's global ambitions. After Aditya's death, in 1995, son Kumar Birla continued to focus on growth; by 1999, the group was one of the world's biggest manufacturers of cement, carbon black, and viscose staple fiber.

By then, Hindalco had grown into India's largest aluminum producer, with a nearly 40% share of the market. It had built a dozen processing plants and also captive power plants and coal mines, and the organization concentrated on upstream operations such as bauxite

mining, alumina refining, and aluminum smelting. It was a commodity manufacturer predominantly focused on the Indian market, although it exported a fifth of its output. Senior executives in the group, like Debu Bhattacharya, who became Hindalco's CEO in July 2003, were dissatisfied with that. Hindalco could do better, they believed, because India had large reserves of bauxite and the company boasted low processing costs.

A turn-of-the-century strategy review convinced top management that Hindalco could become a global leader by expanding the aluminum business, manufacturing more value-added products, and selling both aluminum and aluminum products all over the world. However, success factors in upstream and downstream businesses differ, so Hindalco decided to pursue a two-pronged strategy: It would generate economies of scale in the aluminum manufacturing business by setting up projects in India, and it would use cross-border acquisitions to break into the product market. The latter would be risky; Hindalco had never before acquired a company. It would therefore have to learn to integrate acquisitions and, at the same time, absorb new capabilities.

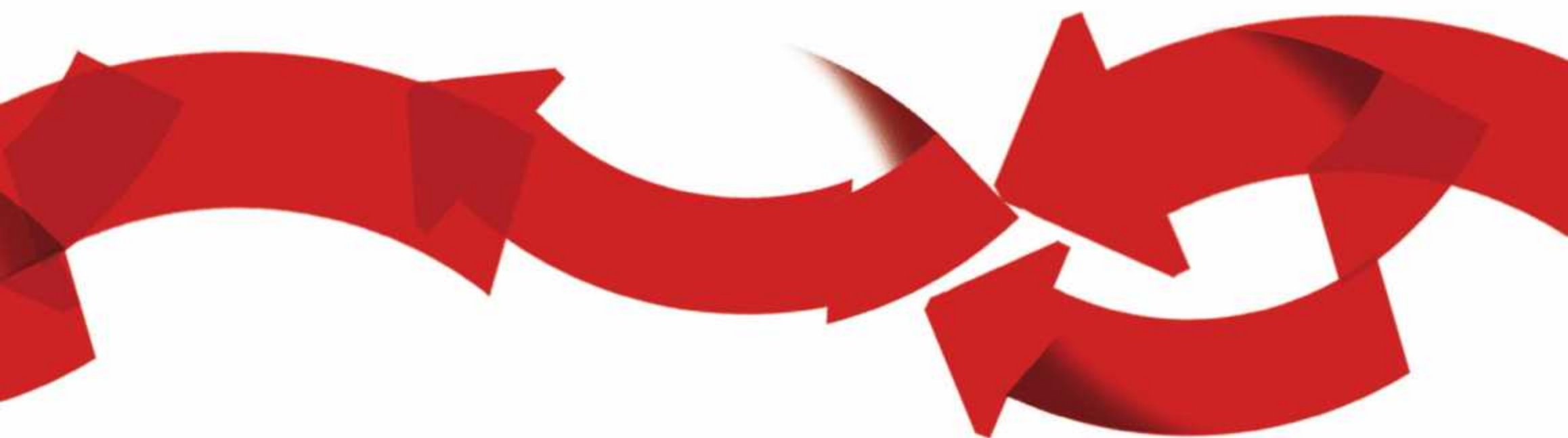
Climbing the M&A Competency Stairway

Hindalco didn't immediately cast about for targets overseas. Instead, it patiently executed small takeovers, first in India

and later abroad, before making a big global play. Each of the initial acquisitions, my research suggests, taught the company something new and served as a stepping-stone toward another acquisition (see the exhibit "Lessons Learned from Each Acquisition"). Combined, those moves created an M&A competency stairway, as I call it, which the company steadily climbed over a period of eight years.

The process started in 2000. Canada's Alcan, one of the aluminum industry's global leaders, wanted to merge with France's Pechiney and Switzerland's Alusuisse to focus on the upstream business. It decided to pull out of India, where it had only a downstream operation, and put its 55% equity stake in Indal – the longtime leader in the Indian market – on the block. A bidding war ensued, and in July 2000, Hindalco, which had long coveted Indal, managed to land the prize catch for a total of \$230 million.

This takeover enabled Hindalco to straddle the length of the industry's value chain. Over the past nine years, the company has become adept at developing aluminum products such as sheets, foils, and extrusions, and manufacturing them cost-effectively. It has developed the ability to brand products, distribute them to retailers and other business customers, and cultivate customer relationships. From Indal, Hindalco inherited a small company, Annapurna Foils, which



had gone into receivership. Hindalco's executives, who had never had to nurse a company back to health, joined the team dealing with the situation. By installing cutting-edge equipment, reengineering processes, and fostering demand for packaging foils, such as lid foil and confectionery wrap, they helped turn around Annapurna.

Hindalco also learned to cope with touchy postmerger integration issues. For example, Alcan had operated in India since 1938, and its Indian managers prided themselves on their values and processes. Indal's managers worried that after the merger, Hindalco's "family business" ways would drive out their "professional management" culture. To reassure them, Hindalco decided to retain all of Indal's senior managers. Kumar Birla made it a point to send out the message, internally and externally, that the group "acquires talent, not just assets" and that it would always deploy the best person for the job. Hindalco has tried to live up to that claim. For instance, Indal's CFO, S. Talukdar, continued in that role until 2005, when the two companies formally merged, and then stepped in as Hindalco's CFO – a rare postmerger occurrence. Hindalco's approach helped turn Indal into a growth machine: Its profits were five times as big in 2006 as they were in 1999.

Three years after picking up the majority stake in Indal, Hindalco felt it could tackle cross-border acquisitions. A nascent copper division took over the Nifty and Mount Gordon mines, two Australian companies, one of which was in receivership and the other was heading there. The companies were small, but the takeovers forced Hindalco to cut its teeth in a developed country, where, among other challenges, labor costs were high and regulations were strict. It used the opportunity to create an overseas company. After merging the two acquisitions, Hindalco made a public offering and listed Aditya Birla Minerals – the first Indian company to trade publicly in Australia – on the Australian Securities Exchange.

Hindalco's growing confidence in its ability to take over and turn around companies spread throughout the Aditya Birla Group. In 2005 the group picked up a pulp mill in Canada to feed its fiber plants in China, India, Indonesia, and Thailand. The deal allowed the group's managers to cope with the dynamics of a global supply chain from the perspectives of both sellers and buyers, and to understand the intricacies of hedging foreign exchange and price risks in different countries. The next year, the group's outsourcing services unit, TransWorks Information, bought a Canadian company, Minacs Worldwide, to create a global player in that field.

The experience the Aditya Birla Group gained through all these takeovers convinced Hindalco that it was time to go after the big one. In December 2006, after the group had scooped up six companies in six years, Hindalco made a bid for Novelis, one of the world's largest producers of flat-rolled aluminum and aluminum products. The Atlanta-headquartered company's facilities were new; it had earned a reputation for technological innovation; and its customers included Anheuser-Busch, Coca-Cola, Ford, Tetra Pak, and ThyssenKrupp. Novelis had reported a 2005 profit of \$90 million, but for fiscal 2006 it was projecting a loss of between \$240 million and \$285 million. That's because it had been born with a large amount of debt on its books. In addition, the company had entered into fixed-price long-term contracts with four major customers, and when raw materials prices rose sharply in 2005, Novelis started losing money on those deals.

Hindalco's unsolicited offer took Novelis's board by surprise. The board later warmed to the idea of a sale and initiated a competitive bidding process. In May 2007, Hindalco succeeded in picking up Novelis for \$6 billion – the second-largest takeover by an Indian company in the United States. If Hindalco hadn't gained a wealth of M&A experience, it probably wouldn't have overcome the diffidence of many emerging-market

Lessons Learned from Each Acquisition

Indian aluminum producer Hindalco acquired several companies before it picked up Atlanta-headquartered giant Novelis in 2007. From each takeover, the Indian enterprise learned new industry-related skills and M&A techniques. It needed to cultivate both kinds of capabilities to acquire a North American company more than twice its size.

companies and made a bid for a North American corporation more than twice its size.

Sticking to Strategic Acquisitions

It may appear as though Hindalco acquired firms willy-nilly, as most Western enterprises do. However, it pursued companies such as Indal and Novelis only after it had carefully figured out what it would achieve by buying them. Hindalco identified its weaknesses and targeted only those corporations whose purchase would offset them, as I shall demonstrate next. So far, it hasn't shown much interest in using M&A to grow quickly or to deal with overcapacity.

Three years before the Novelis bid, Hindalco identified four types of companies in the aluminum industry: Miners like Rio Tinto and BHP Billiton mainly extract bauxite and convert it into aluminum. Aluminum producers such as Dubal and Rusal make aluminum because they have inexpensive access to energy, which accounts for 40% of production costs. Downstream producers such as Novelis and Sapa buy aluminum on the London Metal Exchange and convert it into aluminum products.

ACQUISITIONS



And integrated giants like Alcoa and Alcan combine upstream and downstream operations.

There are good companies of all four kinds, so no single business model is preferable. Enterprises that focus on upstream rather than downstream operations are more profitable, but their profits fluctuate more. That's because speculators on commodity exchanges influence aluminum prices, whereas consumer demand mostly determines product prices.

Hindalco was then an upstream player, so its profits varied every year. It decided to add downstream operations for a few reasons: First, the company wanted to steady the profit stream. Second, it realized it had to be globally competitive at home since India wasn't a protected market anymore. And third, to move away from the commodity business, Hindalco had to manufacture value-added products. Making aluminum at competitive prices requires economies of scale, process skills, and cheap raw materials. Selling value-added aluminum products demands attention to quality, service, and brands; product development skills; and a knack for forging customer relationships—capabilities

that Hindalco didn't possess. To learn them, it decided to acquire the leading downstream companies: Indal in India and Novelis overseas. The objective was to gain new competencies—not to get big fast or to reduce costs.

Once it has identified a target, Hindalco doesn't worry much about the stock market's reaction. The day after it announced the Novelis deal, for instance, Hindalco's scrip price fell (on February 11, 2007) by 13% and its market capitalization declined by \$600 million. In the 2006–2007 annual report, Birla acknowledged the adverse impact of the takeover on Hindalco's bottom line. He asked shareholders to be patient: "I do realize that in the short-term [the acquisition] does cause a strain on your Company's Balance Sheet. However, if you look at the bigger picture, this is one of the most striking acquisitions and over the long-term will undeniably create enormous shareholder value."

This philosophy, which will stand Birla in good stead as Hindalco battles the current recession, is one of the distinguishing features of takeovers by emerging giants. Unlike the many Western companies that merely pay lip service to the idea of generating value in the

long run, smart emerging giants are content to reap the benefits from takeovers over time. In an interview for this article, Birla told me: "I'm not worried. Investors may have a short-term perspective, but my vision is to build a world-class company that is still the leader four decades from now." One downside of this approach is that if the logic driving an acquisition is flawed, it will be too late before the company realizes its mistake. Companies like Hindalco can conceal a multitude of sins by telling investors, "We know best; trust us."

Allowing Integration to Evolve

Hindalco's management doesn't believe in the 30-day or 100-day integration plan; it allows the postmerger process to evolve naturally and rarely intervenes. By the time the company bid for Novelis, it had developed a simple, four-step process to help meet its initial postmerger objectives. The steps are standard ones, relating to finance, organizational issues, business processes, and markets, but the Indian company prioritizes them in a unique way. Most Western and Asian companies spend a lot of time after a merger tackling knotty organizational issues—that is, who's going to get what

job – as well as financial ones. Hindalco resolves those issues quickly and then focuses on integrating business processes to score immediate wins and combining markets to create long-term value.

Financial integration. Instead of centralizing the financial operations after taking over a company, Hindalco tackles only the reporting systems at first. Senior executives want the acquirer and the acquired to speak the same financial language, see the same reports, and set similar benchmarks – as soon as possible. Managers from Novelis and Hindalco worked side by side to get their reporting periods aligned. Prior to June 2007, Hindalco's financial year ended on March 31 whereas Novelis's ended on December 31, so standardization was essential. Other teams took up the consolidation of quarterly results and ensured that both entities met the guidelines of regulators such as the Securities and Exchange Board of India and the U.S. Securities and Exchange Commission. Taxation too required an integration team; Hindalco and Novelis had to meet the tax laws in all the countries in which they operated, but they wanted to optimize the tax bill as well. In none of these cases did Hindalco insist on doing things its way; it shared best practices with Novelis, and vice versa, so that they could find common ground.

Organizational integration. Hindalco doesn't disturb an acquisition's management structure, systems, or people unless necessary. For example, it kept Novelis people in all the top management jobs there – including COO Martha Finn Brooks, who has held her position since 2005. Moreover, in the first six months after the takeover, Hindalco deputed just two of its own executives to Novelis: It sent an expert from its copper division to institutionalize a risk-management process and installed a senior executive in Novelis's logistics department to help improve its global supply chain. This dampened the fears at Novelis that "the Indians were coming." By sending two of its best people, Hindalco was able to impress Novelis's

Two Approaches to M&A		
Emerging giants have different reasons from Western corporations for acquiring companies abroad. They also use novel integration techniques and measure performance in light of long-term goals. It's too early to tell if their approach will work – but if it does, it will take cross-border M&A to new heights.		
	Traditional Approach to M&A	Emerging Giants' Approach to M&A
RATIONALE	The aim of a takeover is usually to lower costs, though some companies use acquisitions to obtain technologies, enter niches, or break into new countries.	The aim is to obtain new technologies, brands, and consumers in foreign countries.
SYNERGY LEVELS	The acquirer and the acquisition usually have the same business model. Even when a company takes over a start-up, the approach to market is the same.	The acquirer is often a low-cost commodity player, while the acquisition is a value-added branded-products company.
INTEGRATION SPEED	The buyer makes several changes in the acquisition soon after the takeover. It slows the quest for synergies thereafter.	Integration is slow-moving at first. After a while, the buyer starts pulling the acquisition closer.
ORGANIZATIONAL FALLOUT	High executive turnover and head-count reduction are likely at first. Culture clashes occur and productivity declines, but things settle down over time.	Little interference, executive turnover, or head-count reduction occurs right after the acquisition. Although it's too soon to tell as of now, tensions could simmer over the long run and blow up.
GOALS	The buyer has clear short-term aims but may not have thought through long-term goals.	The acquirer's short-term objectives may be fuzzy, but its long-term vision for the acquisition is clear.

executives, who now routinely check with the Indian company before going outside the group for ideas or people.

Business process integration. Hindalco looks for easy and painless business wins in the short term. For instance, it has set up a company in India to manage Novelis's information technology systems because of the availability of

inexpensive engineers there. Hindalco didn't lay off Novelis employees, but it stopped the hiring of consultants. By 2010 the IT project will reduce the merged entity's costs by \$40 million a year. Similarly, Hindalco noticed that Novelis's stock turns – the number of times inventory sells – were six a year, compared with its own 20. If stock turns

at Novelis were to increase by just one, the company reckons, that would free \$50 million to \$70 million in working capital. Hindalco has set Novelis a target of seven to 12 stock turns a year by 2010, which could free about \$300 million in working capital. Novelis has started overhauling its supply chain management and inventory control practices, but it's too early to say what the results will be. Besides, the company's sales are falling in the current slowdown, so its stock turns are unlikely to rise.


Wherever Hindalco has felt that Novelis had superior processes, the acquirer has learned from the acquired. For instance, the U.S. company relies on value-based management systems, so Hindalco has enlisted Novelis's managers to develop similar processes in all its units

consumption to 2.25 kilograms – a quarter of China's current consumption – India will consume everything that Novelis produces today. The first signs of change are visible. Two years before the Novelis deal, Hindalco sounded out the world's majors about setting up can-making operations in India. None were interested, but after the Novelis takeover, five entered India. Hindalco is supplying all of them with flat-rolled aluminum from a Novelis plant in South Korea. When the volumes become bigger, the company will set up a plant in India to manufacture flat-rolled aluminum.

The future of these investment plans will of course depend on how well Hindalco weathers the global recession, which has shrunk the demand for aluminum and aluminum products. Although the

fluctuations in its profits from year to year. It did not anticipate a meltdown of the market, with demand all along the value chain falling so dramatically. Hindalco has faced other problems at Novelis as well. For instance, Hindalco has not been able to commercialize Novelis's technologies quickly. It has several products in its innovation funnel, but their development is moving at a very slow pace. As with most acquisitions, Hindalco took over Novelis when the stock market was at its peak. When booms become busts, acquirers often run into problems as interest costs rise and debt repayments come due. Not only will it take Hindalco longer than it expected to realize the benefits of the Novelis acquisition, but the Indian company will have to invest a lot of money to ride out this storm. What will help, though, is the fact that Hindalco developed a clear long-term strategy and adhered to it while making acquisitions.

...

Traditionally, the desire to consolidate has driven acquisitions. However, emerging giants are taking over companies abroad to connect sophisticated technologies and brands with low costs and relatively high growth rates at home. Western multinational companies can fight back by giving global mandates to their overseas subsidiaries. But that will happen only when the locus of M&A shifts from the corporate headquarters in the developed world to regional headquarters in emerging markets. 

Nirmalya Kumar (nkumar@london.edu) is a professor of marketing at London Business School and a codirector of the school's Aditya Birla India Centre. The research for this article was not funded by the center or conducted under its aegis. Kumar's latest book, with Pradipta K. Mohapatra and Suj Chandrasekhar, is *India's Global Powerhouses: How They Are Taking On the World* (Harvard Business Press, 2009).

Reprint R0905K
To order, see page 131.

Hindalco identified its weaknesses and acquired only firms that would offset them.

in India. On the basis of analyses of competitors, markets, plants, financials, and customer data, they are developing planning models that will enable Hindalco to craft better strategies for the future.

Market integration. Despite the competition in the Indian market, Hindalco can easily stoke demand in India for the products of companies it acquires. This type of integration is peculiar to emerging giants, which have fast-growing home markets. For example, India's demand for aluminum products is projected to almost double from 1 million tons in 2007 to 1.9 million tons in 2012, and half of that increase in demand will be for the kind of flat-rolled products Novelis produces. Thus, India could absorb a third of the North American company's output in three years' time. Even then, India's per capita consumption of aluminum will be one kilogram compared with China's 9 kilograms and the United States' 25. If Hindalco can grow India's

price of aluminum fell by about one-third in the last three months of 2008, the Indian company's revenues grew by 1.8% and it reported a profit of \$395 million for the period from April to December 2008. By contrast, Novelis's performance suffered: Sales fell by 1.7% in the nine months leading up to December 31, 2008; in the last quarter of the calendar year, they tumbled by 20%. The company realized a huge net loss of \$1.9 billion from April to December. This included a onetime financial charge of \$1.5 billion, which Novelis, like several other North American companies, incurred because its value fell by that amount in 2008, and the SEC required that the sum be written off. Excluding all the financial charges, Novelis recorded a pretax loss of \$32 million for the quarter, compared with a loss of \$22 million for the same period in 2007.

Hindalco believed that Novelis's steady earnings would help offset the

Letters to the Editor

Seize Advantage in a Downturn

In their article “Seize Advantage in a Downturn” (February 2009), David Rhodes and Daniel Stelter provide a comprehensive checklist of worthy business tactics to implement in a recession. We agree with the notion of monitoring and optimizing cash positions during this downturn. We also believe that thinking about scenarios along a continuum of best case to worst case is both necessary and prudent. We disagree with the authors, however, on four points.



First, we question the overarching theme of taking certain actions only during a downturn. Many of those actions are sensible business practices at any time, not just during a crisis. Focusing on strategy process and content – as crisis teams do, for example – should be an ongoing activity.

Second, selling nonproductive assets can, in fact, be nonstrategic, especially when a market for those assets may not

even exist. Rather than expend scarce resources trying to sell nonproductive assets, therefore, companies should re-evaluate their use and look for opportunities from within.

Third, leveraging with credit default swaps may not, in fact, strengthen a company's cash position. The market for credit default swaps lacks regulation and transparency and is thus a high-risk environment. In addition, investors reviewing any given company may conclude that accepting initially high and variable interest rates constitutes reckless behavior on its part – a side effect that could negate any immediate gains in strategic investment funding that the company might secure.

Fourth, the authors barely mention what is commonly regarded as a company's most valuable asset: its people. Addressing issues of morale, motivation, engagement, and the like should be on every company's to-do list in order to seize advantage during a downturn.

Executive MBA Class of 2009

Hankamer School of Business
Baylor University
Austin, Texas

Gary R. Carini

Associate Dean for Graduate Programs
Hankamer School of Business
Baylor University
Waco, Texas

Rhodes and Stelter respond: We agree with the letter writers that much of what we prescribe constitutes sensible busi-

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ness practice even during more normal times, and we thank them for reminding us all of that fact.

Clearly, management can seek to re-deploy unproductive assets if there is no market for them. But when cash is tight, mothballing or closing down may be preferable.

We think the question of taking credit while you can is dependent on the motive for doing so. Obviously, we would not favor recklessly overextending the company simply for the sake of grabbing credit. Preserving options around liquidity, however, may indeed be necessary – unusual times often require unusual actions.

Finally, we believe passionately that the people issues are important. (To see more of our thoughts on this subject, please see our Collateral Damage series at www.bcg.com). We believe that substantial actions should be taken concerning leadership style, open and direct communication, releasing employees respectfully while also upgrading talent, looking after your stars, and treating the crisis as a transformational opportunity.

Women and the Vision Thing

Herminia Ibarra and Otilia Obodaru conclude that if only women would learn to develop and communicate a vision like men do, their chances of reaching the top as business leaders would improve significantly (“Women and the Vision Thing,” January 2009).

On balance, I agree with the authors that women have a harder time developing and communicating a vision than men and that they tend to downplay the importance of doing so as well. Instead, they take a more pragmatic and detail-oriented approach. That does not neces-

sarily make them less effective business leaders, however. Moreover, “visioning” on its own has been an overrated competency in the recent past. We could have used more leadership along the lines of “That’s a great vision, but how exactly do we achieve sustainable growth through investments in subprime loans?”

I still favor the “helicopter” leadership perspective that I and my colleagues used during our assessments of high-potential people at Royal Dutch/Shell in the early 1990s. The metaphor was particularly apt: We were looking for leaders who could rise above the fray to see the big picture *and*, when necessary, land at any location to drill down into the detail. Those qualities are difficult to find and develop in any given individual. Individuals working together in a group, however, often do develop them, particularly if anyone has a natural propensity for one or the other side of the dimension.

Hence, the way out of the current economic crisis into sustainable profitability is through gender-balanced leadership that leverages the differences – rather than the similarities – between the sexes.

Paul Vanderbroeck

*Executive Coach and Organizational Consultant
20-first
Geneva*

Ibarra and Obodaru respond: We could not agree more that organizational success depends on harnessing the diverse talents of a team in which each member has different strengths. But it is important to recognize the provenance of those “natural” talents and skills, particularly when one group holds 85% of the positions of power and authority in business while the other group, with complementary propensities, holds just 15%.

The direct reports of the women we interviewed found them to be just as visionary as the men, suggesting that the issue is not the skills of those women but how they are perceived. Again and again we were told that women often did not get credit for their visions because they developed them collaboratively. They were also more likely to be challenged if they departed from the facts and figures.

Paul Vanderbroeck is right that taking a pragmatic and detail-oriented approach does not make women less-effective business leaders. But it does dramatically decrease the likelihood that they will be given a chance to lead at the highest levels. Much of what we might observe as gender differences in leadership behavior is the result of women adapting to implicit bias and lack of recognition. If we continue to view those differences as natural propensities, we will continue to create teams where the men always pilot the helicopters while the women drill into detail when the helicopter lands.

Stop Overdoing Your Strengths

In their article “Stop Overdoing Your Strengths” (February 2009), Robert E. Kaplan and Robert B. Kaiser assert that managers who overdo their strengths can recover balance in their behavior through a greater understanding of root causes. They offer two examples of executives they had worked with: Tom, who was seen as too forceful, and Maureen, who was too focused on building consensus. Both managers, through the force of sheer will, were able to balance their lopsided tendencies.

As the authors point out, however, more typically change is easy to talk

about but very hard to do – especially when dealing with strengths that seem to have produced success in the past. Fortunately, when willpower is lacking, there are many other work-arounds. Instead of dialing back his forcefulness, for instance, Tom could have honed his active-listening skills; Maureen could have increased the efficiency of her meetings by improving her time-management skills or assigning a timekeeping role to another team member.

In today's marketplace, feedback on overused strengths must be fully integrated into leadership development. Let me add that the VOICES 360 feedback instrument developed by Lominger International has long included ratings on whether the person receiving feedback is overdoing a competency.

Lawrence P. Clark

*Independent Lominger Associate
Chappaqua, New York*

Kaplan and Kaiser respond: We heartily agree with Lawrence P. Clark that the remedy for overused strengths isn't just for managers to dial back – they must also dial up the other side. Leaders who come on too strong do well not only to keep their powerful personalities in check but also to improve their listening and empowering skills. That two-sided approach can rectify lopsidedness – which, though common, often goes undiagnosed by typical assessment tools, for two reasons: (1) the underlying concept of leadership is unidimensional, not the yin-and-yang type it needs to be, and (2) most five-point scales don't capture overused strengths.

Managers can't rely on willpower alone to rebalance lopsidedness. They also need to adjust the tilt in their mindset that sent them overboard in the first place. This is what Clark meant by getting a better understanding of root causes. One common root cause is underestimating your own strength – how analytical or direct or inclusive you are, for instance. If your standards are too high or you worry needlessly about exercising one of your leadership abilities

well enough, you run the risk of overcompensating by employing that ability too much or too intensely. The outer work of behavior change hinges on the inner work of personal growth.

The Quick Wins Paradox

Having recently left a large, global organization, I can affirm that the concept of leaders' needing a quick or early win is prevalent, as Mark E. Van Buren and Todd Safferstone assert in their article "The Quick Wins Paradox" (January 2009). You can almost hear "We need a quick win!" echoing in conference rooms across the land.

Often, however, quick or early wins may be confused with easy-to-solve issues that have been around for a while – the proverbial low-hanging fruit. That can create another trap. Focusing on those issues may distract a transitioning leader from more important items or more meaningful quick wins.

Ed Evarts

*Principal
Evarts Coaching
Wakefield, Massachusetts*

What Can Coaches Do for You?

The series of articles on executive coaching offered by Diane Coutu and Carol Kauffman in "What Can Coaches Do for You?" (January 2009) meets an essential need in the marketplace. Consumers have little guidance on how to choose, value, or assess the effectiveness of executive coaching as a form of leadership development. Both P. Anne Scoular's and Anthony M. Grant's recommendations are reminiscent of the advice offered to people trying to select a physician or psychotherapist 30 years ago. Specialized training, certification, experience, and, of course, personal endorsements all have been used to select individuals whose expertise would otherwise be difficult to measure. Currently, research in health care outcomes has

begun to supplant credentials and experience, but, as David B. Peterson noted, the coaching industry is a long way from developing objective measures of success with executives.

The next step in selecting a coach should be to more carefully match a coach to the type of coaching that a particular individual or organization needs. In an article I coauthored for the journal *Professional Psychology: Research and Practice* in 2006, I described several types of coaching engagements and suggested that the optimal coaches for each would differ greatly. Executives transitioning into a new organization or a new role within a large organization, for example, benefit most from a business-savvy professional who understands the application of strategic, operational, and organizational actions and encourages focus and results. Coaches for high-potential individuals, however, need to have experience in, and knowledge about, fostering strengths and helping people make mental shifts to new levels of strategy and abstraction. Still other engagements require coaches skilled in behavior change techniques, such as cognitive-behavioral, systems, and interpersonal approaches.

Just as we choose lawyers and doctors based on their expertise in a particular domain of law or medicine, executives should choose coaches according to their knowledge of, and experience with, the particular problems they face.

Bill Berman

*Managing Partner
Berman & Associates
Stamford, Connecticut*

The Global Entrepreneur

In "The Global Entrepreneur" (December 2008), Daniel J. Isenberg presents an analysis of factors that drive the creation of global start-ups and describes the challenges facing those companies. He cites two reasons for the growing trend. The first is defensive: to ensure access to global markets and a global supply

chain. The second is offensive: because new business opportunities span more than one country and because distance can be used to create new services.

There is also a third reason. Most entrepreneurs and start-ups focus on niche markets, many of which can now be found worldwide. Businesses that go global immediately, therefore, can gain an advantage by focusing on one of those worldwide niche markets. This is particularly true for software, internet-related, or online-service ventures.

Dan McAran

*Product Manager
Do Process Software
Toronto*

Isenberg responds: There are several types of international or global ventures. The “global niche” that Dan McAran presents is an example of what I call a *global-product* venture, which addresses a need that is relatively borderless. Medical devices and many technology-based products fall into this category. The four other venture archetypes are each defined by what drives the opportunity.

Context-bound ventures are created from the unique aspects of a given country. *Bilateral* ventures arise when the opportunity and means for importing a proven business model from one place to another are identified. Cinemex, for example, did so in the mid-1990s, establishing a chain of large multiscreen cinemas in Mexico. *Regional* ventures – such as Studio Moderna, which established a television shopping venture in Central and Eastern Europe – form because of commonalities within a given region. Those commonalities are often based on geography, climate, culture, language, or political system. *Global* ventures – including medical tourism, outsourcing, and international trade – are created by distance. RacingThePlanet, for example, exploits distance to create challenging and exotic adventure races. To make them successful, each of the global venture types requires different skills from the entrepreneur.

Fulfill the Dream of Leading a Nonprofit

I was a bit taken aback with David Simms and Wayne Luke’s portrayal of the public sector in their article “Fulfill the Dream of Leading a Nonprofit” (Forethought, January 2009). Highly trained and experienced professionals are, of course, assets in any organization. But few would consider hiring an executive with little to no experience in that organization’s industry. The public sector is no different, and to suggest that leadership positions can be quickly filled by people with limited – if any – experience in that segment does a disservice to the industry.

To achieve success in the public sector, leaders must understand the intricate challenge of achieving profound social change while handling the realities of running a business. They must meet the needs of multiple stakeholders – who, oftentimes, have conflicting demands and expectations – with inadequate resources. And they have to realize that failure does not mean just missing quarterly earnings: It can ruin lives and entire communities.


To address the future leadership gap, nonprofit organizations should implement two strategies: First, invest heavily in leadership training for your current midlevel staff. Countless individuals dedicate their “first career” to the public sector. Since those individuals already demonstrate their commitment to your cause and are familiar with the challenges of your industry, you want them to advance in your organization. Second, identify peer organizations for potential mergers. Smaller nonprofits often lack the infrastructure necessary to operate in an environment that requires more reporting, more compliance, and more oversight than the corporate sector. Merging overlapping nonprofits should improve services while reducing administrative needs and costs.

Peter Beyer

*Controller
Housing Authority of Portland
Portland, Oregon*

Simms and Luke respond: Peter Beyer’s points are certainly well taken. There are many differences between the for-profit and nonprofit sectors, and while our data and experience working with hundreds of nonprofits show that “bridgers” from for-profits to nonprofits constitute one important source of talent, not everyone can cross over effectively. Thus, to solely rely on bridging for leadership enrichment would be inadequate and ill advised.

As we pointed out in our article, however, successful bridgers will typically have a demonstrated track record of active involvement in the nonprofit sector, whether through volunteering or board service. In addition, many bridgers have gained valuable experience and expertise in functional areas, and the fresh outlooks and for-profit perspectives that they offer give rise to new ideas and approaches. Through their work, therefore, bridgers can have an extraordinarily positive effect not only upon the nonprofit groups with which they are affiliated but also beyond the four walls of those organizations.

We also agree with Beyer that, in order to fill the leadership deficit, it is critical to foster career progression and nurture professional development within the nonprofit sector. And it’s certainly true that nonprofits could make greater use of mergers and acquisitions to gain efficiencies and increase reach both in programs and leadership talent. A recent Bridgespan Group study shows a surprising result. When we analyzed more than 3,300 nonprofit deals across four states over 11 years, we found that while the incidence of nonprofit M&A is similar to that among for-profits, the prevailing rationale for nonprofit mergers is largely one of last resort – financial distress or leadership vacuums. Our study, *Nonprofit M&A: More than a Tool for Tough Times* (at www.bridgespan.org), found that large, strategic mergers occur at one-tenth the rate among nonprofits as they do among for-profits. Filling this gap calls for more funders to proactively play the role of matchmaker. 

Executive Summaries

MAY 2009



“Determining which businesses we should not be in...calls for continual pruning and weeding. Disposing of assets is not as sexy as acquiring them, but it's just as important.”

—page 54

COVER STORY

54 | What Only the CEO Can Do

A.G. Lafley

The author combines his nine years' experience as the CEO of Procter & Gamble with the last writings of the management scholar Peter Drucker to answer the question “What is the work of the CEO?” The chief executive, Lafley says, is held singularly accountable for the performance and results of the company – according not just to its own goals but also to those of diverse and often competing external stakeholders. In other words, he or she is responsible for linking the outside to the inside – a job that consists of four fundamental tasks.

Defining the meaningful outside. At P&G this means emphasizing that the consumer is boss. The company has also worked to change what had been win-lose negotiations into win-win partnerships with retail customers and suppliers.

Deciding what business you are in (or not in). After a thorough analysis of its strengths, current competitive position, and structural conditions, P&G chose to grow from its core – laundry products, baby diapers, feminine care, and hair care – and also to focus more on low-income consumers and developing markets, where sales have grown from 21% to 31% of the total since 2000. The company has exited food and beverages and is selling its pharmaceutical business. Where to compete and where not to compete remain ongoing questions.

Balancing present and future. P&G defines realistic growth targets and uses a flexible budgeting process with complementary short-term, midterm, and long-term goals.

Shaping values and standards. The CEO must interpret the organization's values in the context of change and competition and define the standards that will guide decisions. Trust at P&G had come to mean that employees could rely on the company for lifetime jobs. Lafley redefined it as consumers' trust in the company's brands and shareholders' trust in its value as a long-term investment.

Reprint R0905D

FORETHOUGHT

20 | How to Get Unstuck

Rita Gunther McGrath and Ian C. MacMillan

Two professors who have studied how leaders regain momentum in uncertain times suggest four ways to get your employees to face their fear, outrun hesitant competitors, and seize advantage. **Reprint F0905A**

Hospital Visitors Ask for More Shopping Outlets

Andreas B. Eisingerich and Leslie Boehm

Is an institution that instills fear in many people a good spot to set up shop? Yes, say the authors, whose research shows that hospital lobbies are places where businesses can connect with consumers. **Reprint F0905B**

Equity or Cash? The Signal Sent by the Way You Pay

Marie E. Sushka and Ulrich Hege

It's well known that stock markets react more favorably if a company is bought with cash rather than with stock. But the opposite holds true for just a business unit. Here's why. **Reprint F0905C**

Embrace Your Enemy

Marcelo Bucheli and Erica Salvaj

In Chile, as in much of Latin America, business is identified with right-wing politics. Two Spanish multinationals found a simple but effective way to overcome this historical prejudice so that they could establish a productive relationship with the present left-wing government. **Reprint F0905D**

To Boost Knowledge Transfer, Tell Me a Story

Shad Morris and James B. Oldroyd

By learning how to turn field reports into compelling stories, the World Bank's International Finance Corporation has made them fulfill their true purpose: to become effective tools that actually transfer knowledge among employees. **Reprint F0905E**

A Conversation with Shai Agassi

The CEO of Better Place talks about what went through his mind the night he decided to start a venture to end the world's dependence on oil as a transportation fuel. **Reprint F0905F**

When Contracts Destroy Trust

Deepak Malhotra

Contracts exist to foster trust, but they can actually do the opposite. Overly detailed contracts leave no room for spontaneous acts of kindness to create goodwill between parties; too-rigid contracts leave parties unable to respond to the unanticipated; and, strangely enough, incentives can end up being just plain insulting. **Reprint F0905G**

Risk Gone Wild

Jonathan Rosenoer and William Scherlis

IT systems increasingly hold the potential to launch cascading disasters, triggered by the most trivial of incidents. A new type of risk-management culture is needed, warn these Carnegie Mellon professors, to guard against such extreme, but no longer unthinkable, events. **Reprint F0905H**

Reviews

Featuring *Management Rewired: Why Feedback Doesn't Work and Other Surprising Lessons from the Latest Brain Science*, by Charles S. Jacobs



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HEALTH & WELL-BEING

30 | Do Take That Break

Samuel Z. Goldhaber, MD

A recent study from Wellington Hospital in New Zealand found that office workers who sat for several hours without getting up were more likely to form a deep-vein thrombosis – that is, a blood clot in a vein deep in the leg – than those who moved about more often. Together, deep-vein thromboses and pulmonary embolisms (which occur when a piece of the clot breaks away and blocks blood flow to the lungs) kill upwards of 100,000 Americans each year, or about as many as die from breast, prostate, and colon cancer combined. In this article, Goldhaber, a professor of medicine at Harvard Medical School, explains the connection between DVTs and prolonged periods of sitting anywhere (not just on airplanes) and offers tips for prevention.

Reprint R0905A

“If the company stops cleaning the restrooms, the odds are that workers won’t clean their work areas or strive to provide superior quality and service.”

–page 45

HBR CASE STUDY

35 | World-Class Bull

John Humphreys, Zafar U. Ahmed, and Mildred Pryor

When Chris Knox, a top salesperson at Specialty Fleet Services, volunteers to go after the business of Armadillo Gas & Power, he decides to try a new approach. After all, no one else from SFS has succeeded with Dale Landry, Armadillo’s CFO. Knox shows up at Landry’s ranch, asks to photograph his beloved bull, presents the photo as a gift to Landry’s wife, and engineers several other encounters before Landry learns that Knox is anything more than a charming young man. Not long after he reveals his position at SFS, Knox wins the account. Sales VP Jeremy Silva e-mails the sales team, praising Knox’s maneuvers. But the human resources vice president thinks that Knox breached the company’s ethics code. Does Knox deserve a reprimand?

Kirk O. Hanson, the executive director of the Markkula Center for Applied Ethics, believes that Knox went astray not by trying to share a potential client’s passion but by treating the Landrys as a means to an end – deceiving them and violating their personal space along the way.

There’s a big difference between deceiving competitors and deceiving customers, explain consultants Don Peppers and Martha Rogers. SFS needs to clarify this difference in its ethics code, apologize to Landry, and fire Silva, who demonstrated in hitting the “send” button that he does not understand the policies and behaviors that build shareholder value.

James Borg, a business psychologist and author, argues that Knox didn’t coerce Landry into buying SFS’s services but instead simply got the CFO’s attention and let his persuasive techniques do the rest. Whereas coercion and manipulation satisfy the needs of only one party, persuasion is about achieving a positive outcome all around – exactly what Knox accomplished. Armadillo got a superior product, and SFS won a new customer.

Reprint R0905B

Reprint Case only R0905X

Reprint Commentary only R0905Z



FIRST PERSON

45 | The Right Way to Close an Operation

Kenneth W. Freeman

Many managers have never before had to shrink their operations or workforces drastically. Now, as they struggle to weather the storm of recession, they risk making what the author says is a common mistake: assuming that they will have to make the tough initial decision but can leave it to others to carry out.

Long experience at Corning, Quest Diagnostics, Masonite International, and Accellent taught Freeman the benefits of what he calls a “soft hands” approach, which involves ensuring that employees, customers, suppliers, and communities are treated with consideration and compassion. Such behavior is simply good business. He offers four commonsensical – but frequently ignored – principles.

Treat employees with dignity, fairness, and respect. Tell them why they’re losing their jobs, what you will do to help them cope, and what you’ll need from them during the transition. Communicate fully and often, be visible and personal, and honor company commitments.

Treat your customers and suppliers like valued partners. Keep them informed, consider their needs, maintain your focus on quality, and take pains to transfer the business smoothly.

Manage the layoff or closure like a project. Appoint an experienced, full-time project leader and a strong team. Define stages of the process, establish criteria for passing through them, and conduct regular reviews.

Use judgment and, if necessary, fight back. Don’t be pushed by Wall Street or others to move so quickly that the organization ends up suffering.

The shutdown of a Corning plant in Indiana, the merger of Quest with SmithKline Beecham Clinical Labs, and the closure of an Accellent factory in Tennessee illustrate successful outcomes of a soft-hands approach.

Reprint R0905C



64 | Need Cash? Look Inside Your Company

Kevin Kaiser and
S. David Young

The boom years have made business careless with working capital. So much cash was sloshing around the system that there seemed little point in worrying about how to wring more of it out, especially if that might dent reported profits and sales growth. Today, capital and credit have all but disappeared, customers are tightening belts, and suppliers aren't putting up with late payments. It's time, therefore, to take a cold, hard look at the way you're managing your working capital. If you do, say Insead professors Kaiser and Young, you'll very likely find that you have an awful lot of capital tied up in receivables and inventory.

In this article, the authors explore six common mistakes that companies make in this area: *managing to the income statement*, which can encourage executives to tie up capital in stock and receivables because income statements often fail to include important cost items; *rewarding the sales force for growth alone*, which makes concessions in the terms of trade more likely, as salespeople look for ways to get customers to buy; *overemphasizing production quality*, which often results in gold-plated and slow production processes; *tying receivables to payables*, because even an unfortunate and costly change in supplier terms should in no way be a reason for revisiting the customer relationship; *applying bankers' current and quick ratios*, which tends to increase the likelihood that a company will face a liquidity crisis; and *benchmarking competitors*, which can make managers complacent when their working capital metrics are in line with industry norms. Simply correcting these mistakes will release a lot of hidden cash.

Reprint R0905E



74 | The Definitive Guide to Recruiting in Good Times and Bad

Claudio Fernández-Aráoz,
Boris Groysberg, and
Nitin Nohria

Few companies are thinking about hiring right now, but that's a mistake. If history is any guide, staffing will become a front-burner issue once the economic upheaval eases. Even now, companies are running into staffing problems in emerging markets, and many will have to find talented replacements for baby-boom retirees. Will they be able to meet their needs?

Not likely, say Fernández-Aráoz of Egon Zehnder and Harvard Business School professors Groysberg and Nohria. Their research, conducted with scores of CEOs, HR executives, and recruiters, found current hiring practices to be haphazard at best and inept at worst.

And no wonder. Ignorant of their staffing needs, most companies treat hiring top-level executives as an emergency. That leaves them little choice. One study found that nearly a quarter of the time, the executive selected was the only candidate considered. Far too few companies conduct reference checks; far too many rely on gut reactions when judging qualifications and cultural fit. Hardly anyone considers whether candidates will be good team players. And, shockingly, only half of the top managers recruited by the companies studied were interviewed by anyone in the C-suite. The result: About a third of promising new hires depart within three years of being recruited.

As a remedy, the authors offer their best thinking about state-of-the-art hiring practices for the top levels of the organization. Their recommendations cover the entire hiring cycle in seven steps: anticipating the need for new hires, specifying the job, developing a pool of candidates, assessing the candidates, closing the deal, integrating the newcomer, and reviewing hire-process effectiveness. Whatever the future brings, firms that follow these practices successfully will have a distinct advantage over their short-sighted competitors.

Reprint R0905F

86 | Is Your Growth Strategy Flying Blind?

Mehrdad Baghai, Sven Smit, and
Patrick Viguerie

Despite an abundance of raw data, few organizations have figured out how to parse and analyze all that information to reveal the best opportunities for growth. Even fewer have attempted to structure and manage themselves to match the texture of the markets in which they play. But a fine-grained understanding of company performance and markets is critical, especially during an economic downturn, which calls for a nuanced approach to cutting costs and making long-term investments.

Baghai, Smit, and Viguerie urge firms to target narrower market slices and to measure sources of growth – market momentum, mergers and acquisitions, and market share gains – in a more detailed way. When they reviewed growth patterns of global firms from 1999 to 2006, they found that companies can get a much more accurate picture of growth prospects by digging deeply into micro-markets (typically ranging from \$50 million to \$200 million in value) than by looking at the division-level performance numbers commonly used for measuring, organizing, and managing.

The authors examine several companies – including Amazon and Ping An – that have benefitted from greater granularity. For instance, one large European manufacturer of personal-care products went beyond an aggregated view of performance and discovered that some of its higher-growth segments were lurking in the unit with the lowest overall growth rate. Another company, an integrated telecommunications service provider, retooled its marketing mix – making fewer roughly calculated media trade-offs (television versus direct mail versus radio) and instead selecting the right media within narrowly defined regions for specific lines of business. As a result, it boosted sales between 10% and 15% in several regions and increased average lifetime customer value by 15%.

Reprint R0905G

THE HBR INTERVIEW

98 | Why Teams Don't Work

J. Richard Hackman

Interviewed by Diane Coutu

The belief that teams make us more creative and productive – and are the best way to get things done – is deeply entrenched. But Hackman, a professor of organizational psychology at Harvard and a leading expert on teams, is having none of it. Research, he says, consistently shows that teams underperform despite all their extra resources.

In an interview with senior editor Diane Coutu, Hackman explains where teams go wrong. Shockingly, most of the time members don't agree on what the team is supposed to be doing or even on who is on the team. The belief that bigger is better also compounds problems; as a team grows, the effort needed to manage links between members increases almost exponentially. Leaders need to be ruthless about defining teams and keeping them small (fewer than 10 members), and some individuals (like team destroyers) should simply be forced off. The leader also must set a compelling direction for the team – but in so doing, may encounter intense resistance that puts him or her at great risk.

Hackman explores other fallacies about teams – for instance, that teams whose members have been together a long time become stale. In fact, research reveals that new teams make 50% more mistakes than established teams. To avoid complacency, though, every team needs a deviant – someone who is willing to make waves and open up the group to more ideas. Unfortunately, such individuals often get thrown off the team, robbing it of its chance to be magical.

Leaders can't *make* a team do well. However, by being disciplined about how a team is set up and managed, instituting the right support systems, and providing coaching in group processes, they can increase the likelihood that a team will be great.

Reprint R0905H

TOOL KIT

106 | Making Better Investments at the Base of the Pyramid

Ted London

Though they have feel-good stories and data on milestones, most ventures that serve the world's poor don't have a systematic way to gauge how well they're achieving their goals. To address that need, London, the director of the University of Michigan's Base of the Pyramid Initiative, has devised a new tool.

London's Base of the Pyramid Impact Assessment Framework explores how ventures influence the well-being of local buyers, sellers, and communities. It guides managers through a detailed look at an organization's effects on those constituencies in three areas: economics, capabilities, and relationships. The framework examines negative as well as positive effects – for instance, whether activities that increase the income of the poor also prompt them to mistreat arable land. It helps managers focus success measures on the most likely high-magnitude outcomes.

VisionSpring, which trains rural women to provide affordable eye care in India, knew it had improved the economic fortunes of its microentrepreneurs. After applying the framework, however, the venture had an appreciation of its impact on some of its buyers: artisans whose eyesight had deteriorated with age. The nonprofit's glasses boosted the artisans' productivity, income, and dignity. VisionSpring also uncovered negative effects – strife and jealousy in families that weren't used to women's working outside the home. The organization helped ease those tensions by encouraging the women's spouses to become involved in product distribution, thus improving their relationships and reducing the risk that sellers might quit.

The more holistic, fact-based view provided by London's framework has helped VisionSpring make better decisions about how to enhance positive effects, mitigate negative ones, and demonstrate clear value to potential funders and partners.

Reprint R0905J

BEST PRACTICE

115 | How Emerging Giants Are Rewriting the Rules of M&A

Nirmalya Kumar

While Western companies struggle with mergers and acquisitions, emerging giants like Indian aluminum producer Hindalco are using M&A as their main globalization strategy. That's partly because developing economies grew at near double-digit rates in the past 15 years, enabling many enterprises to make acquisitions. It's also because, according to the author's research, those corporations create more value from takeovers. To compete, Western multinationals should change their mind-set and shift the locus of their M&A efforts to regional headquarters in developing countries.

U.S. and European companies, inhibited by slow-growing home markets, acquire rivals primarily to become bigger and thus create economies of scale. By contrast, emerging giants buy companies – often Western ones – to gain competencies that will help them become global leaders. They acquire only to meet strategic goals; they don't completely assimilate acquisitions; and their CEOs focus on the long term.

Using this approach, Hindalco boosted revenues in seven years from \$500 million to \$15 billion. It acquired companies to expand its aluminum business, manufacture more value-added products, and extend its global reach. Rather than immediately seek targets overseas, the company patiently executed small takeovers, first in India and later abroad, before making a big global play. With each move, Hindalco climbed what the author calls an M&A competency stairway, gaining the skills it needed to pursue other targets. When it was ready, Hindalco bought Novelis, a North American corporation more than twice its size.

Because of the global downturn, Hindalco will not realize the benefits of that acquisition as quickly as it had expected. But the fact that the company developed and adhered to a long-term M&A strategy will help it ride out the storm.

Reprint R0905K

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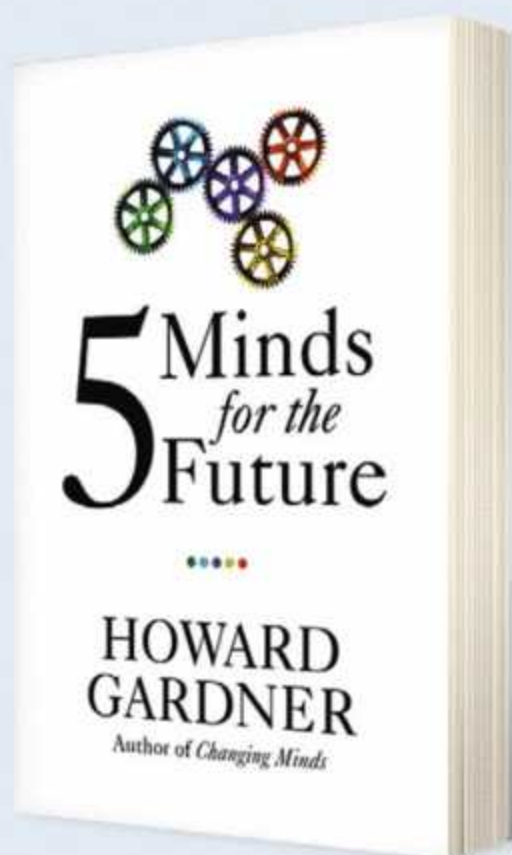
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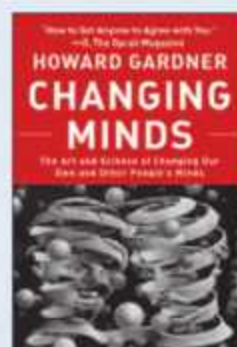
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That's Going to Cost You

COMMON SENSE suggests that you can't base a business on giving things away. But countless industries thrive by offering value to one group of customers at no cost while charging a different set of buyers to pay the bills. That's how auction houses, real estate brokers, print and online media, dating services, and head-hunters work. The internet is a magnet for these kinds of businesses because it makes it so easy to attract both free and paying customers.

In "What Is a Free Customer Worth?" (HBR November 2008), Sunil Gupta and Carl F. Mela explore the peculiar importance of this segment. "Free customers in the early stages of the business are crucial," they say, "and the firm should be willing to invest a lot of resources to get them on board." The reason? They attract others through referrals and word of mouth, and in the end that draws in more paying customers.

This business model gets in trouble when the balance is off. The wrong mix of free and fee spoils everyone's lunch.

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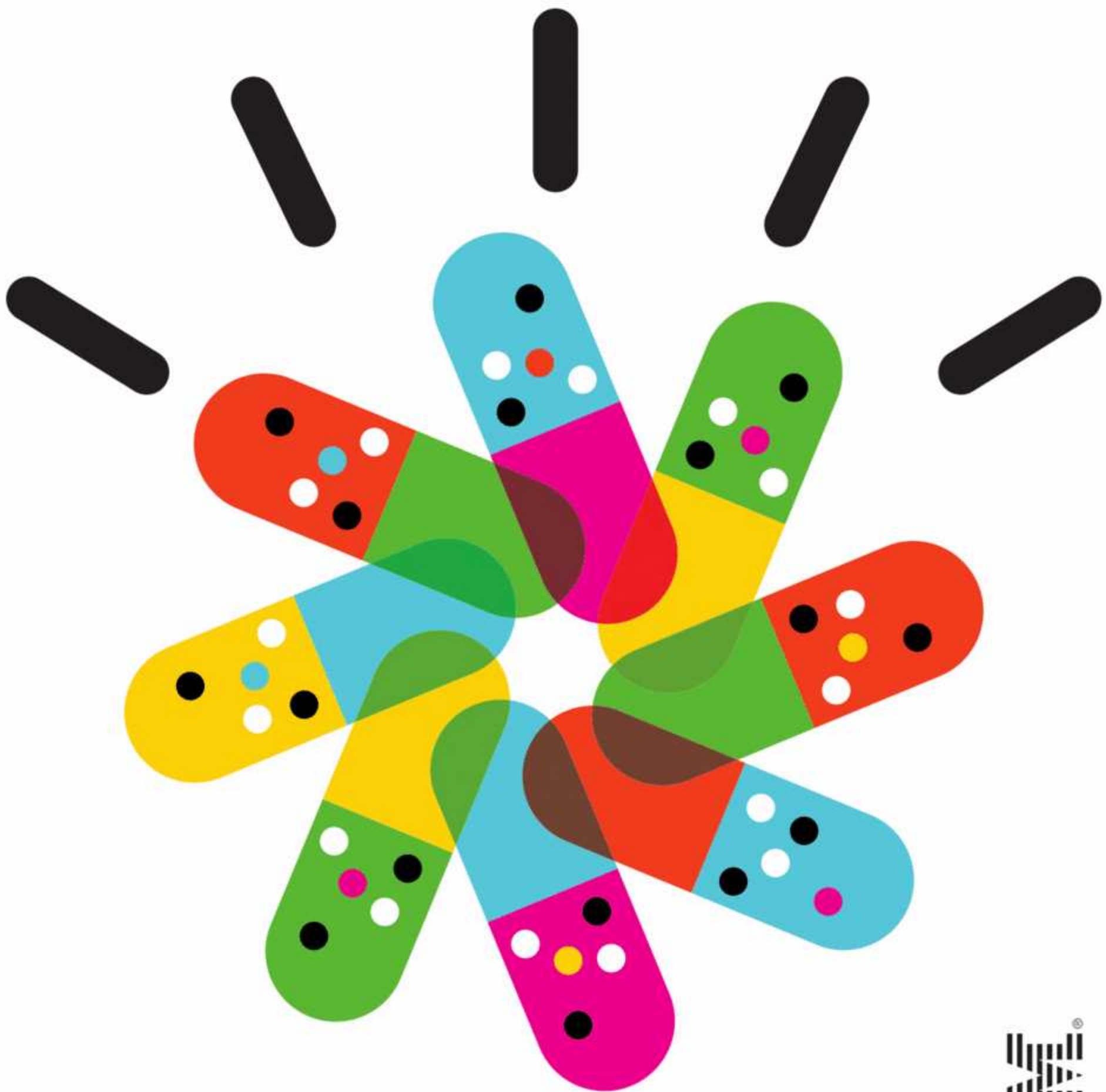


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