SPECIAL: GETTING THE MOST OUT OF TOP TALENT

Harvard Business Review

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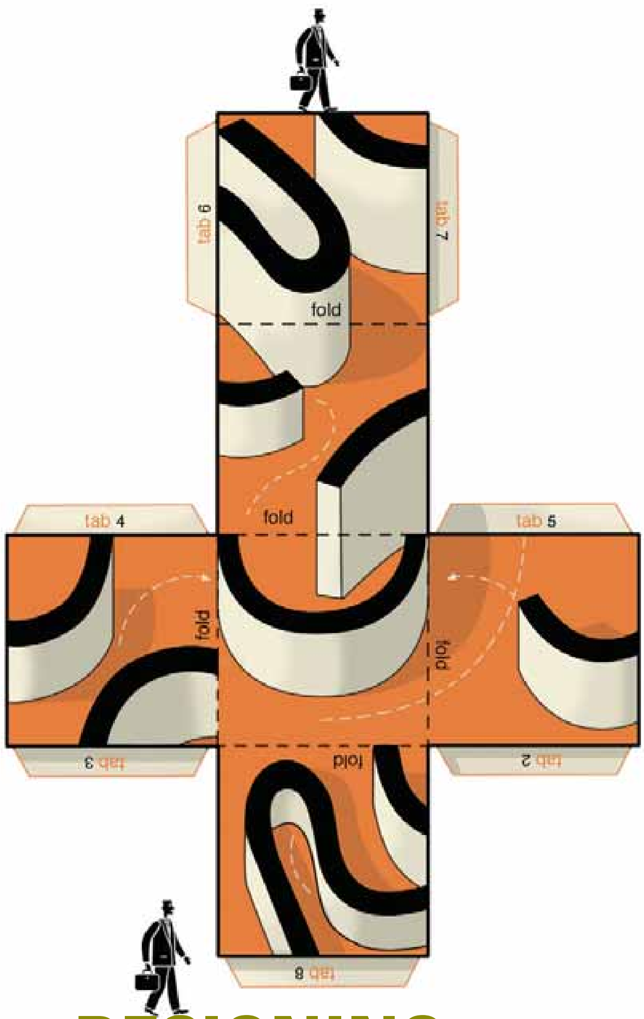


DESIGNING STRATEGY

...page 58

Global Oil Flows
Source: Energy Information Administration

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

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

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

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

willyoujoinus.com

OBJECTIVES
EFFICIENCIES

ENERGY IMPORTS BY OIL EXPORTING COUNTRIES

	GASOLINE	ELECTRICITY	NATURAL GAS	COAL
Saudi Arabia	✓			
Russia		✓	✓	✓
Norway	✓	✓		✓
UAE	✓		✓	
Nigeria	✓			

Source: Energy Information Administration

WHAT NEEDS TO BE DONE
– DIVERSIFY ENERGY SUPPLIES
. FIND MORE TRADITIONAL FUELS
. DEVELOP ALTERNATIVES AND RENEWABLES
– FOSTER OPEN MARKETS & TRANSPARENCY
– ENCOURAGE CONSERVATION/ ENERGY EFFICIENCY

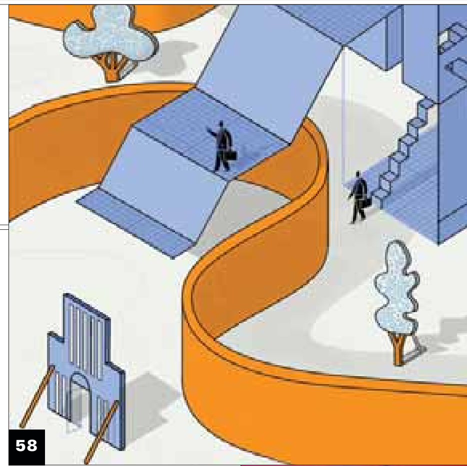
Chevron Steps Taken:
• Investing over $15 billion a year to bring energy to market.
• Developing energy through partnerships in 26 countries.
• Committing hundreds of millions annually to alternative and renewable energies to diversify supply.
• Since 1992, have made our own energy go further by increasing our efficiency by 24%.
Chevron
Human energy

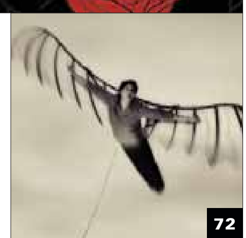
Projected Global Oil Demand
2004 DEMAND 82 mbpd*
2030 DEMAND 115 mbpd

HBR MARCH 2007

Features

continued on page 8





Cover Art: Ian Whadcock

HBR MARCH 2007

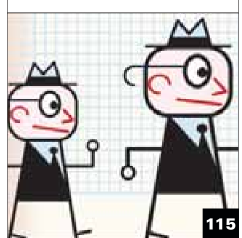

14

Departments


20


37


51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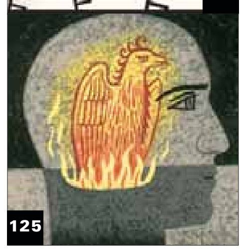
125

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

AUTHOR AFFILIATIONS

"Fellow Disney stockholders..."

Harley Schwadron

Making a Difference

"IT'S MORE COMPLICATED than you think." That could almost be our motto. Most business situations, the kind that come to the attention of the senior decision makers you are, require that leaders get a couple of big things right: the destination, so people know where they're going, and a polestar, so they don't get lost. But the voyage itself is sure to be anything but clear sailing. Success comes to those who read and react to the unobvious but important complications of wind and current, who tack tirelessly in the face of adversity, who exploit every puff in the doldrums, who seize the chance for a long run downwind. This issue is all about the discriminations and the moves, large and small, that successful leaders make. My problem is picking only one or two among them to call out for your special attention.

Start with "Managing Differences: The Central Challenge of Global Strategy," by Pankaj Ghemawat, who is teaching at IESE Business School in Barcelona, Spain. By now, every thoughtful businessperson has read Tom Friedman's *The World Is Flat* (or knows enough about it to bluff) and understands its thesis. With the demise of the Soviet bloc, the rise of the Internet, and the emergence of India and China, the world has become a level playing field, where competitive advantage accrues to talent and effort, not to accidents of birth or geography. This is an important argument, but the discriminating mind sees two things wrong with it. First, walls may be down, but the world's not flat as all that. Second, businesspeople want to fight on high ground, not the plains, because you make money on the bumpy bits.

Ghemawat is the great cartographer of the competitive landscape and its irregularities. "Managing Differences" sums up and extends a thesis that he has developed through years of research and several HBR articles, including 2005's McKinsey Award winner "Regional Strategies for Global Leadership." In the world according to Ghemawat, most companies' global strategies are flawed and incomplete. Flawed because they assume that cross-border integration is or should be the same thing as standardization. (A company can be integrated across borders without presenting a uniform offering or business model; it's the ability to manage differences well – which includes both acquiescing to and overcoming them – that matters.) Incomplete because, in the pursuit of simplicity, they tend to omit a whole class of approaches that exploit differences (in the cost of labor, for instance).

The same discriminating spirit animates Jonathan Lash and Fred Wellington's "Competitive Advantage on a Warming Planet." Lash, president of the World Resources Institute, is a leading expert on climate change and has helped many corporations understand its severity and its implications for them. He, too, sees complexity where others don't: Although climate change is a global problem, it's one that presents many different faces, ranging all the way from regulatory risk to competitive opportunity. In this extremely important article, Lash and Wellington provide a framework that allows you to audit your company's exposure to climate-change risk, both in your operations and in the competitive context in which you do business. It will help you identify ways to mitigate risk and understand how to compete successfully in a carbon-constrained world.

I can't stop at just two. A word about "Crisis at the Summit," by George Parsons and Richard Pascale. We've all seen the syndrome or been there: It strikes when a star performer, at the top of his or her game, gets bored. When the old challenges aren't challenging enough. These are dangerous times for great performers, who may make stupid mistakes, get wooed by headhunters, turn their energy away from work and into hobbies or other activities, or mess up their personal lives. Like sharks that cannot breathe unless they are moving forward, truly talented people start to suffocate if they are not learning. Recognizing the summit syndrome, in others or in yourself, is not easy, but it can be one of the most important discriminations a leader makes.

Thomas A. Stewart

Robert Meganck

Harvard Business Review

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forethought

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

Chris Pyle

GRIST

Take Your Third Move First

by Jeff Cares and Jim Miskel

Traditional approaches to strategic planning work fine – if you make decisions in simple strategic contexts that have only a few possible outcomes. But for military planners, and for most global companies, simple contexts are the exception. They're faced with what systems theorists call "complex competitions": The number of plausible, distinct outcomes is not just uncertain, it's so large it would be a fool's errand to try to quantify the odds of all possibilities. How can you reliably plan in such an environment, when the outcome, by definition, is unknowable?

We've developed a nontraditional form of scenario planning – *the coevolutionary war game* – that's designed for navigating complex strategy landscapes. In these games, now played at the highest levels in the U.S. Department of Defense, as many as four teams, each with up to 20 executives and senior managers, engage in a highly competitive series of strategy moves and countermoves. A game typically lasts as long as three days, during which up to five moves and responses propel the teams on a simulated multiyear trajectory that no single team directly controls. Strategic horizons of more than 20 years are not uncommon. These games don't directly produce strategy, but all players get a deeper understanding of the competitive dynamics that drive strategy development and can use this insight to create more robust strategies.

In one game, for example, a DOD team invested heavily in high-cost, long-term R&D of remote sensor technology. When the adversary learned of the plan, it countered with a clandestine investment in low-cost concealment and deception, a move that proved successful when the first sensor product was fielded a few "years" later. The first team interpreted its product's underperformance as a technical issue and increased R&D investment, a futile strategy that went uncorrected for one more move. Just as in real life – where strategic feedback occurs over long time horizons – staggering moves allows these bullwhip effects to fully develop and influence strategic plans.

The term "coevolution" is not just a metaphor. Coevolutionary gaming mimics the dynamics fundamental to ecological competition in order to explore the effects of conflict and cooperation between teams. Teams start in the present day with existing assets and near-term plans, and perhaps some quantity of a scarce resource, just as species in an ecosystem exist in a current evolutionary state and compete for their niches under some kind of selective pressure. One team imposes a shock to the system – such as introducing new technology in a war game – to increase the selective pressure. In successive moves, the teams fight for their futures through strategy adaptation and selection, just as generations of organisms coevolve in ecological competition.

Consider what a coevolutionary war game might look like in the case of a major bank that wants to expand its market. In conventional scenario planning, strategy development might proceed this way: The bank conducts an analysis to see what products and services will best serve the new market. Competitive analysis shows the likely reactions of the major incumbents in the market. A senior management team then develops a strategic plan to overcome these reactions. The problem with this approach, of course, is that the bank probably won't see an incumbent's actual adaptive response until the throes of real competition. By that time, if the response was unanticipated, strategic initiative is lost.

In coevolutionary gaming, strategy exploration unfolds very differently. The bank's market analyses suggest the best products and services, as well as the probable incumbent responses. But then senior management is split into, say, two teams: one to guide the bank through a simulated market entry and the other, representing the incumbent competition, to formulate responses – such as an unexpectedly innovative competing line of products and services or a surprise counteroffensive into the attacker's own markets. After two or three moves, an interim end state results in which senior management reassesses its initial strategy. In this way, management learns strategic dynamics from both sides: from the firm's perspective and through the eyes of a determined competitor. Indeed, one of the most useful outcomes of game play occurs when strategic planners, acting in the role of adversary, come to recognize and attack flaws in their own company's strategy – in effect using the method to unmake, rather than to make, strategy.

The most compelling results from the DOD's coevolutionary gaming, we've found, occur when players navigate through initial failure to success. Many teams have a strategy crisis after being shocked by a clever competitor's response to their first moves. Such crises compel the teams to think more deeply about the dynamics of the competition so they can make more robust moves in the future.

Often, teams discover fundamental strategies that will work in most of the likely trajectories – but usually not until the third or fourth set of moves. Knowing what they now know, they can write a more effective strategic plan, one that starts three or four steps ahead of the competition. They can take their third move first. Coevolutionary gaming allows this awakening to unfold during the course of the game, not when real resources, brands, or equity are on the line.

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Reprint F0703A

SUPPLY CHAIN

High-Tech Ways to Keep Cupboards Full

by Peter J. McGoldrick and Peter M. Barton

What good is keeping your brand stocked on retailers' shelves if the shelves that really count – the ones in customers' refrigerators, pantries, and medicine cabinets – are bare? The supply chain only ends at the retailer if your product is consumed at the point where it is purchased. Once most products leave the store, though, they enter a disjointed supply chain, managed (or, far more often, mismanaged) by the consumer, whose out-of-stock levels at home are frighteningly high.

Our research shows that on average at any given time, consumers have completely run out of nearly 10% of the products they normally purchase. The situation is far worse at the end of the replenishment cycle (just before the weekly grocery run, for instance). We estimate that fast-moving consumer-goods manufacturers in the UK alone are losing $9 billion a year, owing to the poor job consumers are doing in keeping their cupboards filled.

The problem is particularly acute for marketers who rely, at least partly, on impulse consumption rather than routine or planned consumption. We found household stock control to be relatively good for basics such as milk and toothpaste – less than 2% of consumers run out of these unexpectedly. By contrast, 20% of households that normally stock beer are out of it, 18% are unintentionally out of carbonated drinks, and 14% have run out of snack foods they normally buy. What's more, scarcity theory suggests that consumption is curbed when supply is low, so the impulse to drink the last Coke or beer is more likely to be suppressed. Even worse, when they run out, consumers seek alternatives, breaking the loyalty patterns that retailers and manufacturers have so carefully and expensively nurtured.

How do you keep those household fridges and pantries full? First, make in-home availability a primary strategic objective – one that influences marketing, pricing, product packaging, and distribution strategies. Second, work with partners who play a key role. Retailers influence many of the mechanisms needed to facilitate better stock control by consumers, and they share your interests. Germany's largest retailer, Metro, for example, provides personal shopping assistants (PSAs) in its "Future Store" in Rheinberg. These resemble small laptops that clip to the trolley, greeting customers by name after their loyalty cards are swiped in. The PSAs permit self-scanning, offer personalized shopping lists, and draw attention to promotional displays that complement shoppers' transaction profiles.

Third, exploit the opportunities that Internet retailing already offers. Conventionally, shoppers decide how much to buy of each item at the store, far from the point of storage and consumption, using incomplete lists or none at all. The world's largest Internet grocer, Tesco.com, offers customers shopping lists and promotions based on their most recent orders and their longer-term buying patterns.

Fourth, look ahead: As RFID tags get cheaper, technology providers will soon offer options for capturing product data at home. Electrolux has taken a leading role in the development of intelligent household appliances. One of its concept refrigerators already includes a scanner that lets consumers keep track of products as they use them. Another contains remotely accessible webcams, allowing consumers to check in-home stocks from the store.

The home of the future could well feature intelligent trash cans that may automatically reorder or prompt consumers to restock items carrying RFID tags; this technology is already used for recycling control. In the nearer term, simple bar code scanners, such as IntelliScanner's Kitchen Companion, enable consumers to keep track of items they may want to repurchase.

So, where is the end of the supply chain? Much closer to home than you might have thought. Extending the concept of the supply chain offers rewards not only for brand marketers, distributors, data providers, and technology companies, but also, of course, for customers.

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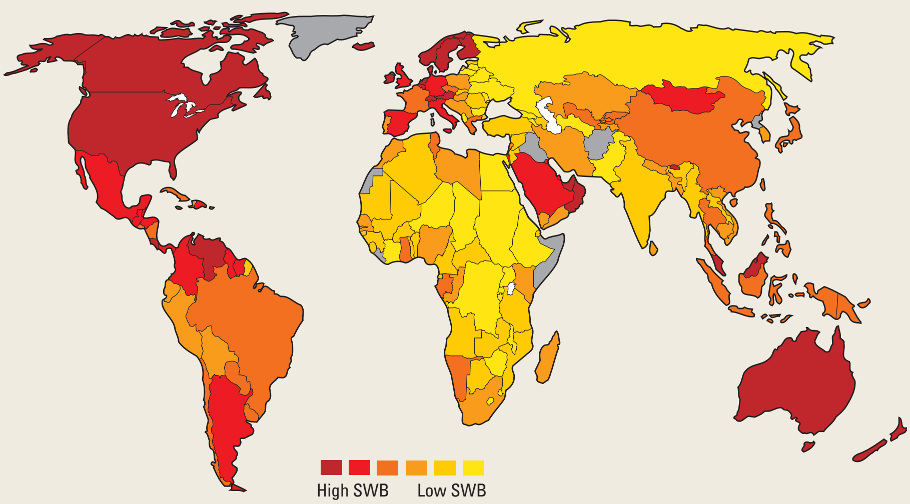
Reprint F0703B

DATA POINT

Pursuit of Happiness

Ideally, businesses improve lives by creating things people want. At the very least, companies produce wealth (which, at the individual level, is an imperfect but passable proxy for happiness). So businesses should be interested in this map, developed by Adrian G. White, a social psychologist at the University of Leicester, which shows the global distribution of happiness. White combined data from more than 100 studies involving 80,000 people worldwide to gauge countries' "subjective well-being" – which, he found, correlates most strongly with health, wealth, and access to basic education, in that order. White's map suggests regions that need more of what companies do best (for further details, see http://www.le.ac.uk/pc/aw57/world/sample.html).

A Global Projection of Subjective Well-Being



BRAND EQUITY

Hidden Wealth in B2B Brands

by James R. Gregory and Donald E. Sexton

Consumer marketers obsess about brand equity, as well they should. B2B companies would be wise to follow suit. Our quantitative, 16-year study of more than 450 firms shows that billions of dollars are locked up in B2B brands, yet managers consistently skimp on brand building. That's an expensive mistake.

Every corporation reaps the value of brand equity in two ways: as revenue, when it drives customer purchases, and directly, as a rise in market capitalization. Using a tool we've developed that gauges the relationship between brand perception and performance measures like revenue, profits, and cash flow, we have ranked the brand equity of all of our study companies and have statistically linked it with their financial data. The result is a measure of a corporate brand's impact on stock performance – what we call "brand equity as a percentage of market capitalization," which we refer to simply as "brand equity." We've found that for B2B companies, the corporate brand is responsible for, on average, 7% of stock performance for the 47 industries we track.

That figure may seem small, but bear two things in mind: First, it's an average; the range spans from a low of 0.5% for new or unmanaged brands, such as electricity distributor PPL, to a high of nearly 20% for the best-managed B2B brands, like FedEx. The current dollar value for B2B companies' brand equity ranges from a few million to tens of billions. This implies that with more strategic brand management, total brand equity for B2B companies could be worth billions of dollars more.

B2B companies shouldn't try to become consumer brands, of course, but they should seek to attain the maximum value possible within their industry. The average brand equity for B2B medical suppliers, for example, is 5.99%. However, the best-managed brands in that field are worth nearly 20%. If you are a medical supplier and your brand equity is 6%, then you know your brand management is only average, and you can reasonably set your sights on a goal of 20%. If you're in the paper and forest products industry, on the other hand, 20% is probably unattainable. The best performers in your industry achieve brand equity levels just under 7%, so that would be an ideal target.

B2B brand equity, when used as a dashboard measure, should be updated quarterly. It provides both a market cap percentage and a dollar-value metric that everyone in the company, especially the CEO and CFO, will understand. Most important, it can eliminate any doubts among B2B managers that brand equity matters.

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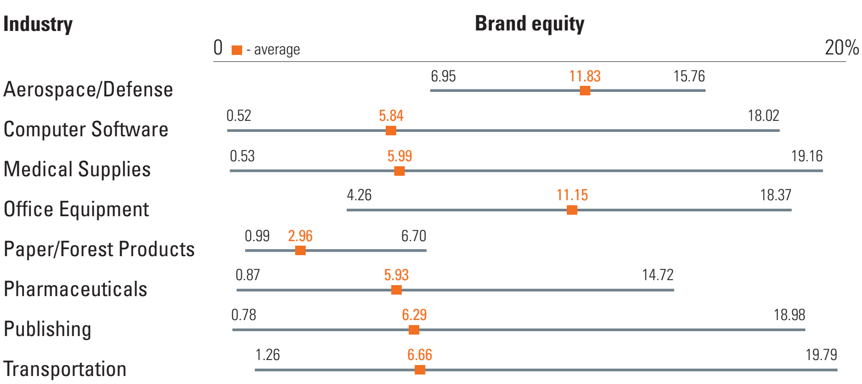
Reprint F0703C

How Much Are B2B Brands Worth?

What percentage of a B2B company's stock price is due to its brand equity? When we looked at more than 450 B2B firms over 16 years, we found that some brands were far more valuable than others in the same industry, indicating a great deal of room for improvement. A fraction of a percent of brand equity can mean hundreds of millions of dollars in value.



Source: CoreBrand, "Directory of Brand Equity – 3rd Quarter 2006." For a full list of all the companies tracked, see www.corebrand.com/brandpower-database.

forethought

INNOVATION

Meet the Innovation Capitalist

by Satish Nambisan and Mohanbir Sawhney

Everyone talks these days about the external sourcing of innovation. Yet few are aware of the full array of practices that concept covers, which range from licensing raw ideas or technology to acquiring companies with market-ready products. In assembling a balanced portfolio of open-innovation strategies, businesses are seeking help from a variety of "innomediaries." Product scouts, electronic

R&D marketplaces, and patent brokers are helping them identify early-stage ideas with potential, while venture capitalists are adept at introducing firms to start-ups that have products ready for commercialization.

But the area in the middle of the spectrum – acquiring a fully developed technology or concept not yet ready for market – has largely been ignored. This gap has forced companies to make critical trade-offs in their innovation outsourcing. Those that buy innovation already packaged pay a premium and sacrifice access to a variety of technologies in exchange for reduced risk and a shorter time to market. Those that seek help in identifying potentially useful but still far from market-ready ideas or technology reduce their costs but raise their risks. Fortunately, a new entity, which we call the "innovation capitalist," is emerging to fill this critical gap in the innovation-outsourcing spectrum.

Innovation capitalists are firms, often with a particular industry expertise, that seek out and evaluate ideas and technologies from the inventor community and other external sources. They develop and refine those ideas to the point where their market potential is validated, and they then pitch them to large client firms. An innovation capitalist reduces a client company's acquisition costs and early-stage risks. In return, it shares in the proceeds from the innovation.

These firms do more than "just broker the idea," says Debra Park, the director of technology acquisition at Dial, maker of Dial soap, Purex laundry detergent, and other consumer products. "By investing in concept development and market validation, they may not always improve the invention, but they reduce our risks and offer a concept that's more business ready."

Consider one product concept – a refrigerator organizer called Selectables – that is being developed by the innovation capitalist Evergreen IP. An individual inventor came up with the idea, and Evergreen IP first evaluated and then validated its market potential through consumer research. It further refined the concept, suggesting, for example, that Selectables be positioned to emphasize benefits related solely to meal preparation rather than to controlling portion size or making children's snacks more convenient. Evergreen IP built prototypes and confirmed that the product could be manufactured economically. It developed a more robust patent strategy. With a market-focused, economically feasible, and patentable concept in hand, the company conducted a brand assessment to identify potential client firms and began negotiations with a handful of them. Despite the value that Evergreen IP had added, the idea's ultimate purchaser ended up paying substantially less for the innovation than it would have had it acquired a fully baked start-up firm.

Large companies seeking to work with innovation capitalists should forget the short-term transactions they usually make with innomediaries and instead try to establish long-term strategic partnerships with them – partnerships designed to improve the fuzzy front end of their own innovation processes. In this way, companies can become the portals of choice for innovation capitalists' ideas. As Tom Cripe, the associate director of open innovation and external business development at Procter & Gamble, says, "We want innovation capitalists to consider P&G as the preferred destination when they come across interesting ideas in the inventor community."

We foresee that innovation capitalists will play a crucial role in the next decade, much as venture capitalists did during the technology boom of the 1990s. They will add value not through capital investments, as venture capitalists do, but through a unique combination of market expertise, networking skills, and early-stage innovation management acumen. This combination – and the unique value proposition derived from it – makes innovation capitalists key players in meeting the challenge of sustained innovation.

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Reprint F0703D

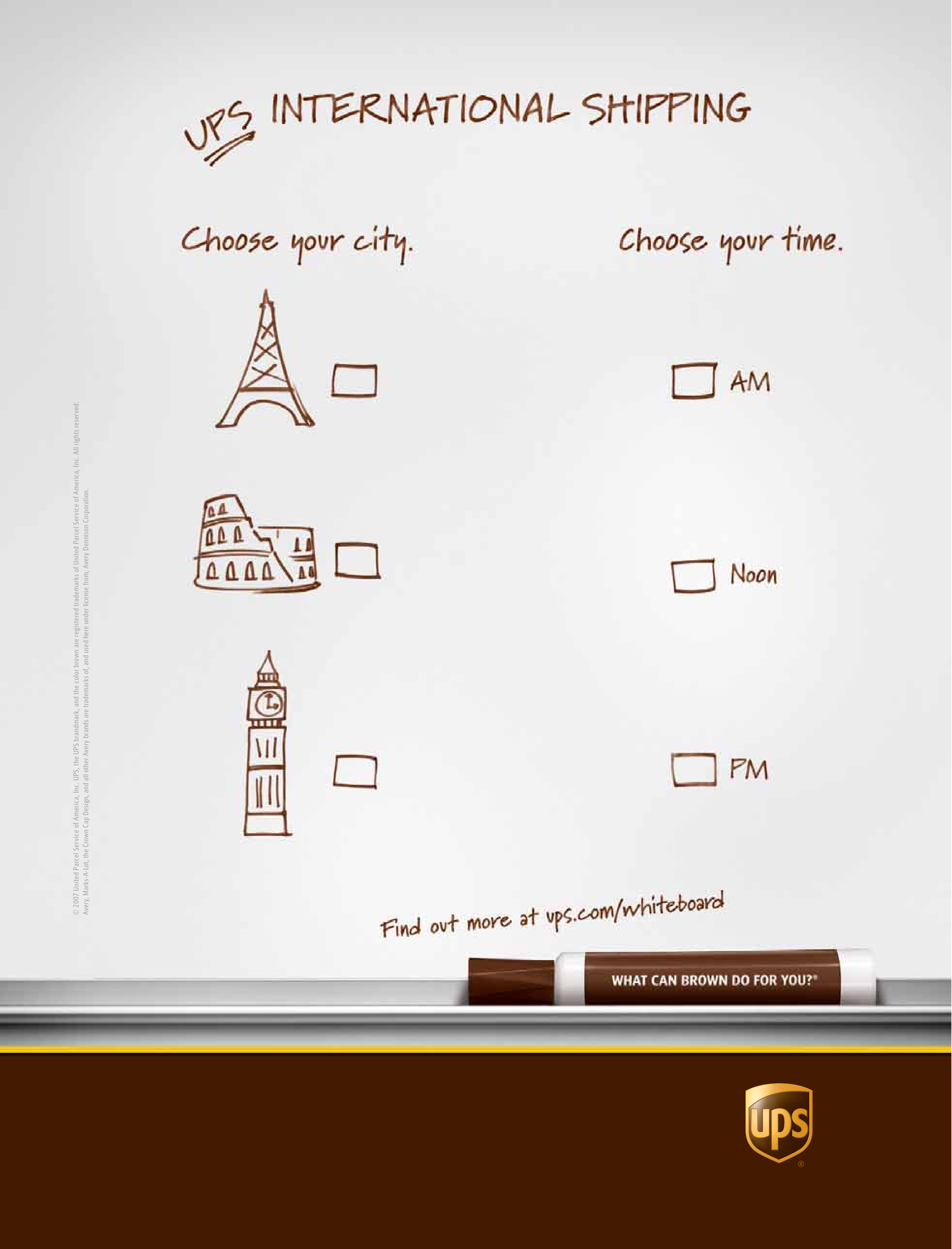
MARKETING

Getting Attention for Unrecognized Brands

by Daniel G. Goldstein

I've recently come to see consumers' preference for recognized brands as akin to what animal behaviorists call

continued on page 28



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Conversation

DANIEL VASELLA ON CHINA AS AN EMERGING SCIENTIFIC POWER

Novartis's Great Leap of Trust

Novartis, the $33 billion Swiss pharmaceutical company, is opening a pioneering biomedical R&D facility in China. The $100 million plant, scheduled to begin operations in May, will increase the company's long-term access to the huge Chinese pharmaceutical market and attract top Chinese scientific talent. But CEO Daniel Vasella says there's more to the story. Novartis, one of the first of the drug giants to open a bench-science R&D center in China, sees the country as an emerging center of scientific inquiry.

Novartis's investment in an R&D facility in Shanghai appears to be a big bet on China's future as a world scientific power. What was the thinking behind the move?
In China, several factors have come together. One is that the government has put a lot of effort into having people study sciences such as chemistry and engineering, specialties that have been declining in the West. At the same time, China has improved the quality of its training and educational system. And fluency in English, the lingua franca of R&D and business, has become prevalent. All this adds up to an environment that is right for fostering world-class research and development.

Of course, you still have to attract and retain the best scientists. Most important is to create a scientifically challenging environment, where people can learn and work with a significant degree of freedom. Other important aspects concern the quality of life and of the environment – air, water, and noise. We also need networks and clusters. That requires both world-class academic institutions, such as teaching hospitals and medical schools of high caliber, and a pool of talented academics. The increasing number of such institutions not only allows us to recruit researchers but also provides intellectual stimulation and an exchange of innovative ideas. At our Cambridge, Massachusetts, R&D facility, which opened in 2003, we are in the neighborhood of MIT and Harvard. When you work in Cambridge and you go to a restaurant, you're more likely to bump into someone with an interesting idea who is an expert in his or her field than if you're in other places in the world.

These factors – work culture, quality of life, schools, jobs for spouses, networks and clusters – are not yet ideal in cities like Shanghai and Beijing, but there is so much progress that many scientists of Chinese origin who trained in the West now find it attractive to return and make a real impact.

One should not look at where we are today. One should try to imagine, from the trajectory, where things will stand tomorrow. Someday in the future, Shanghai will be a globally respected scientific center, fulfilling national objectives. This competitive spirit, paired with large human and monetary resources, makes China, and Shanghai in particular, a highly promising place.

In biomedical research, it is also an undeniable advantage to be close to a large number of patients so that we can truly understand their needs.

What role did potential cost savings play?
Today, costs for R&D in China are about 40% lower than in the U.S. But we estimate that this cost advantage will eventually disappear. With Chinese GDP and disposable income rising, and with competition for skilled labor becoming more intense, wages for highly trained people are increasing, year after year. It would be very shortsighted to make costs the main reason for establishing an R&D institute in China. While we obviously conduct cost analyses, we primarily focus on human resources and a stable environment that respects intellectual property rights.

Does Novartis's move indicate that from the standpoint of intellectual property rights, China is now safe for foreign R&D?
The IP environment in China is now safer, but it is not without risks. We are convinced that, from a legal and political point of view, China is committed to protecting IP rights. But China is very large, and the tradition there has been to copy things. It will take time for the idea to permeate the population that there is more advantage in respecting IP than in taking it.

Ultimately, locating our new R&D center in China is an expression of trust – trust that the government and the people we hire will respect our property and work together to build a global scientific center of excellence.

–Andrew O'Connell

Reprint F0703F

forethought

neophobia: avoidance of the new. The neophobic response can be powerful, more so than managers already imagine. Research shows that customers may prefer a recognized brand even if it has clear shortcomings – even if, in certain circumstances, it's dangerous.

Consumers in a recent study believed that airlines whose names they recognized were safer than unrecognized carriers. On the whole, this belief persisted even after participants learned that the known airlines had poor reputations, poor safety records, and were based in undeveloped countries. In other words, a lack of recognition was more powerful than three simultaneous risk factors. *That's* neophobia.

Here's another example of neophobia. In a laboratory taste test, unwitting participants preferred a better-tasting peanut butter only 20% of the time when it wore an unfamiliar brand label but liked a worse-tasting product 73% of the time when they thought it was a recognized brand. Consumers' awareness runs deep: Images of highly familiar brands have been shown to activate specific areas of the brain.

In general, if you assume people will follow a simple rule – "In a choice between a known quantity and an unknown quantity, I'll take the one I know, even if there's something wrong with it" – you'll be surprisingly accurate in predicting customers' choices in a variety of markets. Over the past decade, my former colleagues at the Max Planck Institute in Berlin and I have studied this rule, which we call the *recognition heuristic.*

Neophobia is certainly understandable. It saves people the effort of weighing the facts. Moreover, it can reduce risk because much of the time, it works. Well-known brands are often popular for a good reason: quality. But neophobia makes life difficult for managers of relatively unknown brands – that is, of most brands. Recognized brands tend to do well even if they don't fully meet customers' needs, while unrecognized brands don't even get tried.

It's possible to alleviate neophobia, however, and here are a few strategies managers can use without spending millions on advertising:

Give buyers time. It has been shown that if people make choices when they are under time pressure, they are more likely to favor recognized alternatives. If you want customers to choose your unknown brand, don't force them to respond quickly. Try to position unfamiliar products in store "havens" where potential buyers have time to stop and compare features. In a B2B setting, get on the prospect's calendar early in the sales process; a purchasing committee that knows you can't use a lack of recognition to eliminate you.

Provide comparison tables. It's wise to list the features of an unrecognized brand side by side with those of the more familiar competition. When customers can easily compare features, they rely less on recognition to make choices. When they can't compare, though, they're more likely to turn to recognition as a rule of thumb.

Change the category. If you present a customer with an unfamiliar product in a category full of familiar offerings, recognition will kick in, to your product's disadvantage. Why does the talented but unknown ad firm win sales when it presents itself not as an "advertising agency" but as a "viral-marketing specialist"? Two reasons. First, clients don't view lack of recognition as a negative if they think there is a good reason for it, so specialist agencies are forgiven for being unknown. Second, among specialist firms, it's likely that the competitors are unrecognized, too. When buyers can't use recognition to discriminate, they are forced to consider other pros and cons.

Managers usually reach first for advertising and public relations when trying to raise a brand's profile. Those tools are expensive, and in order to be effective, they must reach potential customers on many separate occasions. By contrast, salespeople can artfully use time, feature comparisons, and category framing at little or no cost – and they can do so during the sale, when it may be too late for advertising to have an effect.

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Reprint F0703E

LEAN STRATEGY

Make Your Back Office an Accelerator

by Paul Rogers and Hernan Saenz

When back-office costs spiral and services fail to deliver, the reflex is often to cut support services across the board. But our study of 37 companies in industries ranging from consumer products to financial services to energy shows that strategically trimming and reconfiguring support functions such as HR, finance, and procurement is smarter than making wholesale cuts. Done right, it can actually improve effectiveness as it reins in costs.

Most companies find three broad opportunities to extract value when downscaling their support services: by reducing use, by redesigning a process, or by fundamental restructuring.

To *reduce,* companies need to simplify what support functions are expected to deliver and eliminate nonessential activities by focusing on what's most important to the customer or the business. Reducing the number of financial reports at an advertising company we studied, for example, was an easy move to make. A more creative solution is to charge for services, for instance requiring business units to pay for reports from a shared market research function. Often, that reduces use. More important, it creates a market mechanism that favors the most efficient, high-quality services. These types of changes are relatively simple to implement and in our study, accounted for an average of 25% of total savings in strategic back-office cost reduction.

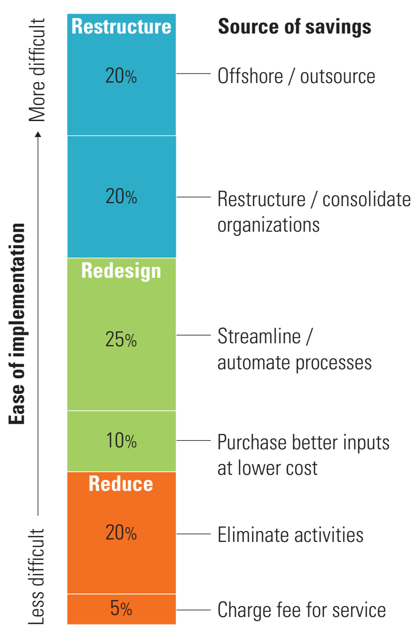
Redesigning smarter support services requires companies to dissect their processes. The key here is to focus on the most essential processes (financial reporting in finance, for instance, or recruiting in HR), eliminating steps that don't truly contribute to the business. Automation is often part of the solution. In a simple example, one telecom equipment company provided its salespeople with CRM software so they could pull up customer details and price quotes in real time, which improved their speed and effectiveness while also reducing costs. The move allowed the company to trim the sales administration and finance functions that managed and updated customer information. Another step is to purchase better inputs at lower cost by consolidating or bidding out for indirect expenses such as hotels and travel, cleaning and maintenance services, telecommunications, and utilities. Working smarter on the right processes is generally harder to do than simply reducing demand, but it yields more savings, accounting for approximately 35% of total savings in our study.

Restructuring, though hardest to execute, typically has the biggest impact, contributing some 40% of the total savings achieved in our study. The goal is to ensure that support services are located and organized in such a way that they can perform most effectively at lowest cost by, for example, consolidating services currently done in several countries into a regional shared service center or by moving services out of the business units and into corporate headquarters.

Sometimes, restructuring will lead to the decision to outsource. Kyobo Life Insurance, in Korea, added an outsourced call center to support customers so salespeople who used to provide support could focus on selling. The result: a jump in revenue, a dramatic increase in customer service rankings, and a savings of nearly 40% in back-office costs.

Getting More Bang from Your G&A Buck

In our study of 37 companies, some simple steps led to high savings but the most benefit came from substantive changes. Here's the average savings for the group as a whole.



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CUSTOMER SERVICE

Beating the Market with Customer Satisfaction

by Christopher W. Hart

If you're looking to boost customer satisfaction, one of the most promising places to start is customer service. Unfortunately, it's also a place where long-term goals tend to buckle under short-term financial pressures. Companies try to meet Wall Street's immediate demands by cutting costs through automation and outsourcing – despite a growing body of research conclusively showing that customers are fed up with lousy service and that increased satisfaction has a positive impact on consumer spending, cash flow, and business performance.

In a groundbreaking 2006 study, University of Michigan business professor Claes Fornell and colleagues showed the relationship between customer satisfaction and financial success by creating a hedge portfolio in which stocks are bought long and sold short in response to changes in the American Customer Satisfaction Index (ACSI). Developed by the University of Michigan's National Quality Research Center, the ACSI is an indicator of economic success that reflects levels of customer satisfaction with goods and services purchased from about 200 companies in more than 40 industries; it's

based on interviews with more than 65,000 U.S. consumers each year.

Collectively, as the exhibit "Why Service Matters" demonstrates, the companies with high customer-satisfaction scores have blown the S&P 500 out of the water, especially over the last few years. Not only have they produced higher stock returns, but their stock values and cash flows have been less volatile.

How are these results possible, given efficient-market theory, which says you can't consistently outperform the market? It's because today's stock valuation methods fail to incorporate the kind of information that forms the basis for making stock trades in the ACSI portfolio. If they did, the ACSI portfolio would closely track the S&P 500.

Customers' attitudes improve or deteriorate as people notice consistent quality differences. Changes in companies' customer satisfaction scores don't happen overnight; they have to work their way through complex value chains that ultimately affect quarterly profits and stock prices. (This accounts for the modest performance difference between the ACSI portfolio and the S&P 500 in the study's early years.) As the ACSI companies have attained higher levels of customer satisfaction and the laggards have been sold short, the fund's performance has significantly improved. A decrease in Home Depot's ACSI score, for instance, led the fund to sell the DIY retailer's stock short – and that was consistent with the company's poor financial performance and downgrades by stock analysts, even before the current housing downturn added to the company's woes.

The implications of the ACSI study will differ from one company or industry to another. In businesses with long purchasing cycles, like life insurance and durable goods, changes in customer satisfaction will take a while to make a difference in a company's sales, ability to increase prices, and so on. (After all, how often do you need to replace your dishwasher?) In many service-intensive industries, however, if a company's customer satisfaction increases, customers will be quick to adjust their behavior and tell other people, whose own purchase behavior is also likely to change quickly.

What's more, in a recent study of the personal computer industry using data from PlanetFeedback.com, I found that problems with service had a much larger effect than problems with the products themselves on customers' likelihood to recommend a brand. Since service calls involve direct interaction between companies and their customers – and customers do the work of initiating contact, expressing a strong desire to solve their problems – such calls elicit more immediate and vocal reactions than do the product problems that stimulated them.

Now that this market inefficiency has been exposed, business leaders – especially CFOs – have a responsibility to seriously question decision-making criteria that result in stronger short-term earnings but could weaken customer attitudes and relationships. The stakes are high. Leaders who do not actively work to increase customer satisfaction will be responsible for damaging their companies' future earnings and shareholder value.

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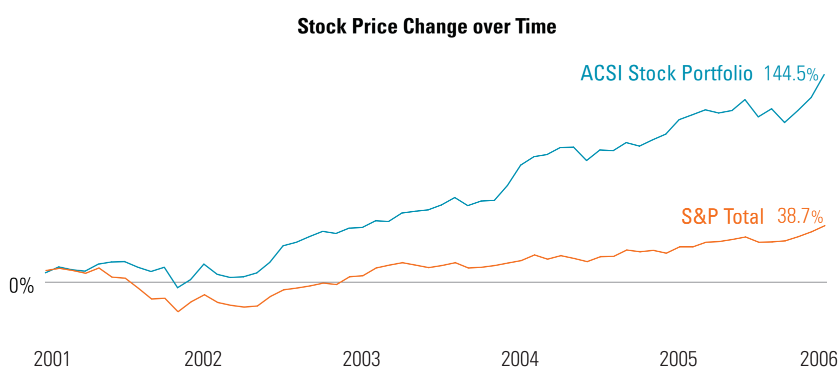
Reprint F0703H

Why Service Matters

A study of 200 companies shows a clear correlation between higher levels of customer satisfaction and higher stock prices.



Reviews

Getting Ahead of the Curve
Corporate Strategies That Address Climate Change
Andrew J. Hoffman
(University of Michigan, 2006)

An Inconvenient Truth, the film about Al Gore's distressing PowerPoint presentation on the imminent dangers of climate change, ultimately forces viewers to ask the question: "What can I do to stop global warming right now?" The answers – drive a hybrid car, turn off your lights, write your government representative – are frustratingly unsatisfying at the individual level. And God help you if you're running a corporation. Faced with the inevitability of more and more climate-based regulatory constraints upon companies, business leaders need to do far more than propose a "Ride Your Bike to Work" day.

Andrew J. Hoffman, the Holcim Professor of Sustainable Enterprise at the University of Michigan, has taken on this challenge. Working in tandem with the Pew Center on Global Climate Change, Hoffman has put together a highly practical and comprehensive report – a how-to manual for companies interested in developing effective climate strategies. The publication – which you can download for free at www.pewclimate.org – is based on a survey of 31 companies by Hoffman and the Pew Center. Readers will find a three-phase umbrella approach consisting of eight specific steps they can use to develop a comprehensive plan for addressing climate change.

Hoffman recommends that companies begin by conducting a general evaluation of their greenhouse gas emissions. They should follow up by identifying options for reducing emissions and then setting reduction targets. Corporations should also look at financial instruments, such as emissions trading, and make sure that their workforces are actively engaged in achieving environmental sustainability goals. Additionally, businesses will want to become involved in policy discussions at the state, national, and even international levels. By taking such steps, your firm gains both a jump on the competition and a seat at the regulatory table. (For more on what it takes to assess risks and possible advantages related to global warming, see "Competitive Advantage on a Warming Planet," by Jonathan Lash and Fred Wellington, in this issue of HBR.)

Almost any report of this kind makes for arid reading, but Hoffman's material is surprisingly engaging. Particularly useful are case studies from half a dozen U.S. and European multinationals, including Swiss Re, Whirlpool, Alcoa, Shell, and DuPont. The profiles describe the unique challenges each company faces, which range from regulatory issues to customer needs to shareholder pressures. The report also outlines the steps these firms have taken so far and how their strategies are evolving. Unfortunately, the case studies occasionally take on rather too celebratory a tone (one CEO's "leadership style infuses the corporation with a strong focus on stakeholder engagement and transparency"), making them sound suspiciously like pages torn from annual reports. Nevertheless, given its otherwise useful and detailed content – and its unbeatable cover price – "Getting Ahead of the Curve" warrants a considered look.

–Bronwyn Fryer

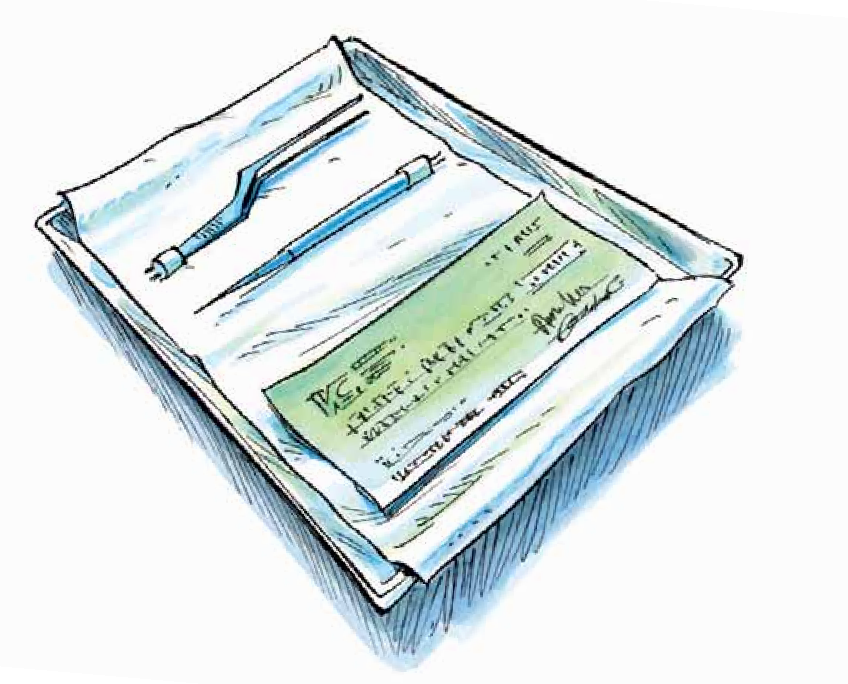
Wikinomics: How Mass Collaboration Changes Everything
Don Tapscott and Anthony D. Williams
(Portfolio, 2006)

Linux and other popular open-source software programs have long captured the imagination of businesspeople eager to attract the efforts of diligent outsiders. Now, as consultants Tapscott and Williams effectively explain, mass collaboration on the Web is possible for nonhigh-tech businesses too. The authors survey a broad landscape that includes not only consumer examples such as Wikipedia but also the innovation intermediary InnoCentive and the sophisticated value chains behind airplanes. Collaborative technology may yield the greatest benefits within companies: As more of the routine jobs are automated, employees increasingly work on loosely organized projects rather than individual tasks. Like its title, the book's prose can fall into breathless hype, but it delves usefully into the main challenge of mass collaboration – how to be open and transparent enough to attract outsiders while restrictive enough to capture economic value.

Growing Great Employees: Turning Ordinary People into Extraordinary Employees
Erika Andersen
(Portfolio, 2007)

More than any other business activity, the management of people gets at fundamental tensions of human life. Business is hard enough without the insecurities of both boss and employee. So it's refreshing to see a book that delivers current thinking on personnel practice while prodding managers to recognize the tensions. Andersen, a consultant, likens managing people to gardening and puts the art of listening to others – and to oneself – at the heart of each step. She challenges managers to reflect on how much they truly seek the success of their employees separate from the demands of their own egos. This well-illustrated book still has the relentless optimism of most advice books, but managers who read carefully will take a sobering message to heart.

–John T. Landry



Daniel Vasconcellos

Good Money After Bad?

Jack Brandon's initial idea has not panned out, and the cash is nearly gone. But he's got a new plan. Will you back him a second time?

by John W. Mullins

FROM A ROCKY PERCH overlooking the sparkling lights of San Francisco, Christian Harbinson gazed across the bay to the hills above Sausalito. "There's nothing like a vigorous hike," he thought, "to clear the mind before a crucial meeting." It was a mild March evening, and the 35-year-old venture capitalist was reflecting on the recommendation he would have to make to his firm's investment committee the next morning about Jack Brandon's young company, Seven Peaks Technologies.

Seven Peaks had developed an innovative device for cauterizing blood vessels during electrosurgery, and although the feedback from surgeons had been excellent, sales had been slow. The Palo Alto–based venture capital firm where Harbinson worked, Scharfstein Weekes, had invested $600,000 in Seven Peaks from its newly raised second fund of $100 million. SW's current investment strategy focused on early-stage medical technology companies, and Seven Peaks was a typical investment for the firm, which liked to get in on promising ideas modestly and

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

then follow with additional rounds of capital after technological and market milestones had been met. The $600,000 was nearly gone; Harbinson and his colleagues had to decide whether to put more into the struggling company.

Seven Peaks was looking for another $400,000 to develop a second product based on its proprietary technology, which enabled surgical instruments to do their work without sticking to tissue – a frustrating problem for most electrosurgeons. Brandon still believed in his technology and in his ability to commercialize it. Harbinson was impressed both with Brandon and with the technology's potential, but some of the senior partners were not so sure. "Would we simply be throwing good money after bad?" SW's cofounder Joe Scharfstein had asked when Harbinson told the investment committee of the request from Seven Peaks. "Does Jack Brandon really deserve a second chance?"

Harbinson was quickly won over by Brandon's abilities as an entrepreneur and by his showmanship. When the cauterizing device made its debut at a surgical trade show in Atlanta, it was the talk of the fair.

Plan A

Brandon, now 37 years old and trained as an engineer, had worked on the R&D side of the medical devices industry for most of his career. Three years before Harbinson's evening hike, Brandon had discovered almost by accident that instruments made of a particular titanium alloy were much less likely than conventional stainless steel instruments to stick to tissue during surgery. When his employer chose not to support him in following up on this discovery, Brandon had decided to take the leap and try to commercialize it on his own.

He had used nearly $65,000 of his savings to build a rough prototype of a cauterization device. He chose cauterization because the alloy's nonstick quality would make a real difference to the success of the procedure. Prototype in hand, Brandon approached investors in the medical devices arena to raise the capital necessary to make his device fully functional, get FDA approval, and bring it to market.

SW was one of the first firms Brandon approached, about a year after his discovery. He was in luck, because the firm was actively looking to invest in medical devices as a means of diversifying its health care portfolio. Lynne Weekes, SW's other founding partner, had liked the technology and thought it had applications beyond Brandon's original vision. She was also impressed by his commitment, as evidenced by his leaving his job and investing his own money in the venture.

Harbinson joined the firm about six months later as an associate. He was immediately assigned to watch over the Seven Peaks project, which was ideally suited to his experience: Before joining SW out of Stanford Business School, Harbinson had worked in the medical devices industry both as a scientist (with two patents to his name) and as part of the business development group at a leading surgical instruments firm. He was quickly won over by the science behind the product and by Brandon's abilities as an entrepreneur.

The Launch

Brandon had certainly done his homework. As Harbinson knew from experience, word of mouth could make or break a new product in the industry; surgeons in particular liked to compare notes and talk to one another about new developments. To make sure he was on the right path, Brandon had given his prototype to a few surgeons he knew to learn what they thought of it. "Too large," one of them said. "It will block my view of the surgical site." Another told him, "I like how it works and saves me time, but it's a lot of trouble to take it apart after each procedure in order to sterilize it."

Brandon redesigned his device based on the feedback, and after several months of diligent work, he won FDA approval. The redesign was smaller and thinner for better access to the surgical site and required no disassembly for sterilization. It was time to see how the market would react.

Harbinson was equally impressed by Brandon's showmanship. The Seven Peaks cauterizer made its debut at a surgical trade show in Atlanta. It was the talk of the fair. Brandon had bought some fish from a local market, and he did side-by-side operations on them with his device and with conventional instruments to demonstrate how the former could cauterize blood vessels in less than half the time. Everyone came to look, if only to see what was causing the smell of cooking fish. A few surgeons who ran their own clinics ordered the device on the spot, while others asked for follow-up calls. Two surgical-products distributors agreed to take on the cauterizer and offer it to their clients. Within a month, a couple of leading surgeons had become so excited by its effectiveness that they agreed to provide testimonials and to let Seven Peaks shoot video footage of them using the device. One of the surgeons proclaimed on the video, "On a scale of one to ten in terms of sticking, it's a zero."

Brandon's device gave surgeons the ability to quickly and reliably stop bleeding. Conventionally, surgeons would use

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electrosurgical forceps to cauterize capillaries or arteries one by one – a time-consuming procedure. Time is money to a busy surgeon. More important, in Brandon's view, because adjacent tissue often stuck to the forceps, as a surgeon sealed one vessel, another would frustratingly open. The cauterizer could seal multiple vessels at once, and it didn't stick.

Plan B

Despite the testimonials and more than a year of further efforts, Brandon had little tangible progress to report. The new instrument was proving difficult to sell, and because it could be reused hundreds of times with no decline in performance, surgeons who had tried it and liked it had no reason to reorder. One of the distributors had returned most of its initial inventory; a single-product line in only two sizes simply wasn't a top priority in sales calls to surgeons and hospital buying groups. The distributor had commented, "We really need a device that sells itself."

Brandon was confident that he understood the problem. "It's a tough sale for a number of reasons," he had told Harbinson and the other Seven Peaks board members during a review of preliminary sales figures. "We're a new company that most surgeons have never heard of. What's more, to make a sale, we have to convince the surgeon that the device works as advertised, and also that using a specialized cauterizer instead of forceps makes sense. It's new to most surgeons, and changing their behavior doesn't come easily. But perhaps the biggest problem is that distributors don't have much incentive to show our tool. It's a very small product line, and even if surgeons like it, there's little reason to reorder because of how long it lasts. The educational process is an uphill road."

"That seems like a pretty big hill to climb," Harbinson put in. "How do you propose to do it?"

"I don't propose to try," Brandon replied. "I think I've found a better way forward. A plastic surgeon told me last week, 'If you could make a line of electrosurgical forceps with the same nonstick properties, I'd buy them.' As we all know, surgeons use forceps in pretty much every surgical procedure, and they need them in a dozen or more sizes. We should be able to use our nonstick alloy in forceps, and forceps wouldn't have many of the drawbacks we've been facing to date. Surgeons use as many as six or eight of them for each procedure. If a surgeon does two or three procedures a day, that's a lot more demand than we seem to have for our current device. And we wouldn't have to change the surgeons' behavior, as we do now."

"If we go this way, there are a couple of questions we will have to address," Brandon continued. "First, what market should we target? Most plastic surgeons run their own clinics, and sticking tissue may be a crucial problem for them, given the importance of appearance to their surgical results. So they might be a good place to start. But other target markets could be attractive as well, including surgeons who do most of their work in hospitals. The typical hospital has half a dozen operating rooms and two or three procedures a day in each room, plus some backup stock. That's a lot of forceps to sell."

"Distributors don't have much incentive to show our tool," Brandon said. "It's a very small product line, and there's little reason to reorder because of how long it lasts. The educational process is an uphill road."

Brandon thought he could develop a forceps prototype in less than a year and put it into some surgeons' hands for feedback. FDA approval could also be won in that time, with limited production and sales starting soon thereafter. But his small team would have to spend nearly all its time developing a line of forceps, finding suppliers, working out a new design and production details, and filing patent applications – time that would have to be taken away from marketing the cauterizer, which still held some promise.

Brandon projected a spreadsheet on the room's whiteboard. His preliminary figures suggested that Seven Peaks would lose money in the first year on a modest level of sales and then double sales the following year. Revenues would come initially from sales to plastic surgeons, broadening to include other surgeons in hospitals after two years. He expected to reach break-even in the third year. It was clear that he had put a lot of work into the plan and was ready to move. Harbinson couldn't help feeling a little steamrollered, but he agreed to present the plan to the Scharfstein Weekes investment committee at its next meeting.

Will It Fly?

The investment committee met just three days later. The partners gave Brandon's idea a rough ride. Joe Scharfstein was especially critical. "Why didn't Brandon think about this issue with the distributors earlier?" he asked. "Given that mistake, how can we be sure that his marketing plan for the forceps will work? They take forever to make decisions in hospitals, and I can see us next year right back where we are today. And what about the competition? At least the cauterizer is something new. This is just a fancy twist on a product that a lot of big firms are already selling. I don't suppose they'll take this lying down. Does Seven Peaks have the ability to compete with the big guys? Is there anyone on Brandon's team who can put a real business plan together?"

Karl Schumacher, another SW partner, from the pharmaceutical side, joined in: "What about the technology, Christian? Can they adapt it to produce forceps? They're a lot smaller than the cauterizer, aren't they? I'm sure Seven Peaks can get a prototype going, but can they manufacture anything commercially? Perhaps we should be thinking in terms of making a trade sale to someone who can really develop the technology rather than putting more money in ourselves."

At this point, Scharfstein, whose own focus was on drug delivery technologies, added, "If nonstick instruments are such a good idea, why haven't the bigger players in the industry come calling yet? Where I come from, the big boys are all over the start-ups."

Lynne Weekes, who had approved the initial investment and later assigned Harbinson to supervise it, spoke up. "I think this should really be Christian's call," she said. "Christian, why don't you go over the plan and give us a recommendation at next week's meeting? If you feel strongly that Brandon deserves a second chance, then we'll invest. But don't be afraid to turn him down – there'll be other opportunities for SW. Think about the questions we've raised here today. Now let's move on to the next item. Christian, could you ask Peter to come in?"

Harbinson left the room with his mind racing. How should he interpret that exchange? Joe and Lynne were known to be very close, and yet here was Joe aggressively critiquing an investment that Lynne had made. "Whatever else," he thought, "this recommendation is not going to be easy to work out."

Put to the Test

A week later, from his perch above San Francisco, Harbinson thought he understood a little better what was going on. The recommendation was as much a test of his abilities as a VC as it was a decision on the investment itself. Joe and Lynne wanted to see what he had learned in his 18 months at SW. Joe's critique, another associate had told him shortly afterward, was typical. Whenever a particular investment got into trouble, Lynne and Joe always did some kind of double act, with one or the other of them as the bad cop.

"They play that game all the time," the associate said. "The idea is to prevent the associate from getting too close to the investment emotionally and to give each other an out, I think. Don't worry too much about it. Decide what you honestly believe the firm should do, but try to distance yourself. There really are more investments we can make, so don't feel that pulling out is such a failure. You know that we do it all the time."

Harbinson started back down the hill to his San Francisco home, nestled just east of the University of California's famous medical research hospital on Parnassus, where some of Brandon's early trials had been conducted. There was little doubt in his mind that Brandon's technology had real promise, somewhere, somehow. But how long – and how much of SW's money – would it take to find the right application and the right market? Very few deals actually panned out in any early-stage portfolio. "The easy answer is probably to say no," Harbinson thought, as he watched a container vessel pass under the Golden Gate Bridge and set forth into the open sea. "On the other hand, if we stay at it, can this be one of the winners?"

No one could have made a better effort than Brandon had, and his commitment was unquestionable. "Jack's a really good guy," Harbinson thought. "He's given it his all. I believe in him. But I wonder if I'm too close to the deal. Am I able to view it objectively, given that we've worked together to bring things this far? If I support the investment, will the partners think I'm not hard-nosed enough to be a VC?"

Should Harbinson recommend further investment in Seven Peaks?
Four commentators offer expert advice.

Ivan Farneti (ivan.farneti@doughtyhanson.com) is a partner with Doughty Hanson Technology Ventures, the venture capital fund of Doughty Hanson, a private equity firm based in London.

This is a faithful picture of a normal day at the office in any venture capital firm that invests in early-stage companies. The partners would normally set a high hurdle for the new money they are being asked to put in, and they would require a risk-management plan that might involve a dilution of the founder's stake. This could sour the relationship between Christian Harbinson and Jack Brandon, but the two of them have been working together for 18 months, so they should be able to straighten things out.

If I were sitting in on that meeting, I would be interested in understanding the opportunity cost of not reinvesting in the company. How big is the market in units per year? What is the price elasticity? Are these premium products that could outsell the incumbents' products because of superior performance, or is a discount to the distributor the only way to get them pushed ahead of the competition? The company cost base is not the issue here – that is a relatively easy thing to control. This is not a new market that might require big educational investments; these are replacement products in an existing market.

Clearly, Brandon would struggle to provide the kind of insightful analysis I'd expect. He is not a marketing expert, and that's why the first product tanked. The cauterizer could have been designed with disposable parts to remove the need for deep sterilization, and at the same time had components that could periodically have been sold back into the market – the old story of the razor and the blades.

Harbinson, however, is really the one in the spotlight. Two things matter: *what* he is going to say and *how* he is going to frame it for the partners.

The "what" is the easy part. Harbinson could be criticized for being too close to Brandon. His presentation, therefore, should be a cold and factual analysis of the economics: market size, possible returns, price elasticity, and competition. He should not defend or justify the entrepreneur, whose credibility is weakened at this point. If the market is big enough and the business plan (with the new investment) projects a good return, he should defend the deal.

The "how" is the tricky part. Harbinson may be smart, and I am sure he can run spreadsheets. But you do not make partner in a venture capital fund just because you are good at math. The partners may well be looking at *him* more than at the deal, because he represents a bigger investment than the $600,000 already put into Seven Peaks. He might want to introduce his recommendation to the committee by classifying the $600,000 invested so far as sunk cost. Yet the Seven Peaks team has learned a lot, and the forecast underpinning the current investment decision has a much higher level of integrity and credibility. Harbinson should point out that all the experience the company has gained is well worth the seed money and would reduce the risk in any further investment.

Harbinson could be criticized for being too close to Brandon. His presentation, therefore, should be a cold and factual analysis of the economics. He should not defend or justify the entrepreneur.

He may want to give the committee two options: a conservative one that he is comfortable defending (such as a $400,000 down round, with focus on only one of the two products) and a riskier one ($600,000, maybe in tranches, but with options on both products) for which he should request unanimous backing from the committee. The latter option might serve as a decoy to help the former through, but it would also make clear Harbinson's belief that this deal is definitely not a basket case and may be an opportunity to invest in a company with two potentially good products for the same market and channel of distribution.

Wendy Wray

Are you losing your most valuable asset - people?

Human capabilities will determine the winners and losers in tomorrow's global markets. For most organisations today, people are the major source of value. In survey after survey, including the Economist Intelligence Unit's prestigious CEO Briefing 2007,[1] CEOs of global organisations see the acquisition and development of 'talent' as one of the top challenges for future growth.

In order to maximise the business impact of any key asset, it is necessary to understand its contribution and how it is built and deployed over time. For 'tangible assets', such as buildings and money, the value is easily shown in the balance sheet and can be monitored over time. However, much of the organisation's share value is made up of 'intangible assets' including the value of people's potential and actual contribution. This value can be described as human capital, human resources, human assets – or simply as 'talent'.

It is important, however, to distinguish between the people themselves and their individual or group capabilities, which are the real assets of the organisation. Many valuable capabilities are expressed through groups of people rather than individuals.

It is relatively easy to measure the costs associated with people (for example in terms of salary or overhead costs) but much more difficult to assess the true value of the capabilities they bring. In measuring and developing human capital, therefore, it is important to focus on valuable capabilities rather than people themselves.

The UK Chartered Management Institute, in association with the Centre for Applied HR Research at Oxford Brookes University, supported by Oracle, has identified three levels at which organisations can measure human capital, or capabilities[2]:

Level 1: Basic Measures. Concerned with headcount, salaries, staff turnover, recruitment costs or training days, these measures tend to relate to costs associated with people. Although they are relatively easy to obtain and compare with other organisations, they are much less useful than Level 2 or 3 measures.

Level 2: Strategic Capabilities. These measures aim to assess the value of human capital and how it changes over time. For example, staff turnover split by high and low value capabilities. High and low value capabilities could be identified, in a simple way, by appraisal or performance rating and/or by the value of the role. So, for example, 20% turnover of low rated personnel combined with a 1% turnover of the best might be a cause of celebration, even if the overall rate was therefore higher than average.

Level 3: Differentiating Capabilities. These measures focus on those capabilities, which will add sustainable competitive advantage to the organisation. Any organisation operates in a unique competitive situation. In order to achieve its goals, it must develop and build new capabilities, which are rare, valuable and difficult to copy. Human capabilities fulfil these requirements as they arise within unique organisational cultures.

Level 3 measures can also work at a national level. In the UAE, for example, the very high proportion of expatriate workers combined with a strategy of very rapid growth, means that it has to build an exceptional capability in management and leadership and is developing programmes to do so. The UK, with a strategy of attracting substantial external investment, provides exceptional capabilities in advanced skill areas of science and technology and is one of the top three locations globally for scientific disciplines including biological, business, environmental, health, social sciences, humanities and mathematics.

Companies and governments need to identify those capabilities that are critical to the achievement of strategic intent. They must find and utilise key capabilities wherever they exist, including direct investment to set up operations in locations where rare capabilities exist or where they can be developed.

Direct investment can be facilitated through organisations such as UK Trade & Investment, the UK Government's international business development organisation, which supports business seeking to establish in the UK and help UK companies grow globally.

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[1] Sponsored by UK Trade & Investment, available from www.ukinvest.gov.uk/ceobriefing

[2] Scott-Jackson W. B., Cook P. & Tajer P. (2006). *Measures of workforce capability for future performance: Volume 1: Identifying the measures that matter most. Chartered Management Institute London*

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Large, innovation-driven companies like Schering-Plough have project champions who act like entrepreneurs. Senior managers play the important role of funding projects as they move along, functioning in many ways like internal VCs – feeding the better opportunities and starving the mediocre ones.

The VCs at Scharfstein Weekes are at a decision point I've seen with many innovation-driven ventures. The entrepreneur, Jack Brandon, has demonstrated proof of concept with his titanium-alloy technology for cauterizing. But he has not demonstrated – or even defined – proof of commercial viability. And he has introduced more complexity by adding a forceps project to the initial cauterizer project.

In my opinion, Brandon should be looking to launch a new and improved version of his cauterizer before exploring the forceps idea. Once it's an established success, he and the VCs can consider the cross-selling synergies that would arise from marketing forceps as well.

Brandon clearly needs to regain the trust of SW, and it's Christian Harbinson's job to help him do this by pushing him to come back with a proposal that reflects deep knowledge of his product, of his customers, and of what it takes to execute a business plan. Harbinson should also press him to recruit the marketing expertise that Seven Peaks obviously needs. Harbinson should tell the investment committee that this will be his advice to Brandon and that he will personally commit to Brandon's development as an entrepreneur. He should then ask the committee to agree to a full and balanced review of a new proposal for investing in Seven Peaks in three months' time.

At that review, the burden will be on Harbinson to demonstrate not only that Brandon has a differentiated proposition that is relevant to customers but also that Brandon will rein in his obvious emotional attachment to the titanium-alloy technology. Potential investors have more confidence in entrepreneurs who demonstrate an ability to look at their own projects' strengths and weaknesses objectively. At Schering-Plough, our project champions work hard to prevent emotional attachment to projects in which they may have invested many years from blinding them to realities that may dictate major course correction or even project abandonment. Brandon needs to prove that he has this ability before he can expect to receive more money.

Like many entrepreneurs, Brandon made the mistake of relying excessively on his own feelings about the technology when he launched his first product. What's more important is that his customers have confidence in a product that will be at the center of their relationship with patients. But did Seven Peaks really try to understand what the customers thought about the cauterizer? Did it research what the surgeons who used it liked or disliked about it? Did it ask other surgeons why they had not tried the tool and if more information might change that decision?

Without this knowledge, Brandon probably mispriced the cauterizer the first time around. The product has durability and reusability advantages for those surgeons who elect to use it, suggesting that it should be priced to reflect the number of times it can be used. Going forward, Brandon needs to stay in tune with his customers by making them an integral part of his marketing plan. Surgeons are probably similar to other professional customer groups when it comes to adopting an innovation. Early adopters lead the way, followed by the middle majority and finally the conservatives. If Brandon recruits peer-to-peer missionaries for his cauterizer from among the early adopters, he will undoubtedly increase his chances of getting his forceps off the ground at a later date.

Brandon should be looking to launch a new and improved version of his cauterizer. Once it's an established success, he can consider the cross-selling synergies that would arise from marketing forceps as well.

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Having been in both Jack Brandon's position and Christian Harbinson's role, I can sympathize with Brandon while understanding the dilemma facing Harbinson and the Scharfstein Weekes partners. Brandon has done all that he can to make the new business work – investing his own money, developing the product, doing all the selling and additional market research, winning customers and endorsements, identifying new product and market possibilities – essentially living the business every waking hour.

But building sales for a new product or service, especially one that requires the user to change behavior, is among the most challenging tasks an entrepreneur can take on, so it should not be a surprise to SW that initial sales have fallen short of target. It's also not unusual for a new company to end up with a product, a market, or a strategy that's somewhat different from the original business plan, so moving to Plan B should not be Harbinson's major concern. His challenge is to assess more-fundamental issues regarding the business, a challenge that every venture capitalist faces many times. It's in making these assessments that venture capitalists are truly tested and can add real value by helping management set an effective direction for the company. Harbinson will have to focus on three key questions.

First: Is the business concept still sound, or does it have a basic flaw? This question has to be raised before every follow-on round of financing (whether the plan has changed or not), because if a flaw was overlooked earlier, then the next two questions become moot. If the concept stands up, the investor must then address execution: What has gone well, what has gone wrong (and why), and what will it take to correct any deficiencies? The third and final question relates to the entrepreneur (or the team): Is this someone we should back again?

It is clear that the technology works and provides demonstrable benefits for surgeons. The difficulties seem to lie in which products can incorporate the technology and which strategies should be used to sell them. Harbinson should be able to use his science background and his network in the medical devices industry to answer the product question, and he and the partners should have enough experience with the industry to make, with Brandon, an assessment of alternative sales strategies.

In terms of execution, Harbinson and SW have been party to a fundamental mistake. It was clear from the start that Brandon needed to be paired with someone with strong marketing skills, yet that has not happened. Such a person would have sorted through the marketing issues more quickly and could have helped in deciding which products to pursue. If Harbinson decides to follow on, addressing this problem must be a condition of the funding. An important subissue may be how well Brandon will work with a marketing person (especially after the board decides who will report to whom), which Harbinson will have to deal with in his ultimate assessment of Brandon.

This assessment of the entrepreneur, most venture capitalists will tell you, is the most important factor in deciding whether or not to back a start-up, both initially and in follow-on rounds. Here, the question has essentially already been answered. Harbinson still believes in Brandon and his superior knowledge of the space; he and the SW partners recognize Brandon's total commitment to the business; and they have built a good working relationship with him. On that basis, it seems clear to me that they should give Brandon a second chance – provided that they are satisfied with the answers to the first two questions and that Brandon is open to bringing in a good marketing executive.

Is the business concept still sound, or does it have a basic flaw? This question has to be raised before every follow-on round of financing (whether the plan has changed or not).

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The real question for me is, Should Scharfstein Weekes have made an investment in Seven Peaks in the first place? Yes, there were some attractive features – the proprietary technology, a committed and resourceful entrepreneur, a product that works, customers who like and endorse the product, and a good fit with the VC firm's investment strategy. But there were also three big question marks.

First, the venture was a product in search of a market. Although Jack Brandon took into account feedback from potential customers on the design of the cauterizer, he did not carefully assess the size of the market or figure out the proper marketing strategy. Why did he not anticipate that his distributors would have little incentive to push single products from unknown vendors? How could he (and SW, for that matter) not recognize the product's low potential for reorders, given its high quality and reusability? Focusing on building a better mousetrap at the cost of doing the requisite market research and fine-tuning the marketing strategy is a mistake that entrepreneurs make over and over again.

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Second, Plan A placed all bets on one product. VCs usually recognize the risks this strategy entails, and they therefore prefer "platform deals," in which the entrepreneur can demonstrate a viable path toward a whole portfolio of products based on a technology that, ideally, is proprietary to the venture. Seven Peaks could provide such a platform, but at the time of the original investment it was probably too early to tell. In any case, little thought seems to have been given to this issue – by Brandon or by the VCs.

Third, the product required a change in customer behavior, something that can take a long time. A case in point: Chemdex, an online marketplace for specialty chemicals that was established in the late 1990s, required research scientists to order on the Internet rather than from paper catalogs. Because these scientists were sophisticated Internet users, nobody questioned the advisability of that requirement. As it turned out, they preferred the catalogs. Of course, they did eventually switch to electronic ordering, but much more slowly than anyone had anticipated. Experienced VCs know that it can take up to ten years for such behavioral shifts to occur. But the original Seven Peaks plan didn't even anticipate the issue.

This demonstrates Brandon's inexperience. Brandon is a good, capable engineer and designer of medical devices, but he clearly lacks marketing and strategy talent, and he obviously hasn't assimilated the lessons from his initial failure. In Plan B, he's emphasizing an ad hoc endorsement from one surgeon without thoroughly assessing the customer need for nonstick forceps. And he's still focusing his energy on developing and designing the product.

Why didn't Harbinson and his colleagues help Brandon with these issues? Building a profitable business is a social process, during which an opportunity is shaped and developed through the contributions of many parties. VCs play a key role in the early stages of this process. Maybe the real problem is that the match between Seven Peaks and Scharfstein Weekes is not ideal, and together they cannot develop a viable strategy. What Harbinson should do now is have a candid talk with the SW partners about whether and how the firm can help Brandon. If SW doesn't have the requisite knowledge or resources to make the venture a success, or if the partners don't want to make their time available, they should refrain from investing further in Seven Peaks – they are not the partners Brandon needs.

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Jonathan Kannair

The Ethical Mind

A Conversation with Psychologist **Howard Gardner**

It's not enough to espouse high standards. To live up to them – and help others do the same – requires an ethical cast of mind that lets you practice your principles consistently.

If you're running a large company, don't expect the public to like you. Soaring executive pay packages, continuing rounds of layoffs, and the memory of ethical failures at firms like Enron, WorldCom, and Hewlett-Packard have raised public animosity toward corporate executives as never before. A U.S. Roper poll conducted in 2005 revealed that 72% of respondents believed wrongdoing was widespread in industry. Only 2% felt that leaders of large firms were "very trustworthy" (a drop from 3% in 2004), and the pattern is "not improving," according to Kathy Sheehan, a senior vice president at GFK Roper Consulting in New York. Meanwhile, the public increasingly demands that companies take better care of their employees, communities, and the environment.

It is now, more than ever, incumbent on business leaders to repair relations with customers and employees by stepping up to the ethical plate, says Howard Gardner, the John H. and Elisabeth A. Hobbs Professor of Cognition and Education at the Harvard Graduate School of Education in Cambridge, Massachusetts. Gardner is an influential cognitive and educational psychologist, not an ethicist per se. But as a psychologist, he believes that his first responsibility is to understand how moral and ethical capacities develop, or fail to develop. His reflection on ethical issues has deep underpinnings and a very long reach. In the seminal 1983 book *Frames of Mind,* he put forth his theory that individuals possess not one but multiple varieties of intelligence: linguistic, logical-mathematical, spatial, bodily-kinesthetic, musical, interpersonal, and intrapersonal. The theory, which Gardner continues to refine, has found broad acceptance in the educational community, and teachers around the globe tailor their lessons to the different kinds of intelligence.

Gardner became personally embroiled in ethical issues when he observed how his ideas were being adopted by educators: Some schools and policy makers claimed that certain racial and ethnic groups were lacking specific intelligences. As the founder of the theory, he felt an obligation to denounce such distorted interpretations of his work. Later, when he taught a course at Harvard called "Mind, Brain, and Education," he found himself thinking about ethical dilemmas, such as those involved in brain and genetic testing and whether it's wise to share troubling test results with parents, particularly when no proven intervention exists.

Gardner's core insights into the ethical mind come from more than a dozen years of studying working professionals. Since 1995, he and teams of investigators at four universities have been researching the ways in which people aspire to do good work – that is, work of high quality that matters to society, enhances the lives of others, and is conducted in an ethical manner. The researchers have also observed firsthand the ways in which good work is eroded by cultural, economic, and technological forces. (For more on this long-term project, go to www.goodworkproject.com.) In his new book, *Five Minds for the Future* (forthcoming from Harvard Business School Press in 2007), Gardner cogitates on what it takes to develop an ethical mind-set. In this edited interview with senior editor Bronwyn Fryer, Gardner offers his thoughts about what managers must do to develop and maintain high standards for themselves and their organizations.

What is an ethical mind?

In thinking of the mind as a set of cognitive capacities, it helps to distinguish the ethical mind from the other four minds that we particularly need to cultivate if we are to thrive as individuals, as a community, and as the human race. The first of these, the disciplined mind, is what we gain through applying ourselves in a disciplined way in school. Over time, and with sufficient training, we gain expertise in one or more fields: We become experts in project management, accounting, music, dentistry, and so forth. A second kind of mind is the synthesizing mind, which can survey a wide range of sources, decide what is important and worth paying attention to, and weave this information together in a coherent fashion for oneself and others. [For more on the synthesizing mind, see "The HBR List: Breakthrough Ideas for 2006" (February 2006).] A third mind, the creating mind, casts about for new ideas and practices, innovates, takes chances, discovers. While each of these minds has long been valuable, all of them are essential in an era when we are deluged by information and when anything that can be automated will be.

A person with an ethical mind asks, "If all workers in my profession… did what I do, what would the world be like?"

Yet another kind of mind, less purely cognitive in flavor than the first three, is the respectful mind: the kind of open mind that tries to understand and form relationships with other human beings. A person with a respectful mind enjoys being exposed to different types of people. While not forgiving of all, she gives others the benefit of the doubt.

An ethical mind broadens respect for others into something more abstract. A person with an ethical mind asks herself, "What kind of a person, worker, and citizen do I want to be? If all workers in my profession adopted the mind-set I have, or if everyone did what I do, what would the world be like?"

It's important to clarify the distinction between the respectful and the ethical mind, because we assume that one who is respectful is ethical and vice versa. I think you can be respectful without understanding why: As a child, you might have respected your parents and grandparents because you were taught to. But ethical conceptions and behaviors demand a certain capacity to go beyond your own experience as an individual person. Once you have developed an ethical mind, you become more like an impartial spectator of the team, the organization, the citizenry, the world. And you may have to sacrifice respect for another person if your role as a citizen or worker calls on you to do damage control to protect an idea or institution you believe in.

Whistle-blowers display ethical minds. Many people might see a top manager doing something unethical, but they won't do anything about it because they want to keep their jobs, and they feel that they must respect the boss. A whistle-blower steps back from those concerns and considers the nature of work and the community in a larger way. He takes a mental leap past daily doings; his allegiance is to the workplace or the profession. He acts ethically even though it may cost him his respectful relation to his supervisor and, ultimately, his job and relation to his colleagues. He is able to do this because his own momentary well-being is less important than the broader mission he has endorsed.

It sounds as if the ethical mind is fundamentally more community focused than any of the other four minds. If that's true, then how does the ethical mind develop?

An ethical orientation begins at home, where children see whether their parents take pride in their work, whether they "play fair," whether they give the benefit of the doubt or are closed minded, and so on. Children absorb their parents' religious and political values. As children get older, their peers have an enormous effect, especially in America. Just as influential is the behavior of the surrounding community toward its citizens. Are young and old people cared for? Beyond the necessary services, are there cultural and social events to learn from and participate in? Do parents take part in these "gluing" activities and expect their children to do the same?

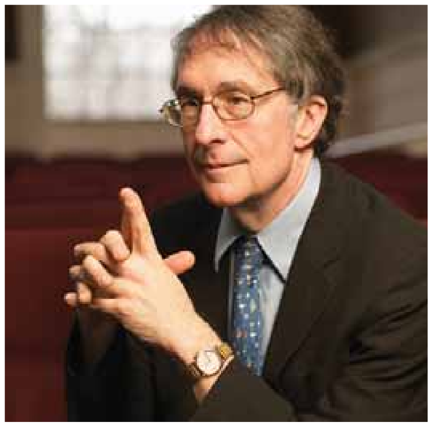
My favorite example of an ethical community is a small city called Reggio Emilia in northern Italy. Aside from providing high-quality services and cultural benefits to its citizens, the city provides excellent infant and toddler centers and preschools. Children feel cared for by the community. So when they grow up, they return this regard by caring for others. They become good workers and good citizens. The tone has already been set at such a high level that one rarely encounters compromised – that is, qualitatively or ethically sullied – work. And in such cases, the ethical action taken by the community is to ostracize the compromised worker (in effect, if not by law) so he does not undermine community mores. This stance works as long as everyone sees that everyone wins.

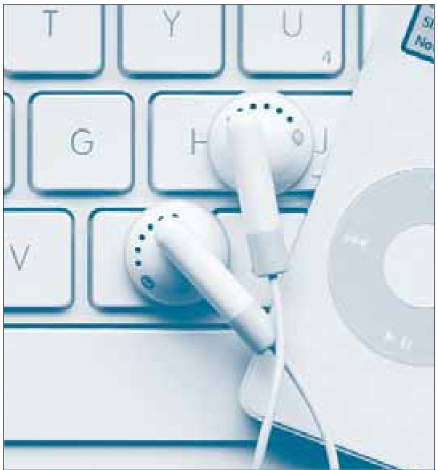
What gets in the way of the ethical mind?

Sadly, even if you grow up with a strong ethical sense, the bad behavior of others can undermine it. A study conducted by Duke University recently found that 56% of students in the United States pursuing a master's degree in business administration admit to cheating – the highest rate of cheating among graduate student groups. If you are a very ambitious MBA student and the people around you are cheating on their exams, you may assume that cheating is the price of success, or maybe you do it because "everyone does it." You might even come to think of ethical behavior as a luxury. A study we published in 2004 found that although young professionals declared an understanding of and a desire to do good work, they felt that they had to succeed by whatever means. When they had made their mark, they told us, they would *then* become exemplary workers.

As young people go into business today, the temptation to skirt ethics is mounting. We live in a time of intense pressure on individuals and organizations to cut corners, pursue their own interests, and forget about the effect of their behavior on others. Additionally, many businesspeople have internalized Milton Friedman's belief that if we let people pursue their interests and allow the processes of the marketplace to operate freely, positive moral and ethical consequences will magically follow. I am not one to question the power and benefits of the marketplace in any absolute sense. But markets are amoral; the line between shading earnings and committing outright fraud is not always clear. The chief rabbi of the United Kingdom, Jonathan Sacks, said it well: "When everything that matters can be bought and sold, when commitments can be broken because they are no longer to our advantage, when shopping becomes salvation and advertising slogans become our litany, when our worth is measured by how much we earn and spend, then the market is destroying the very virtues on which in the long run it depends." Confidence in business is undermined; individuals distrust one another. Reggio Emilia seems light-years away.







Do you think it's more difficult for businesspeople to adhere to an ethical mind than it is for other professionals?

Yes, because strictly speaking, business is not – nor has it ever been – a profession. Professions develop over long periods of time and gradually establish a set of control mechanisms and sanctions for those who violate the code. True professionals, from doctors and lawyers to engineers and architects, undergo extensive training and earn a license. If they do not act according to recognized standards, they can be expelled from their professional guild. In addition, mentoring is an understood component of regulated professions: A medical intern works with head residents or senior physicians who serve, in part, as ethical guides. But business lacks this model; you don't need a license to practice. The only requirements are to make money and not run afoul of the law. Even if you start out with high personal ethical standards, it's easy to wander off the proper path, because professional standards are a vocational option, not part of the territory. Certainly, there are businesspeople who act professionally, who feel obligated to serve their customers and employees and communities. Businesses can also voluntarily take on corporate social responsibility. But there are no penalties if they elect not to. And some economists argue that it is illegitimate for businesses to direct profits toward anything other than shareholders.

Would you say that compromised work is catching – in the same way that the emotional state of a leader affects others, as Daniel Goleman has observed?

Employees certainly listen to what their leaders say, and they watch what their leaders and colleagues do even more carefully. Employees feel psychologically emboldened or pressured to emulate the bad behavior they see in leaders and others who "get away with it." Alternatively, leaders who model ethical behavior, especially in spite of the temptations of the market, inspire employees to do likewise and thus win for their firms in the long run. Though hoary, the example of CEO James Burke of Johnson & Johnson is still useful. When Burke immediately recalled all Tylenol products during the scare in the 1980s, he exemplified what it is to be ethical in the face of odds. In the end, his company benefited: Twenty-five years later, Johnson & Johnson is rated in the top spot for corporate reputation among large companies.

It matters enormously whether the various interest groups with a stake in the work are in harmony or in conflict and whether the particular role models are confident about the hats they are wearing. When everyone is focused on the same thing, it's easier to do good work. For example, in the late 1990s, our studies found that geneticists in the United States had a relatively easy time pursuing good work because everyone was focused on the same ends of better health and longer life. We found that journalists had a harder time pursuing good work because their desire to report objectively on the most important events clashed with the public's desire for sensationalism and the pressure from publishers to generate advertising dollars and avoid controversy.

In business, it's easy to wander off the proper path, because professional standards are a vocational option, not part of the territory.

Then the real test of an individual's – or a company's – ethical fiber is what happens when there are potent pressures. How does one stand up to those pressures?

Well, if you are a leader, the best way for you to retain an ethical compass is to believe doing so is essential for the good of your organization. What are you trying to achieve? What are your goals, in the broad sense of doing good in the world? Once you understand these factors, you must state your beliefs unwaveringly from the first and tie rewards and sanctions to their realization.

When everything is going swimmingly, it is easier to hold yourself and others to high standards – the costs are not evident. But when circumstances are tempting you to drop your standards, you have to practice rigorous self-honesty. Being ethical really means not fooling yourself or others. I recommend that you look in the mirror from time to time, without squinting, and ask yourself if you are proceeding in ways you approve of. The questions to pose are "Am I being a good worker? And if not, what can I do to become one?"

I also believe that individuals increase their chances of carrying out good work when they make the time and take the opportunity to reflect on their broadly formulated mission and determine whether they are progressing toward its realization. There's a great story – possibly apocryphal – about James Bryant Conant, the former president of Harvard. When he was offered the presidency, he said, "I'm happy to take it, but I can't come to work on Wednesdays, because I have to go to Washington." The hiring committee agreed to this condition. In fact, Conant didn't go to Washington on Wednesdays; he just took the time to be quiet and read. He felt he needed a day each week to be alone with his thoughts. All executives ought to be able to step back and reflect and think about the nature of their work, develop new work projects, or solve work problems.

Another way to keep yourself on the ethical path is to undergo what I call "positive periodic inoculations." These happen when you meet individuals or have experiences that force you to examine what you're doing or to set a good example for others. A businessperson might be inoculated by the model of Aaron Feuerstein, the owner of Malden Mills, who kept paying his workers even after the mills burned down. Feuerstein's action might inspire a leader to do something beneficial for employees, like give them an opportunity to acquire a desired skill. Another kind of inoculation – call it an "antiviral" one – allows you to draw object lessons from instances of compromised work. When Arthur Andersen went bankrupt following the Enron scandal, for example, auditors at other firms took a hard look at their own practices.

But we're all subject to self-delusion. Certainly, one needs a more objective gauge than oneself.

Yes, and that's why it's important that other knowledgeable and candid individuals be consulted. Two worthy consultants could be your own mother – "If she knew everything I was doing, what would she think?" – and the press. Michael Hackworth, the cofounder and chairman of Cirrus Logic, uses this personal temperature gauge: He insists that he will not do something that would embarrass him if it were printed in the morning paper. Even if the stock drops temporarily, he knows that his honesty with the mirror builds his credibility in the long run.

Ideally, business leaders ought to have three types of counselors who are prepared to speak truth to their power. First, they need a trusted adviser within the organization. Second, they need the counsel of someone completely outside the organization, preferably an old friend who is a peer. Third, they need a genuinely independent board. If you actually listen to these three sources of information and act on the basis of what they say, then you cannot go too far wrong. George W. Bush is an example of a leader who has lacked – or at least disregarded – this kind of frank feedback. Franklin D. Roosevelt sought it regularly and was a far more effective president.

In hiring or promotion, are there ways companies can sort the wheat from the chaff?

It would be much wiser to admit people to business school who would never consider cheating – and there are some people like that – than to hope that at age 30, when they're on the make, slippery characters can suddenly be converted into responsible paragons. That said, there is no substitute for detailed, textured, confidential oral recommendations from individuals who know the candidates well and will be honest. I don't particularly trust written letters or the results of psychological tests. A single interview is not much help, either. A colleague of mine says "It takes ten lunches," and I think there is truth in that.

I might also ask a young person about mentors. Our studies found that, across the board, many young professionals lack deep mentoring from individuals in authoritative positions. This was in contrast to veteran professionals, who spoke about important mentors and role models. So I might ask, "Who influenced you in cultivating a particular moral climate, and why?" The influence of antimentors – potential role models who had been unkind to their employees or who had shown behavior that others would not want to emulate – and a lack of mentors is something that we underestimated in our studies. Negative role models may be more powerful than is usually acknowledged. Of course, one has to listen carefully to which traits are considered to be positive and which ones are critiqued. Sometimes the responses are surprising.

If you are not prepared to resign or be fired for what you believe in, then you are not a worker, let alone a professional. You are a slave.

What if you are in a position to speak truth to power? How do you gird yourself for that task?

With the assumption of authority and maturity comes the obligation to monitor what our peers are doing and, when necessary, to call them to account. As the seventeenth-century French playwright Jean-Baptiste Molière declared, "It is not only for what we do that we are held responsible but for what we do not do."

It is not easy to confront offending individuals. But it is essential if you want to have an effective organization, be it a family or a *Fortune* 500 company. Two factors make it easier. First, you need a firm belief that what you are doing is right for the organization. Second, you don't wait for egregious behavior. As soon as you – or others – see warning signs, you confront them, not in an accusatory fashion but in a fact-finding mode. If a person has been warned or counseled, it is much easier to take action the next time a wrong is identified.

As for confronting superiors, if that is impossible, you are not in the right organization. Of course, it is helpful to consult with others, to make sure that your perceptions are not aberrant. But if you are not prepared to resign or be fired for what you believe in, then you are not a worker, let alone a professional. You are a slave. Happily, in the United States, at least, most people have some options about where they work.

In the end, you need to decide which side you're on. There are so many ways in which the world could spiral either up toward health and a decent life for all or down into poverty, disease, ecological disaster – even nuclear warfare. If you are in a position to help tip the balance, you owe it to yourself, to your progeny, to your employees, to your community, and to the planet to do the right thing.

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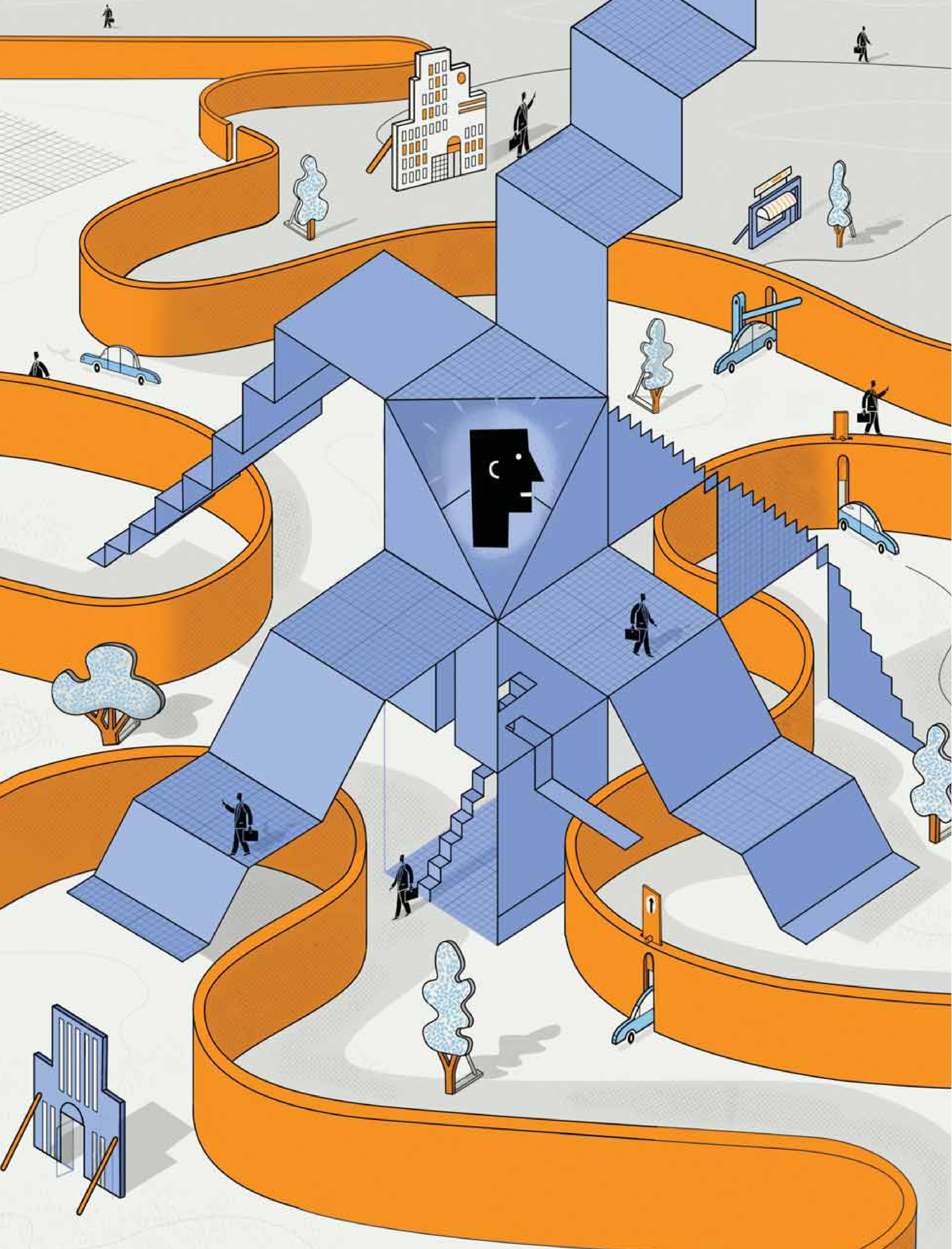

With the globalization of production as well as markets, you need to evaluate your international strategy. Here's a framework to help you think through your options. **by Pankaj Ghemawat**

When it comes to global strategy, most business leaders and academics make two assumptions: first, that the central challenge is to strike the right balance between economies of scale and responsiveness to local conditions, and second, that the more emphasis companies place on scale economies in their worldwide operations, the more global their strategies will be.

These assumptions are problematic. The main goal of any global strategy must be to manage the large differences that

Managing Differences

The Central Challenge of Global Strategy

Ian Whadcock

arise at borders, whether those borders are defined geographically or otherwise. (Strategies of standardization and those of local responsiveness are both conceivably valid responses to that challenge – both, in other words, are global strategies.) Moreover, assuming that the principal tension in global strategy is between scale economies and local responsiveness encourages companies to ignore another functional response to the challenge of cross-border integration: arbitrage. Some companies are finding large opportunities for value creation in exploiting, rather than simply adjusting to or overcoming, the differences they encounter at the borders of their various markets. As a result, we increasingly see value chains spanning multiple countries. IBM's CEO, Sam Palmisano, noted in a recent *Foreign Affairs* article that an estimated 60,000 manufacturing plants were built by foreign firms in China alone between 2000 and 2003. And trade in IT-enabled services – with India accounting for more than half of IT and business-process offshoring in 2005 – is finally starting to have a measurable effect on international trade in services overall.

In this article, I present a new framework for approaching global integration that gets around the problems outlined above. I call it the AAA Triangle. The three A's stand for the three distinct types of global strategy. *Adaptation* seeks to boost revenues and market share by maximizing a firm's local relevance. One extreme example is simply creating local units in each national market that do a pretty good job of carrying out all the steps in the supply chain; many companies use this strategy as they start expanding beyond their home markets. *Aggregation* attempts to deliver economies of scale by creating regional or sometimes global operations; it involves standardizing the product or service offering and grouping together the development and production processes. *Arbitrage* is the exploitation of differences between national or regional markets, often by locating separate parts of the supply chain in different places – for instance, call centers in India, factories in China, and retail shops in Western Europe.

Because most border-crossing enterprises will draw from all three A's to some extent, the framework can be used to develop a summary scorecard indicating how well the company is globalizing. However, because of the significant tensions within and among the approaches, it's not enough to tick off the boxes corresponding to all three. Strategic choice requires some degree of prioritization – and the framework can help with that as well.

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Understanding the AAA Triangle

Underlying the AAA Triangle is the premise that companies growing their businesses outside the home market must choose one or more of three basic strategic options: adaptation, aggregation, and arbitrage. These types of strategy differ in a number of important ways, as summarized in the exhibit "What Are Your Globalization Options?"

The three A's are associated with different organizational types. If a company is emphasizing adaptation, it probably has a country-centered organization. If aggregation is the primary objective, cross-border groupings of various sorts – global business units or product divisions, regional structures, global accounts, and so on – make sense. An emphasis on arbitrage is often best pursued by a vertical, or functional, organization that pays explicit attention to the balancing of supply and demand within and across organizational boundaries. Clearly, not all three modes of organizing can take precedence in one organization at the same time. And although some approaches to corporate organization (such as the matrix) can combine elements of more than one pure mode, they carry costs in terms of managerial complexity.

Most companies will emphasize different A's at different points in their evolution as global enterprises, and some will run through all three. IBM is a case in point. (This characterization of IBM and those of the firms that follow are informed by interviews with the CEOs and other executives.) For most of its history, IBM pursued an adaptation strategy, serving overseas markets by setting up a mini-IBM in each target country. Every one of these companies performed a largely complete set of activities (apart from R&D and resource allocation) and adapted to local differences as necessary. In the 1980s and 1990s, dissatisfaction with the extent to which country-by-country adaptation curtailed opportunities to gain international scale economies led to the overlay of a regional structure on the mini-IBMs. IBM aggregated the countries into regions in order to improve coordination and thus generate more scale economies at the regional and global levels. More recently, however, IBM has also begun to exploit differences across countries. The most visible signs of this new emphasis on arbitrage (not a term the company's leadership uses) are IBM's efforts to exploit wage differentials by increasing the number of employees in India from 9,000 in 2004 to 43,000 by mid-2006 and by planning for massive additional growth. Most of these employees are in IBM Global Services, the part of the company that is growing fastest but has the lowest margins – which they are supposed to help improve, presumably by reducing costs rather than raising prices.

What Are Your Globalization Options?

When managers first hear about the broad strategies (adaptation, aggregation, and arbitrage) that make up the AAA Triangle framework for globalization, their most common response by far is "Let's do all three." But it's not that simple. A close look at the three strategies reveals the differences – and tensions – among them. Business leaders must figure out which elements will meet their companies' needs and prioritize accordingly.

	ADAPTATION	AGGREGATION	ARBITRAGE
Competitive Advantage Why should we globalize at all?	To achieve local relevance through national focus while exploiting some economies of scale	To achieve scale and scope economies through international standardization	To achieve absolute economies through international specialization
Configuration Where should we locate operations overseas?	Mainly in foreign countries that are similar to the home base, to limit the effects of cultural, administrative, geographic, and economic distance		In a more diverse set of countries, to exploit some elements of distance
Coordination How should we connect international operations?	By country, with emphasis on achieving local presence within borders	By business, region, or customer, with emphasis on horizontal relationships for cross-border economies of scale	By function, with emphasis on vertical relationships, even across organizational boundaries
Controls What types of extremes should we watch for?	Excessive variety or complexity	Excessive standardization, with emphasis on scale	Narrowing spreads
Change Blockers Whom should we watch out for internally?	Entrenched country chiefs	All-powerful unit, regional, or account heads	Heads of key functions
Corporate Diplomacy How should we approach corporate diplomacy?	Address issues of concern, but proceed with discretion, given the emphasis on cultivating local presence	Avoid the appearance of homogenization or hegemonism (especially for U.S. companies); be sensitive to any backlash	Address the exploitation or displacement of suppliers, channels, or intermediaries, which are potentially most prone to political disruption
Corporate Strategy What strategic levers do we have?	Scope selection Variation Decentralization Partitioning Modularization Flexibility Partnership Recombination Innovation	Regions and other country groupings Product or business Function Platform Competence Client industry	Cultural (country-of-origin effects) Administrative (taxes, regulations, security) Geographic (distance, climate differences) Economic (differences in prices, resources, knowledge)

Procter & Gamble started out like IBM, with mini-P&Gs that tried to fit into local markets, but it has evolved differently. The company's global business units now sell through market development organizations that are aggregated up to the regional level. CEO A.G. Lafley explains that while P&G remains willing to adapt to important markets, it ultimately aims to beat competitors – country-centered multinationals as well as local companies – through aggregation. He also makes it clear that arbitrage is important to P&G (mostly through outsourcing) but takes a backseat to both adaptation and aggregation: "If it touches the customer, we don't outsource it." One obvious reason is that the scope for labor arbitrage in the fast-moving consumer goods industry may be increasing but is still much less substantial overall than in, say, IT services. As these examples show, industries vary in terms of the headroom they offer for each of the three A strategies.

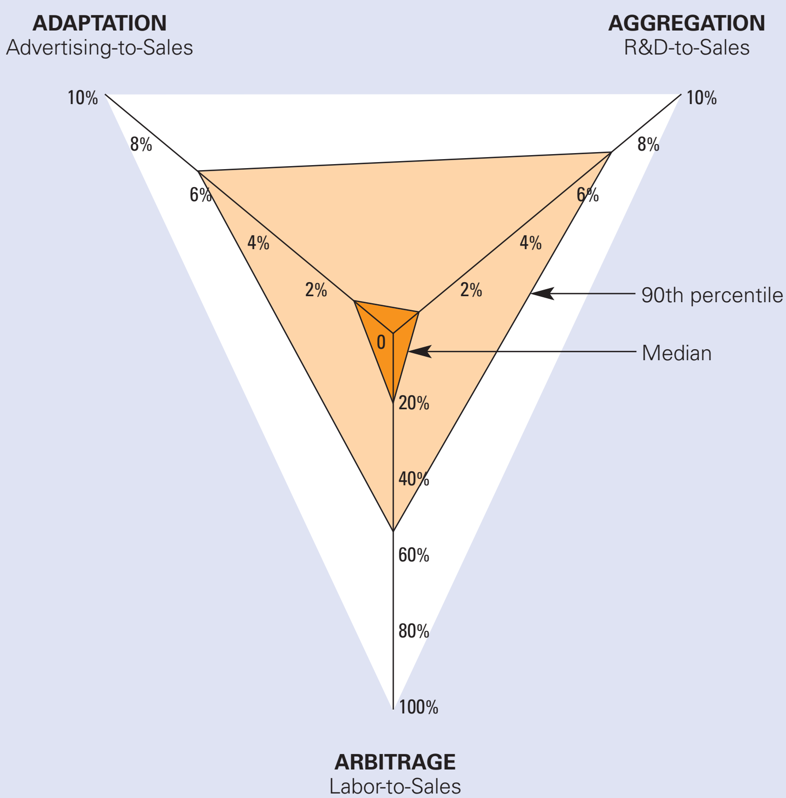
Even within the same industry, firms can differ sharply in their global strategic profiles. For a paired example that takes us beyond behemoths from advanced countries, consider two of the leading IT services companies that develop software in India: Tata Consultancy Services, or TCS, and Cognizant Technology Solutions. TCS, the largest such firm, started exporting software services from India more than 30 years ago and has long stressed arbitrage. Over the past four years, though, I have closely watched and even been involved in its development of a network delivery model to aggregate within and across regions. Cognizant, the fourth largest, also started out with arbitrage and still considers that to be its main strategy but has begun to invest more heavily in adaptation to achieve local presence in the U.S. market in particular. (Although the company is headquartered in the United States, most of its software development centers and employees are in India.)

The AAA Triangle allows managers to see which of the three strategies – or which combination – is likely to afford the most leverage for their companies or in their industries overall. Expense items from businesses' income statements provide rough-and-ready proxies for the importance of each of the three A's. Companies that do a lot of advertising will need to adapt to the local market. Those that do a lot of R&D may want to aggregate to improve economies of scale, since many R&D outlays are fixed costs. For firms whose operations are labor intensive, arbitrage will be of particular concern because labor costs vary greatly from country to country. By calculating these three types of expenses as percentages of sales, a company can get a picture of how intensely it is pursuing each course. Those that score in the top decile of companies along any of the three dimensions – advertising intensity, R&D intensity, or labor intensity – should be on alert. (See the exhibit "The AAA Triangle" for more detail on the framework.)

How do the companies I've already mentioned look when their expenditures are mapped on the AAA Triangle? At Procter & Gamble, businesses tend to cluster in the top quartile for advertising intensity, indicating the appropriateness of an adaptation strategy. TCS, Cognizant, and IBM Global Services are distinguished by their labor intensity, indicating arbitrage potential. But IBM Systems ranks significantly higher in R&D intensity than in labor intensity and, by implication, has greater potential for aggregation than for arbitrage.

The AAA Triangle

The AAA Triangle serves as a kind of strategy map for managers. The percentage of sales spent on advertising indicates how important adaptation is likely to be for the company; the percentage spent on R&D is a proxy for the importance of aggregation; and the percentage spent on labor helps gauge the importance of arbitrage. Managers should pay attention to any scores above the median because, most likely, those are areas that merit strategic focus. Scores above the 90th percentile may be perilous to ignore.



Median and top-decile scores are based on U.S. manufacturing data from Compustat's Global Vantage database and the U.S. Census Bureau. Since the ratios of advertising and R&D to sales rarely exceed 10%, those are given a maximum value of 10% in the chart.

From A to AA

Although many companies will (and should) follow a strategy that involves the focused pursuit of just one of the three A's, some leading-edge companies – IBM, P&G, TCS, and Cognizant among them – are attempting to perform two A's particularly well. Success in "AA strategies" takes two forms. In some cases, a company wins because it actually beats competitors along both dimensions at once. More commonly, however, a company wins because it manages the tensions between two A's better than its competitors do.

The pursuit of AA strategies requires considerable organizational and material innovation. Companies must do more than just allocate resources and monitor national operations from headquarters. They need to deploy a broad array of integrative devices, ranging from the hard (for instance, structures and systems) to the soft (for instance, style and socialization). Let's look at some examples.

Adaptation and aggregation. As I noted above, Procter & Gamble started out with an adaptation strategy. Halting attempts at aggregation across Europe, in particular, led to a drawn-out, function-by-function installation of a matrix structure throughout the 1980s, but the matrix proved unwieldy. So in 1999, the new CEO, Durk Jager, announced the reorganization mentioned earlier, whereby global business units (GBUs) retained ultimate profit responsibility but were complemented by geographic market development organizations (MDOs) that actually ran the sales force (shared across GBUs) and went to market.

The result? All hell broke loose in multiple areas, including at the key GBU/MDO interfaces. Jager departed after less than a year. Under his successor, Lafley, P&G has enjoyed much more success, with an approach that strikes more of a balance between adaptation and aggregation and allows room for differences across general business units and markets. Thus, its pharmaceuticals division, with distinct distribution channels, has been left out of the MDO structure; in emerging markets, where market development challenges loom large, profit responsibility continues to be vested with country managers. Also important are the company's decision grids, which are devised after months of negotiation. These define protocols for how different decisions are to be made, and by whom – the general business units or the market development organizations – while still generally reserving responsibility for profits (and the right to make decisions not covered by the grids) for the GBUs. Common IT systems help with integration as well. This structure is animated by an elaborate cycle of reviews at multiple levels.

Such structures and systems are supplemented with other, softer tools, which promote mutual understanding and collaboration. Thus, the GBUs' regional headquarters are often collocated with the headquarters of regional MDOs. Promotion to the director level or beyond generally requires experience on both the GBU and the MDO sides of the house. The implied crisscrossing of career paths reinforces the message that people within the two realms are equal citizens. As another safeguard against the MDOs' feeling marginalized by a lack of profit responsibility, P&G created a structure – initially anchored by the vice chairman of global operations, Robert McDonald – to focus on their perspectives and concerns.

Aggregation and arbitrage. In contrast to Procter & Gamble, TCS is targeting a balance between aggregation and arbitrage. To obtain the benefits of aggregation without losing its traditional arbitrage-based competitive advantage, it has placed great emphasis on its global network delivery model, which aims to build a coherent delivery structure that consists of three kinds of software development centers:

- The global centers serve large customers and have breadth and depth of skill, very high scales, and mature coding and quality control processes. These centers are located in India, but some are under development in China, where TCS was the first Indian software firm to set up shop.
- The regional centers (such as those in Uruguay, Brazil, and Hungary) have medium scales, select capabilities, and an emphasis on addressing language and cultural challenges. These centers offer some arbitrage economies, although not yet as sizable as those created by the global centers in India.
- The nearshore centers (such as those in Boston and Phoenix) have small scales and focus on building customer comfort through proximity.

In addition to helping improve TCS's economics in a number of ways, a coherent global delivery structure also seems to hold potential for significant international revenue gains. For example, in September 2005, TCS announced the signing of a five-year, multinational contract with the Dutch bank ABN AMRO that's expected to generate more than €200 million. IBM won a much bigger deal from ABN AMRO, but TCS's deal did represent the largest such contract ever for an Indian software firm and is regarded by the company's management as a breakthrough in its attempts to compete with IBM Global Services and Accenture. According to CEO S. Ramadorai, TCS managed to beat out its Indian competitors, including one that was already established at ABN AMRO, largely because it was the only Indian vendor positioned to deploy several hundred professionals to meet the application development and maintenance needs of ABN AMRO's Brazilian operations.

Arbitrage and adaptation. Cognizant has taken another approach and emphasized arbitrage and adaptation by investing heavily in a local presence in its key market, the United States, to the point where it can pass itself off as either Indian or U.S.-based, depending on the occasion.

Cognizant began life in 1994 as a captive of Dun & Bradstreet, with a more balanced distribution of power than purely Indian firms have. When Cognizant spun off from D&B a couple of years later, founder Kumar Mahadeva dealt with customers in the United States, while Lakshmi Narayanan

Even within the same industry, firms can differ sharply in their global strategic profiles.

(then COO, now vice chairman) oversaw delivery out of India. The company soon set up a two-in-a-box structure, in which there were always two global leads for each project – one in India and one in the United States – who were held jointly accountable and were compensated in the same way. Francisco D'Souza, Cognizant's CEO, recalls that it took two years to implement this structure and even longer to change mind-sets – at a time when there were fewer than 600 employees (compared with more than 24,000 now). As the exhibit "Cognizant's AA Strategy" shows, two-in-a-box is just one element, albeit an important one, of a broad, cross-functional effort to get past what management sees as the key integration challenge in global offshoring: poor coordination between delivery and marketing that leads to "tossing stuff over the wall."

Not all of the innovations that enable AA strategies are structural. At the heart of IBM's recent arbitrage initiatives (which have been added to the company's aggregation strategy) is a sophisticated matching algorithm that can dynamically optimize people's assignments across all of IBM's locations – a critical capability because of the speed with which "hot" and "cold" skills can change. Krisha Nathan, the director of IBM's Zurich Research Lab, describes some of the reasons why such a people delivery model involves much more rocket science than, for example, a parts delivery model. First, a person's services usually can't be stored. Second, a person's functionality can't be summarized in the same standardized way as a part's, with a serial number and a description of technical characteristics. Third, in allocating people to teams, attention must be paid to personality and chemistry, which can make the team either more or less than the sum of its parts; not so with machines. Fourth, for that reason and others (employee development, for instance), assignment durations and sequencing are additionally constrained. Nathan describes the resultant assignment patterns as "75% global and 25% local." While this may be more aspirational than actual, it is clear that to the extent such matching devices are being used more effectively for arbitrage, they represent a massive power shift in a company that has hitherto eschewed arbitrage.

The Elusive Trifecta

There are serious constraints on the ability of any one organization to use all three A's simultaneously with great effectiveness. First, the complexity of doing so collides with limited managerial bandwidth. Second, many people think an organization should have only one culture, and that can get in the way of hitting multiple strategic targets. Third, capable competitors can force a company to choose which dimension it is going to try to beat them on. Finally, external relationships may have a focusing effect as well. For instance, several private-label manufacturers whose businesses were built around arbitrage have run into trouble because of their efforts to aggregate as well as arbitrage by building up their own brands in their customers' markets.

To even contemplate a AAA strategy, a company must be operating in an environment in which the tensions among

Cognizant's AA Strategy

Cognizant is experimenting with changes in staffing, delivery, and marketing in its pursuit of a strategy that emphasizes both adaptation and arbitrage.

STAFFING	DELIVERY	MARKETING
• Relatively stringent recruiting process • More MBAs and consultants • More non-Indians • Training programs in India for acculturation	• Two global leads – one in the U.S., one in India – for each project • All proposals done jointly (between India and the U.S.) • More proximity to customers • On-site kickoff teams • Intensive travel, use of technology	• Joint Indian – U.S. positioning • Use of U.S. nationals in key marketing positions • Very senior relationship managers • Focus on selling to a small number of large customers

adaptation, aggregation, and arbitrage are weak or can be overridden by large scale economies or structural advantages, or in which competitors are otherwise constrained.

Consider GE Healthcare (GEH). The diagnostic-imaging industry has been growing rapidly and has concentrated globally in the hands of three large firms, which together command an estimated 75% of revenues in the business worldwide: GEH, with 30%; Siemens Medical Solutions (SMS), with 25%; and Philips Medical Systems (PMS), with 20%.[1] This high degree of concentration is probably related to the fact that the industry ranks in the 90th percentile in terms of R&D intensity. R&D expenditures are greater than 10% of sales for the "big three" competitors and even higher for smaller rivals, many of whom face profit squeezes. All of this suggests that the aggregation-related challenge of building global scale has proven particularly important in the industry in recent years.

GEH, the largest of the three firms, has also consistently been the most profitable. This reflects its success at aggregation, as indicated by the following:

Economies of scale. GEH has higher total R&D spending than SMS or PMS, greater total sales, and a larger service force (constituting half of GEH's total employee head count) – but its R&D-to-sales ratio is lower, its other expense ratios are comparable, and it has fewer major production sites.

Acquisition capabilities. Through experience, GEH has become more efficient at acquiring. It made nearly 100 acquisitions under Jeffrey Immelt (before he became GE's CEO); since then, it has continued to do a lot of acquiring, including the $9.5 billion Amersham deal in 2004, which moved the company beyond metal boxes and into medicine.

Economies of scope. The company strives, through Amersham, to integrate its biochemistry skills with its traditional base of physics and engineering skills; it finances equipment purchases through GE Capital.

GEH has even more clearly outpaced its competitors through arbitrage. Under Immelt, but especially more recently, it has moved to become a global product company by migrating rapidly to low-cost production bases. Moves have been facilitated by a "pitcher-catcher" concept originally developed elsewhere in GE: A "pitching team" at the existing site works closely with a "catching team" at the new site until the latter's performance is at least as strong as the former's. By 2005, GEH was reportedly more than halfway to its goals of purchasing 50% of its materials directly from low-cost countries and locating 60% of its manufacturing in such countries.

In terms of adaptation, GEH has invested heavily in country-focused marketing organizations, coupling such investments relatively loosely with the integrated development-and-manufacturing back end, with objectives that one executive characterizes as being "more German than the Germans." It also boosts customer appeal with its emphasis on providing services as well as equipment – for example, by training radiologists and providing consulting advice on post-image processing. Such customer intimacy obviously has to be tailored by country. And recently, GEH has cautiously engaged in some "in China, for China" manufacture of stripped-down, cheaper equipment aimed at increasing penetration there.

GEH has managed to use the three A's to the extent that it has partly by separating the three and, paradoxically, by downplaying the pursuit of one of them: adaptation. This is one example of how companies can get around the problem of limited managerial bandwidth. Others range from outsourcing to the use of more market or marketlike mechanisms, such as internal markets. GEH's success has also depended on competitors' weaknesses. In addition to facing a variety of size-related and other structural disadvantages relative to GEH, SMS and particularly PMS have been slow in some respects – for instance, in shifting production to low-cost countries. For all these reasons, the temptation to treat the GEH example as an open invitation for everyone to pursue all three A's should be stubbornly resisted.

Besides, the jury is still out on GEH. Adapting to the exceptional requirements of potentially large but low-income markets such as China and India while trying to integrate globally is likely to be an ongoing tension for the company. What's more, GEH isn't clearly ahead on all performance dimensions: SMS has focused more on core imaging, where it is seen as the technological leader.

Developing a AAA Strategy

Let's now consider how a company might use the AAA Triangle to put together a globally competitive strategy. The example I'll use here will be PMS, the smallest of the big three diagnostic-imaging firms.

At a corporate level, Philips had long followed a highly decentralized strategy that concentrated significant power in the hands of country managers and emphasized adaptation. Under pressure from more aggregation-oriented Japanese competitors in areas such as consumer electronics, efforts began in the 1970s to transfer more power to and aggregate more around global product divisions. These were blocked by country chiefs until 1996, when the new CEO abolished the geographic leg of the geography-product matrix. It is sometimes suggested that Philips's traditional focus on adaptation has persisted and remains a source of competitive advantage. While that's true about the parent company, it isn't the case for PMS. Any adaptation advantage for PMS is limited by SMS's technological edge and GEH's service-quality edge. These can be seen as global attributes of the two competitors' offerings, but they also create customer lock-in at the local level.

More generally, any adaptation advantage at PMS is more than offset by its aggregation disadvantages. PMS's absolute

R&D expenditures are one-third lower than those of GEH and one-quarter lower than those of SMS, and PMS is a much larger part of a much smaller corporation than its rivals are. (Philips's total acquisition war chest at the corporate level was recently reported to be not much larger than the amount that GEH put down for the Amersham acquisition alone.) In addition, PMS was stitched together out of six separate companies in a series of acquisitions made over three years to improve the original and aging X-ray technology. It is somewhat surprising that this attempt has worked as well as it has in a corporation without much acquisition experience to fall back on – but there have also clearly been negative aftereffects. Most dramatically, PMS paid more than €700 million in 2004 related to past acquisition attempts – one consummated, another considered – nearly wiping out its reported earnings for that year, although profitability did recover nicely in 2005.

PMS's preoccupation (until recently) with connecting its disparate parts is also somewhat to blame for the company's lack of progress on the arbitrage front. PMS has trailed not only its rivals but also other Philips divisions in moving manufacturing to low-cost areas, particularly China. Although Philips claims to be the largest Western multinational in China, PMS did not start a manufacturing joint venture there until September 2004, with the first output for the Chinese market becoming available in 2005 and the first supplies for export in 2006. Overall, PMS's sourcing levels from low-cost countries in 2005 were comparable to levels GEH achieved back in 2001, and they lagged SMS's as well.

Insights on positioning relative to the three A's can be pulled together into a single map, as shown in the exhibit "AAA Competitive Map for Diagnostic Imaging." Assessments along these lines, while always approximate, call attention to where competitors are actually located in strategy space; they also help companies visualize trade-offs across different A's. Both factors are important in thinking through where and where not to focus the organization's efforts.

How might this representation be used to articulate an action agenda for PMS? The two most obvious strategy alternatives for PMS are AA strategies: adaptation-aggregation and adaptation-arbitrage.

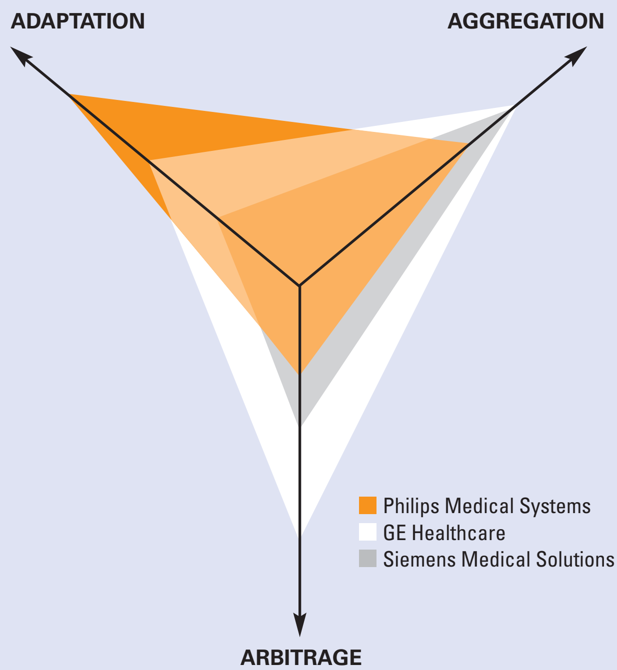
Adaptation-aggregation comes closest to the strategy currently in place. However, it is unlikely to solve the aggregation-related challenges facing PMS, so it had better offer some meaningful extras in terms of local responsiveness. PMS could also give up on the idea of creating a competitive advantage and simply be content with achieving average industry profitability, which is high: The big three diagnostic-imaging companies (which also account for another profitable global triopoly, in light bulbs) are described as "gentlemanly" in setting prices. Either way, imitation of bigger rivals' large-scale moves into entirely new areas seems likely to magnify, rather than minimize, this source of disadvantage. PMS does appear to be exercising some discipline in this regard, preferring to engage in joint ventures and other relatively small-scale moves rather than any Amersham-sized acquisitions.

The adaptation-arbitrage alternative would aim not just at producing in low-cost locations but also at radically reengineering and simplifying the product to slash costs for large emerging markets in China, India, and so forth. However, this option does not fit with Philips's heritage, which is not one of competing through low costs. And PMS has less room to follow a strategy of this sort because of GEH's "in China, for China" product, which is supposed to cut costs by 50%. PMS, in contrast, is talking of cost reductions of 20% for its first line of Chinese offerings.

If PMS found neither of these alternatives appealing – and frankly, neither seems likely to lead to a competitive advantage for the company – it could try to change the game entirely. Although PMS seems stuck with structural disadvantages in core diagnostic imaging compared with GEH and SMS, it could look for related fields in which its adaptation

AAA Competitive Map for Diagnostic Imaging

Philips Medical Systems, the smallest of the big three diagnostic-imaging firms, historically emphasized adaptation but has recently placed some focus on aggregation. Siemens Medical Solutions emphasizes aggregation and uses some arbitrage. The most successful of the three, GE Healthcare, beats each of its rivals on two out of the three A's.



Not all the integration that is required to add value across borders needs to occur within a single organization.

profile might have more advantages and fewer disadvantages. In terms of the AAA Triangle, this would be best thought of as a lateral shift to a new area of business, where the organization would have more of a competitive advantage. PMS does seem to be attempting something along these lines – albeit slowly – with its recent emphasis on medical devices for people to use at home. As former Philips CFO Jan Hommen puts it, the company has an advantage here over both Siemens and GE: "With our consumer electronics and domestic appliances businesses, we have gained a lot of experience and knowledge." The flip side, though, is that PMS starts competing with large companies such as Johnson & Johnson. PMS's first product of this sort – launched in the United States and retailing for around $1,500 – is a home-use defibrillator. Note also that the resources emphasized in this strategy – that is, brand and distribution – operate at the local (national) level. So the new strategy can be seen as focusing on adaptation in a new market.

What do these strategic considerations imply for integration at PMS? The company needs to continue streamlining operations and speed up attempts at arbitrage, possibly considering tools such as the pitcher-catcher concept. It needs to think about geographic variation, probably at the regional level, given the variation in industry attractiveness as well as PMS's average market share across regions. Finally, it needs to enable its at-home devices business to tap Philips's consumer electronics division for resources and capabilities. This last item is especially important because, in light of its track record thus far, PMS will have to make some early wins if it is to generate any excitement around a relaunch.

Broader Lessons

The danger in discussions about integration is that they can float off into the realm of the ethereal. That's why I went into specifics about the integration challenges facing PMS – and it's why it seems like a good idea to wrap this article up by recapitulating the general points outlined.

Focus on one or two of the A's. While it is possible to make progress on all three A's – especially for a firm that is coming from behind – companies (or, often more to the point, businesses or divisions) usually have to focus on one or at most two A's in trying to build competitive advantage. Can your organization agree on what they are? It may have to shift its focus across the A's as the company's needs change. IBM is just one example of a general shift toward arbitrage. But the examples of IBM, P&G, and, in particular, PMS illustrate how long such shifts can take – and the importance, therefore, of looking ahead when deciding what to focus on.

Make sure the new elements of a strategy are a good fit organizationally. While this isn't a fixed rule, if your strategy does embody nontrivially new elements, you should pay particular attention to how well they work with other things the organization is doing. IBM has grown its staff in India much faster than other international competitors (such as Accenture) that have begun to emphasize India-based arbitrage. But quickly molding this workforce into an efficient organization with high delivery standards and a sense of connection to the parent company is a critical challenge: Failure in this regard might even be fatal to the arbitrage initiative.

Employ multiple integration mechanisms. Pursuit of more than one of the A's requires creativity and breadth in thinking about integration mechanisms. Given the stakes, these factors can't be left to chance. In addition to IBM's algorithm for matching people to opportunities, the company has demonstrated creativity in devising "deal hubs" to aggregate across its hardware, software, and services businesses. It has also reconsidered its previous assumption that global functional headquarters should be centralized (recently, IBM relocated its procurement office from Somers, New York, to Shenzhen, China). Of course, such creativity must be reinforced by organizational structures, systems, incentives, and norms conducive to integration, as at P&G. Also essential to making such integration work is an adequate supply of leaders and succession candidates of the right stripe.

Think about externalizing integration. Not all the integration that is required to add value across borders needs to occur within a single organization. IBM and other firms illustrate that some externalization is a key part of most ambitious global strategies. It takes a diversity of forms: joint ventures in advanced semiconductor research, development, and manufacturing; links to and support of Linux and other efforts at open innovation; (some) outsourcing of hardware to contract manufacturers and services to business partners; IBM's relationship with Lenovo in personal computers; customer relationships governed by memoranda of understanding rather than detailed contracts. Reflecting this increased range of possibilities, reported levels of international joint ventures are running only one-quarter as high as they were in the mid-1990s, even though more companies are externalizing operations. Externalization offers advantages not just for outsourcing noncore services but also for obtaining ideas from the outside for core areas: for instance, Procter & Gamble's connect-and-develop program, IBM's innovation jams, and TCS's investments in involving customers in quality measurement and improvement.

Know when not to integrate. Some integration is always a good idea, but that is not to say that more integration is always better. First of all, very tightly coupled systems are not particularly flexible. Second, domain selection – in other words, knowing what not to do as well as what to do – is usually considered an essential part of strategy. Third, even when many diverse activities are housed within one organization, keeping them apart may be a better overall approach than forcing them together in, say, the bear hug of a matrix structure. As Lafley explains, the reason P&G is able to pursue arbitrage up to a point as well as adaptation and aggregation is that the company has deliberately separated these functions into three kinds of subunits (global business units, market development organizations, and global business shared services) and imposed a structure that minimizes points of contact and, thereby, friction.

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For most of the past 25 years, the rhetoric of globalization has been concentrated on markets. Only recently has the spotlight turned to production, as firms have become aware of the arbitrage opportunities available through offshoring. This phenomenon appears to have outpaced strategic thinking about it. Many academic writings remain focused on the globalization (or nonglobalization) of markets. And only a tiny fraction of the many companies that engage in offshoring appear to think about it strategically: Only 1% of the respondents to a recent survey conducted by Arie Lewin at Duke University say that their company has a corporatewide strategy in this regard. The AAA framework provides a basis for considering global strategies that encompasses all three effective responses to the large differences that arise at national borders. Clearer thinking about the full range of strategy options should broaden the perceived opportunities, sharpen strategic choices, and enhance global performance.

1. Figures are for 2005. Otherwise, the account is largely based on Tarun Khanna and Elizabeth A. Raabe, "General Electric Healthcare, 2006" (HBS case no. 9-706-478); D. Quinn Mills and Julian Kurz, "Siemens Medical Solutions: Strategic Turnaround" (HBS case no. 9-703-494); and Pankaj Ghemawat, "Philips Medical Systems in 2005" (HBS case no. 9-706-488).

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"Leave some room in the jacket. Sometimes in court the hairs on my back stand up."

Leo Cullum

HBR Spotlight

HOW TO MANAGE THE MOST TALENTED

TALENT MANAGEMENT: There's no hotter topic in HBR's portfolio, for the obvious, overwhelming reason that in the knowledge economy of the twenty-first century, talent will always be the scarcest of scarce resources. Above all others, it is what companies compete for, depend on, and succeed because of. And, while managing run-of-the-mill, B+ employees may be relatively easy, managing the most talented people is a tough job. They're restless and easily bored; they'd rather solve interesting problems than please their bosses; they don't want to jump through bureaucratic hoops; and other companies are always pursuing them.

The articles in this HBR Spotlight – "Leading Clever People," by Rob Goffee and Gareth Jones, and "Crisis at the Summit," by George D. Parsons and Richard T. Pascale – consider talent management from two distinct points of view. The first article looks at how executives can best manage their most talented direct reports. The second is more about self-management: It looks at what overachievers can do to anticipate and prevent their own rough patches.

Despite the name we've given this section, Goffee and Jones would argue that you should cut way back on managing the most gifted people in your company. "Clever people" – brilliant scientists, researchers, and software developers, for example – respond better to a benevolent guardian than to a traditional boss. They need you to protect them, defer to their expertise, recognize their worth, keep them from bureaucratic nonsense, and give them interesting people to talk to. They'll respect you if you have your own impressive credentials – if you, too, are best in class at something – and if you grant them an extraordinary degree of freedom. Don't kowtow. Do keep them on a very long and flexible lead.

Like Goffee and Jones's clever people, extremely talented executives get bored easily. Parsons and Pascale observe that boredom is so common in high-achievement settings like investment banking, and so pernicious, that it deserves a name of its own: the summit syndrome. Once overachievers have mastered the demands of a new position, they're vulnerable. They tend to go off the rails a bit – losing focus at work, looking elsewhere for thrills, and messing up their personal lives. Generally, their problem doesn't become apparent until very late in the game. (These are people, after all, whose coasting looks a lot like others' high productivity.) Thus it's up to the affected individuals to diagnose the syndrome in themselves and figure out how to get back on track.

Managing top talent isn't easy – but it's the most important job the majority of HBR readers have to do. And it can be done well.

programmer who creates a new piece of code or the pharmaceutical researcher who formulates a new drug. Their single innovations may bankroll an entire company for a decade.

Top executives today nearly all recognize the importance of having extremely smart and highly creative people on staff. But attracting them is only half the battle. As Martin Sorrell, the chief executive of WPP, one of the world's largest communications services companies, told us recently, "One of the biggest challenges is that there are diseconomies of scale in creative industries. If you double the number of creative people, it doesn't mean you will be twice as creative." You must not only attract talent but also foster an environment in which your clever people are inspired to achieve their fullest potential in a way that produces wealth and value for all your stakeholders.

That's tough. If clever people have one defining characteristic, it is that they do not want to be led. This clearly creates a problem for you as a leader. The challenge has only become greater with globalization. Clever people are more mobile than ever before; they are as likely to be based in Bangalore or Beijing as in Boston. That means they have more opportunities: They're not waiting around for their pensions; they know their value, and they expect you to know it too.

We have spent the past 20 years studying the issue of leadership–in particular, what followers want from their leaders. Our methods are sociological, and our data come from case studies rather than anonymous random surveys. Our predominant method consists of loosely structured interviews, and our work draws primarily from five contexts: science-based businesses, marketing services, professional services, the media, and financial services. For this article, we spoke with more than 100 leaders and their clever people at leading organizations such as PricewaterhouseCoopers, Electronic Arts, Cisco Systems, Credit Suisse, Novartis, KPMG, the British Broadcasting Corporation (BBC), WPP, and Roche.

The more we talked to these people, the clearer it became that the psychological relationship leaders have with their clever people is very different from the one they have with traditional followers. Clever people want a high degree of organizational protection and recognition that their ideas are important. They also demand the freedom to explore and fail. They expect their leaders to be intellectually on their plane–but they do not want a leader's talent and skills to outshine their own. That's not to say that all clever people are alike, or that they follow a single path. They do, however, share a number of defining characteristics. Let's take a look at some of those now.

Understanding Clever People

Contrary to what we have been led to believe in recent years, CEOs are not utterly at the mercy of their highly creative and extremely smart people. Of course, some very talented individuals – artists, musicians, and other free agents – can produce remarkable results on their own. In most cases, however, clever people need the organization as much as it needs them. They cannot function effectively without the resources it provides. The classical musician needs an orchestra; the research scientist needs funding and the facilities of a first-class laboratory. They need more than just resources, however; as the head of development for a global accounting firm put it, your clever people "can be sources of great ideas, but unless they have systems and discipline they may deliver very little."

That's the good news. The bad news is that all the resources and systems in the world are useless unless you have clever people to make the most of them. Worse, they know very well that you must employ them to get their knowledge and skills. If an organization could capture the knowledge embedded in clever people's minds and networks, all it would need is a better knowledge-management system. The failure of such systems to capture tacit knowledge is one of the great disappointments of knowledge-management initiatives to date.

The attitudes that clever people display toward their organizations reflect their sense of self-worth. We've found most

If clever people have one defining characteristic, it is that they do not want to be led. This clearly creates a problem for you as a leader.

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of them to be scornful of the language of hierarchy. Although they are acutely aware of the salaries and bonuses attached to their work, they often treat promotions with indifference or even contempt. So don't expect to lure or retain them with fancy job titles and new responsibilities. They will want to stay close to the "real work," often to the detriment of relationships with the people they are supposed to be managing. This doesn't mean they don't care about status–they do, often passionately. The same researcher who affects not to know his job title may insist on being called "doctor" or "professor." The point is that clever people feel they are part of an external professional community that renders the organizational chart meaningless. Not only do they gain career benefits from networking, but they construct their sense of self from the feedback generated by these extra-organizational connections.

This indifference to hierarchy and bureaucracy does not make clever people politically naive or disconnected. The chairman of a major news organization told us about a globally famous journalist – an exemplar of the very clever and skeptical people driving the news business–who in the newsroom appears deeply suspicious of everything the "suits" are doing. But in reality he is astute about how the company is being led and what strategic direction it is taking. While publicly expressing disdain for the business side, he privately asks penetrating questions about the organization's growth prospects and relationships with important customers. He is also an outspoken champion of the organization in its dealings with politicians, media colleagues, and customers. You wouldn't invite him to a strategy meeting with a 60-slide PowerPoint presentation, but you would be wise to keep him informed of key developments in the business.

Like the famous journalist, most clever people are quick to recognize insincerity and respond badly to it. David Gardner, the COO of worldwide studios for Electronic Arts (EA), knows this because he oversees a lot of clever people. EA has 7,200 employees worldwide developing interactive entertainment software derived from FIFA Soccer, The Sims, *The Lord of the Rings,* and Harry Potter, among others. "If I look back at our failures," Gardner told us, "they have been when there were too many rah-rahs and not enough content in our dealings with our people. People are not fooled. So when there are issues or things that need to be worked out, straightforward dialogue is important, out of respect for their intellectual capabilities."

Managing Organizational "Rain"

Given their mind-set, clever people see an organization's administrative machinery as a distraction from their key value-adding activities. So they need to be protected from what we call organizational "rain" – the rules and politics associated with any big-budget activity. When leaders get this right, they

Seven Things You Need to Know About Clever People

Leaders should be aware of the characteristics most clever people share, which collectively make them a difficult crew to manage.

1. They know their worth. The tacit skills of clever people are closer to those of medieval guilds than to the standardized, codifiable, and communicable skills that characterized the Industrial Revolution. This means you can't transfer the knowledge without the people.

2. They are organizationally savvy. Clever people will find the company context in which their interests will be most generously funded. If the funding dries up, they have a couple of options: They can move on to a place where resources are plentiful, or they can dig in and engage in elaborate politics to advance their pet projects.

3. They ignore corporate hierarchy. If you seek to motivate clever people with titles or promotions, you will probably be met with cold disdain. But don't assume this means they don't care about status; they can be very particular about it, and may insist on being called "doctor" or "professor."

4. They expect instant access. If clever people don't get access to the CEO, they may think the organization does not take their work seriously.

5. They are well connected. Clever people are usually plugged into highly developed knowledge networks; who they know is often as important as what they know. These networks both increase their value to the organization and make them more of a flight risk.

6. They have a low boredom threshold. In an era of employee mobility, if you don't engage your clever people intellectually and inspire them with organizational purpose, they will walk out the door.

7. They won't thank you. Even when you're leading them well, clever people will be unwilling to recognize your leadership. Remember, these creative individuals feel that they don't need to be led. Measure your success by your ability to remain on the fringes of their radar.

can establish exactly the productive relationship with clever people that they want. In an academic environment, this is the dean freeing her star professor from the burden of departmental administration; at a newspaper, it is the editor allowing the investigative reporter to skip editorial meetings; in a fast-moving multinational consumer goods company, it is the leader filtering requests for information from the head office so the consumer profiler is free to experiment with a new marketing plan.

Organizational rain is a big issue in the pharmaceutical business. Drug development is hugely expensive – industrywide, the average cost of bringing a drug to market is about $800 million – and not every drug can go the distance. As a result, the politics surrounding a decision can be ferocious. Unless the CEO provides cover, promising projects may be permanently derailed, and the people involved may lose confidence in the organization's ability to support them.

The protective role is one that Arthur D. Levinson, Genentech's CEO and a talented scientist in his own right, knows how to play. When the drug Avastin failed in Phase III clinical trials in 2002, Genentech's share price dropped by 10% overnight. Faced with that kind of pressure, some leaders would have pulled the plug on Avastin. Not Levinson: He believes in letting his clever people decide. Once or twice a year, research scientists have to defend their work to Genentech's Research Review Committee, a group of 13 PhDs who decide how to allocate the research budget and whether to terminate projects. This gives rise to a rigorous debate among the clever people over the science and the direction of research. It also insulates Levinson from accusations of favoritism or short-termism. And if the RRC should kill a project, the researchers are not only not fired, they are asked what they want to work on next.

Roche owns 56% of Genentech, and Franz Humer stands foursquare behind Levinson. Leading clever people, Humer told us, is especially difficult in hard times. "You can look at Genentech now and say what a great company," he said, "but for ten years Genentech had no new products and spent between $500 million and $800 million on research every year. The pressure on me to close it down or change the culture was enormous." Avastin was eventually approved in February 2004; in 2005 it had sales of $1.13 billion.

Having a leader who's prepared to protect his clever people from organizational rain is necessary but not sufficient. It's also important to minimize the rain by creating an atmosphere in which rules and norms are simple and universally accepted. These are often called "representative rules," from the classic *Patterns of Industrial Bureaucracy,* by the sociologist Alvin Gouldner, who distinguished among environments where rules are ignored by all (mock bureaucracy), environments where rules are imposed by one group on another (punishment-centered bureaucracy), and environments where rules are accepted by all (representative bureaucracy). Representative rules, including risk rules in banks, sabbatical rules in academic institutions, and integrity rules in professional services firms, are precisely the ones that clever people respond to best.

Savvy leaders take steps to streamline rules and to promote a culture that values simplicity. A well-known example is Herb Kelleher, the CEO of Southwest Airlines, who threw the company's rule book out the window. Another is Greg Dyke, who when he was the director general of the BBC discovered a mass of bureaucratic rules, often contradictory, which produced an infuriating organizational *immobilisme*. Nothing could be better calculated to discourage the clever people on whom the reputation and future success of the BBC depended. Dyke launched an irreverent "cut the crap" program, liberating creative energy while exposing those who had been blaming the rules for their own inadequacies. He creatively engaged employees in the campaign–for example, suggesting that they pull out a yellow card (used to caution players in soccer games) whenever they encountered a dysfunctional rule.

Letting a Million Flowers Bloom

Companies whose success depends on clever people don't place all their bets on a single horse. For a large company like Roche, that simple notion drives big decisions about corporate control and M&A. That's why Humer decided to sell off a large stake in Genentech. "I insisted on selling 40% on the stock market," he told us. "Why? Because I wanted to preserve the company's different culture. I believe in diversity: diversity of culture, diversity of origin, diversity of behavior, and diversity of view."

For similar reasons, Roche limits its ownership of the Japanese pharmaceutical company Chugai to 51%. By keeping the clever people in all three companies at arm's length, Humer can be confident that they will advance different goals: "My people in the Roche research organization decide on what they think is right and wrong. I hear debates where the Genentech researchers say, 'This program you're running will never lead to a product. You are on the wrong target. This is the wrong chemical structure–it will prove to be toxic.' And my guys say, 'No, we don't think so.' And the two views never meet. So I say to Genentech, 'You do what you want, and we will do what we want at Roche, and in five years' time we will know. Sometimes you will be right and sometimes we will be right.'" Maintaining that diversity is Humer's most challenging task; there is always pressure within a large organization to unify and to direct from above.

Companies that value diversity are not afraid of failure. Like venture capitalists, they know that for every successful

Recruiting People with the Right Stuff

Clever people require a peer group of like-minded individuals. Universities have long understood this. Hire a star professor and you can be sure the aspiring young PhDs in that discipline will flock to your institution. This happens in business as well. In the investment banking world, everyone watches where the cleverest choose to work. Goldman Sachs, for example, cherishes its reputation as the home of the brightest and best; a bank that seeks to overtake it must be positioned as a place where cleverness thrives.

For this reason, the CEOs of companies that rely on clever people keep a close watch on the recruiting of stars. Bill Gates always sought out the cleverest software programmers for Microsoft. From the start, Gates insisted that his company required the very best minds; he understood that they act as a magnet for other clever people. Sometimes he intervened personally in the recruitment process: A particularly talented programmer who needed a little additional persuasion to join the company might receive a personal call from Gates. Very flattering–and very effective.

Although you need to recruit clever stars, you must also make sure that your culture celebrates clever ideas. In an effort to create stars, some media organizations divide their employees into "creatives" and administrative support staff. That's a big mistake. It makes about as much sense as recruiting men only–you automatically cut your talent pool in half. The ad agency Bartle Bogle Hegarty doesn't make this mistake. Many of its most successful executives started as assistants but were given the space to grow and express their cleverness. Not surprisingly, BBH has long been regarded as one of the most creative ad agencies in the world. At the heart of its corporate culture is the maxim "Respect ideas, wherever they come from."

The Traitorous Eight

Ineffective leadership of clever people can be costly. Consider the cautionary tale of William Shockley, a London-born research scientist who worked at Bell Labs after World War II. In 1947 Shockley was recognized as a coinventor of the transistor, and in 1956 he was awarded a Nobel Prize. He left Bell Labs in 1955 and founded Shockley Semiconductor Laboratory, in Mountain View, California. His academic reputation attracted some of the cleverest people in electronics, including Robert Noyce and Gordon Moore (of Moore's Law fame). Shockley was blessed with a brilliant mind. Noyce described him as a "marvelous intuitive problem solver," and Moore said he had a "phenomenal physical intuition." But his leadership skills fell far short of his intellectual brilliance. On one occasion Shockley asked some of his younger employees how he might stoke their enthusiasm. Several expressed a wish to publish research papers. So Shockley went home, wrote a paper, and the next day offered to let them publish it under their own names. He meant well but led poorly.

On another occasion, Shockley instituted a secret "project within a project." Although only 50 or so people were employed in his laboratory, the group assigned to work on his new idea (which, according to Shockley, had the potential to rival the transistor) was not allowed to discuss the project with other colleagues. It wasn't long before rumblings of discontent at Shockley's leadership style turned mutinous. The situation deteriorated and a disenchanted group – "the Traitorous Eight" – left to found Fairchild Semiconductor in 1957. Fairchild revolutionized computing through its work on the silicon transistor. It also threw off a slew of clever people who went on to start up or develop some of the best-known companies in the industry: Bob Noyce and Gordon Moore (Intel), Jerry Sanders (Advanced Micro Devices), and Charlie Sporck (National Semiconductor) were all former employees of Fairchild.

Through his poor leadership, Shockley inadvertently laid the cornerstone of Silicon Valley. He brought together some of the best scientists in the field of electronics, many of whom might otherwise not have remained in the region. And he created conditions that provoked his brilliant employees to strike out on their own.

new pharmaceutical product, dozens have failed; for every hit record, hundreds are duds. The assumption, obviously, is that the successes will more than recover the costs of the failures. Take the case of the drinks giant Diageo. Detailed analysis of customer data indicated an opening in the market for an alcoholic beverage with particular appeal to younger consumers. Diageo experimented with many potential products – beginning with predictable combinations like rum and coke, rum and blackcurrant juice, gin and tonic, vodka and fruit juice. None of them seemed to work. After almost a dozen tries, Diageo's clever people tried something riskier: citrus-flavored vodka. Smirnoff Ice was born – a product that has contributed to a fundamental change in its market sector.

It's easy to accept the necessity of failure in theory, but each failure represents a setback for the clever people who gambled on it. Smart leaders will help their clever people to live with their failures. Some years ago, when three of Glaxo's high-tech antibiotics all failed in the final stages of clinical trial, Richard Sykes – who went on to become chairman of Glaxo Wellcome and later of GlaxoSmithKline – sent letters of congratulation to the team leaders, thanking them for their hard work but also for killing the drugs, and encouraging them to move on to the next challenge. EA's David Gardner, too, recognizes that his business is "hit driven," but he realizes that not even his most gifted game developers will always produce winners. He sees his job as supporting his successful people – providing them with space and helping them move on from failed projects to new and better work.

Smart leaders also recognize that the best ideas don't always come from company projects. They enable their clever people to pursue private efforts because they know there will be payoffs for the company, some direct (new business opportunities) and some indirect (ideas that can be applied in the workplace). This tradition originated in organizations like 3M and Lockheed, which allowed employees to pursue pet projects on company time. Google is the most recent example: Reflecting the entrepreneurial spirit of its founders, Sergey Brin and Larry Page, employees may spend one day a week on their own start-up ideas, called Googlettes. This is known as the "20% time." (Genentech has a similar policy.) The result is innovation at a speed that puts large bureaucratic organizations to shame. The Google-affiliated social-networking Web site Orkut is just one project that began as a Googlette.

Establishing Credibility

Although it's important to make your clever people feel independent and special, it's equally important to make sure they recognize their *inter*dependence: You and other people in the organization can do things that they can't. Laura Tyson, who served in the Clinton administration and has been the dean of London Business School since 2002, says, "You must help clever people realize that their cleverness doesn't mean they can do other things. They may overestimate their cleverness in other areas, so you must show that you are competent to help them." To do this you must clearly demonstrate that you are an expert in your own right.

Depending on what industry you are in, your expertise will be either supplementary (in the same field) or complementary (in a different field) to your clever people's expertise. At a law firm, the emphasis is on certification as a prerequisite for practice; at an advertising agency, it's originality of ideas. It would be hard to lead a law firm without credentials. You can lead an advertising agency with complementary skills–handling commercial relationships with clients, for instance, while your clever people write great copy.

A man we'll call Tom Nelson, who was the marketing director of a major British brewer, is a good example of a leader with complementary skills. Nelson was no expert on traditional brewing techniques or real ales. But he was known throughout the organization as "Numbers Nelson" for his grasp of the firm's sales and marketing performance, and was widely respected. Nelson had an almost uncanny ability to quote, say, how many barrels of the company's beer had been sold the previous day in a given part of the country. His clear mastery of the business side gave him both authority and credibility, so the brewers took his opinions about product development seriously. For example, Nelson's reading of market tastes led to the company's development of low-alcohol beers.

Leaders with supplementary expertise are perhaps more commonplace: Microsoft's Bill Gates emphasizes his abilities as a programmer. Michael Critelli, the CEO of Pitney Bowes, holds a number of patents in his own name. Richard Sykes insisted on being called Dr. Sykes. The title gave him respect within the professional community to which his clever people belonged – in a way that being the chairman of a multinational pharmaceutical company did not.

But credentials–especially if they are supplementary–are not enough to win acceptance from clever people. Leaders must exercise great care in displaying them so as not to demotivate their clever employees. A former national soccer coach for England, Glenn Hoddle, asked his star player, David Beckham, to practice a particular maneuver. When Beckham couldn't do it, Hoddle – once a brilliant international player himself – said, "Here, I'll show you how." He performed the maneuver flawlessly, but in the process he lost the support of his team: The other players saw his move as a public humiliation of Beckham, and they wanted no part of that. The same dynamic has played out many times in business; the experience of William Shockley is perhaps the most dramatic, and tragic, example (see the sidebar "The Traitorous Eight"). How do you avoid this kind of situation? One highly effective way is to identify and relate to an informed insider among your clever people – someone willing to serve as a sort of anthropologist, interpreting the culture and sympathizing with those who seek to understand it. This is especially important for newly recruited leaders. Parachuting in at the top and accurately reading an organization is hard work. One leader we spoke to admitted that he initially found the winks, nudges, and silences of his new employees completely baffling. It took an interpreter – someone who had worked among the clever people for years – to explain the subtle nuances.

If you try to push your clever people, you will end up driving them away. As many leaders of highly creative people have learned, you need to be a benevolent guardian rather than a traditional boss.

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Martin Sorrell likes to claim that he uses reverse psychology to lead his "creatives" at WPP: "If you want them to turn right, tell them to turn left." His comment reveals an important truth about managing clever people. If you try to push them, you will end up driving them away. As many leaders of extremely smart and highly creative people have learned, you need to be a benevolent guardian rather than a traditional boss. You need to create a safe environment for your clever employees; encourage them to experiment and play and even fail; and quietly demonstrate your expertise and authority all the while. You may sometimes begrudge the time you have to devote to managing them, but if you learn how to protect them while giving them the space they need to be productive, the reward of watching your clever people flourish and your organization accomplish its mission will make the effort worthwhile.

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Overachievers at the top of their game are vulnerable to a hard-to-detect affliction that can derail their careers. Spot the subtle symptoms early.

CRISIS AT THE SUMMIT

by George D. Parsons and Richard T. Pascale

The romanticized portrayal of superstars celebrates a happy combination of natural gifts, ambition, circumstance, and timing – all fueling an unimpeded ascent to the top. But even for the most gifted individuals blessed with a series of fortuitous career developments, the path to the top is often not smooth. As they master each assignment along the way, an unrecognized affliction can strike. Its cause, paradoxically, is success itself. After the novel demands of the current position have been conquered and before the next job begins (with its new requirements for growth) is a vulnerable time for overachievers. Incapable of coasting, they can lose their bearings and question their purpose. Confusion can evolve into inner turmoil. If left unattended, this *summit syndrome* may derail promising careers and deprive organizations of talent they've banked on for their future. The problem is, its early signs are hard to detect and easy to ignore.

Brian Stauffer

Andrew Thompson (a composite character based on various people we've coached) is a case in point. The 36-year-old gregarious Ivy Leaguer had, by his own description, a dream career at an elite investment bank. The financial service industry's equivalent of an Olympic gold medalist, he attracted and retained wealthy individuals by eking out that extra quarter percent of "alpha" return above the norm. Quickly promoted from covering individual wealthy clients to managing the largest team in the firm's U.S. private-banking group, he oversaw $4 billion in assets and was known for going the extra mile.

In recent months, though, something had changed. What started as a slight diminution in professional edge had now become an intrusive boredom. The buzz was missing. He wasn't driving himself as hard to ferret out the insights that produced those exceptional returns. He was ignoring the friction among his fiercely competitive team members and was vulnerable to distractions. He became obsessed with completing each day's *New York Times* crossword puzzle. Much to his surprise, when friends called with a proposal to row the Atlantic, he found himself genuinely interested. He started overeating and overindulging at cocktail hour. He began taking calls from headhunters, whom he had brushed off in the past; it was the prospect of change, rather than the nature of the jobs themselves, that was appealing. While he continued to excel, observant colleagues, including his boss, thought he seemed slightly distracted. Although the firm continued to treat him like an up-and-coming star, Thompson knew that halos have a short half-life in financial services. He started to worry: Would others soon notice that something was amiss? Had he lost his edge?

Much has been written about the ways individuals end up on the "outs" with their organizations – *frozen out* when stylistic idiosyncrasies clash with a superior's personality or an organization's culture; *burned out* by the toxic triad of an overwhelming workload, the inability to see the positive impact of one's labors, and the failure to achieve career aspirations; *psyched out* by biological or psychological changes that trigger a midlife crisis; or *flaming out* from a fundamental incompatibility between one's abilities and the requirements of the job.

The summit syndrome is quite different. It afflicts extreme overachievers who thrive on challenge. They can be found in abundance in tightly wired organizations – in the premier investment banks and consulting firms; in start-ups; in semiconductor, computer, and software development companies; and in the elite units of multiproduct corporations. These supercharged individuals exult in winning, mastering new skills, acquiring knowledge, and surpassing previous benchmarks of excellence. They are addicted to their own adrenaline. But the rush from pushing beyond their limits tends to dissipate once the new territory has been mastered; an identity built around the galvanizing effects of meeting and conquering daunting challenges loses its purchase as such people near the peak of a job's learning curve. They can't or find it extremely difficult to motor along on flat terrain. An S-curve aptly describes the rapid ascent to proficiency and the gradual loss of career momentum that occurs when such individuals master a job. It's near the top where the troubles begin. (See the exhibit "Dangerous Curves Ahead.")

The summit syndrome afflicts extreme overachievers who thrive on challenge.

This summit experience is not a once-in-a-lifetime event like a midlife crisis. The careers of most overachievers are a sequence of S-curves. The summits, as the Bard says, keep coming, "like as the waves make towards the pebbled shore/…Each changing place with that which goes before/ In sequent toil all forwards do contend."

Unlike people on the "outs" with their organizations, those going through the initial phases of the summit syndrome haven't been frozen out or marginalized; to the contrary, they reside at the inner circle. They are rarely susceptible to

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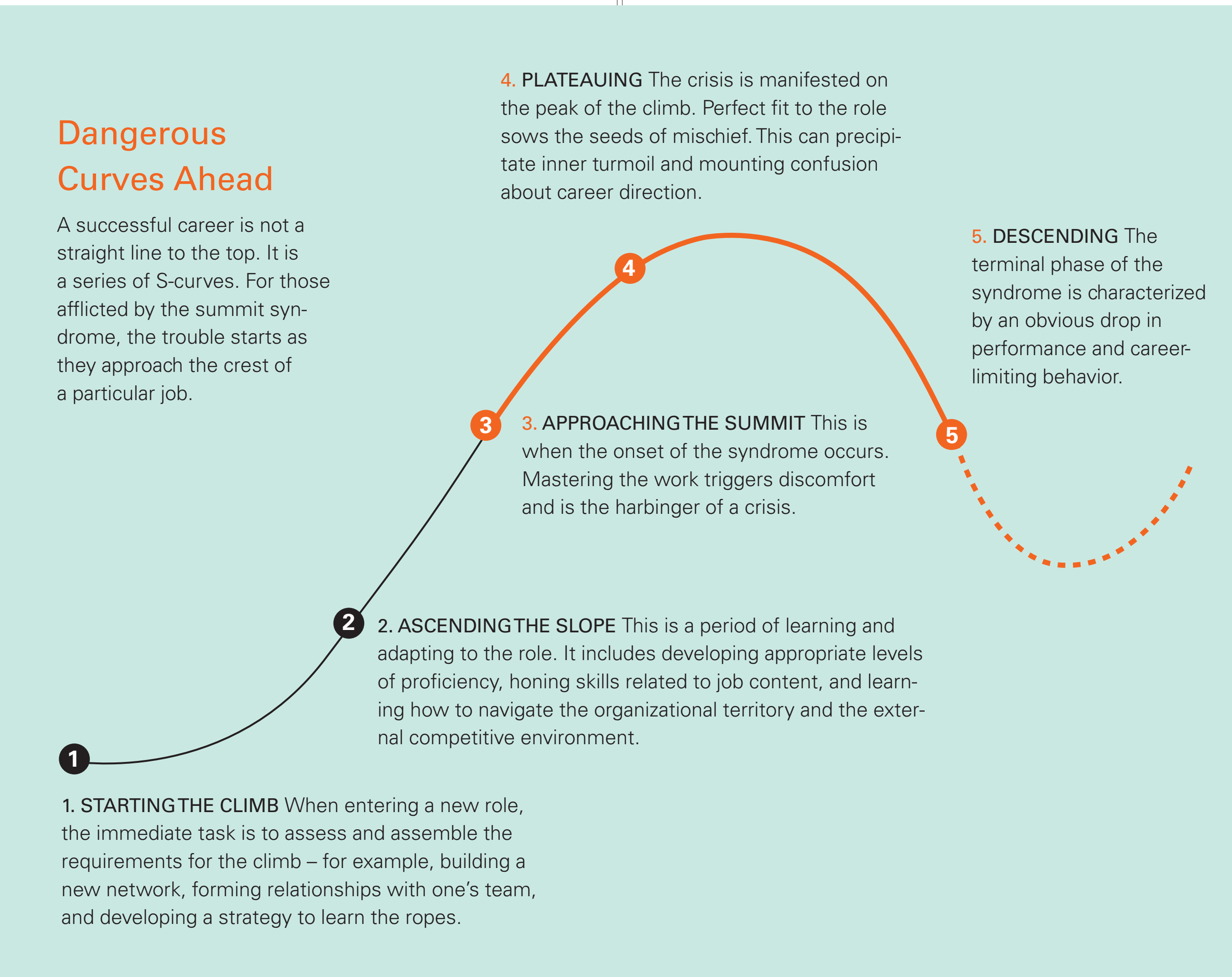


burnout: They see the impact of their work and welcome big demands – indeed, they need them to keep the adrenaline flowing. Their capabilities are not merely aligned with organizational purpose, they are admired – even celebrated – by superiors, peers, and subordinates alike. In short, these individuals are more secure than most and don't suffer from the narcissistic inferiority (and its unquenchable thirst for praise) that haunts many victims of the "outs."

Paradoxically, disorientation at the summit is more profound for the more proficient. Those with the smoothest glide to success in a challenging job tend to experience the greatest degree of confusion. Costs to the individual can go way beyond dropped balls at work or other slips in performance. Inner turmoil can build to the point where it hurts health and family. The search for stimulation may lead to extramarital misadventures or other self-destructive behavior. Distraction and confusion can result in bad career decisions, causing people to leave the fast track and end up drifting from one job to another. They can join the ranks of those highly promising men and women who somehow never managed to achieve the positions or goals that colleagues and friends always assumed they would one day claim.

For the organization, this seemingly uncharacteristic behavior by those we least expect to disappoint us often comes as a shock. Trying to get such individuals back in the saddle can be expensive in terms of lost contribution, organizational disruption, and the price of counseling. And that's the best-case scenario. The worst is surprise departures that needlessly rob companies of their most promising talent. Senior executives wonder how they could have missed the signs, but this failure is the rule rather than the exception. Subtle indicators elude traditional organizational screens such as performance reviews and formal career-development discussions. Indeed, we've witnessed the highly disruptive impact of this disorientation on professional elites at a wide variety of companies. We have observed this syndrome at a large number of firms over the past two decades, including General Electric, Intel, IBM, JPMorgan Chase, Goldman Sachs, and McKinsey. The collateral damage – and our belief that it can be averted – is what prompted us to write this article.

The best defense is early intervention. Companies – and more specifically, overachievers themselves – need to anticipate the onset of the disorientation that strikes near or at the summit of a job. It is possible to detect the lead indicators and take preemptive action. This is mainly the responsibility of individuals, although their bosses and peers certainly can lend a helping hand. In this article, we will highlight the causes, indicators, and progression of the syndrome and describe what must be done to regain personal and professional clarity and career momentum. We are convinced that steps taken at the right time not only can allow extreme overachievers to avoid or surmount the summit syndrome and prepare for the next climb in their careers but also can deepen their capacity to lead.

Steps taken at the right time not only can allow extreme overachievers to surmount the summit syndrome but also can deepen their capacity to lead.

Recognizing the Syndrome

The summit syndrome unfolds in three phases, each with its own distinct indicators. The first is *approaching* the crest of a job, when a person, having mastered most of the challenges of the role, is nearing peak proficiency. This is a time when some may push harder to recapture the adrenaline rush of the climb. The second phase is *plateauing,* when the summit has been reached and virtually all of the challenges have been conquered. While the less ambitious person is apt to coast at this point, the overachiever bears down even harder to produce ever more stellar results. The third phase is *descending.* It is the terminal stage of the syndrome, when a leader's job performance begins to slip noticeably, triggering an accelerating slide. As the person's superstar status fades, he jumps ship, accepts a demotion, or takes a lateral transfer. (See the exhibit "Symptoms of a Summit Crisis.")

Approaching. After the intense, exhilarating experience of attaining new knowledge, acquiring new skills, and rising to meet the challenges of a new role, a shift occurs when the summit comes into sight. The realization that "I've just about conquered the job" sinks in, giving rise to low-level musings about "What's next in my career?" Some tasks or duties begin to seem tedious, feeding anxiety (for overachievers have a low tolerance for boredom) and opening the door to distractions (Sudoku, online solitaire, daydreams of paths untaken, obsessions with hobbies).

The approaching phase is puzzling for overachievers. They feel that something is not quite right. They are disturbed by the fact that external job offers and adventure schemes suddenly seem intriguing. There is no drop in performance yet; the overall work remains rewarding. But ask people in this phase if they are excited about their work, and they will respond with telling qualifiers like "It's still challenging, but it's not the way it used to be" or "I'm enjoying myself, but the rush is missing."

Plateauing. The effects of the summit syndrome are not severe enough in the approaching phase to stop sufferers in their tracks. They will continue to the peak and onto the plateau of job proficiency. Absent new challenges or a new job, however, the syndrome will progress if the early symptoms are left unattended. At this stage, a paradox feeds the confusion: By all external measures (and in the eyes of everyone around them), they are at the top of their game; they have confirmed the faith that others placed in them at the outset of their climb. Yet their enthusiasm for the job continues to wane. They feel increasingly disoriented and uncertain about how to proceed. They begin to agonize about their next career moves. "Should I continue to climb the corporate ladder or start something new?" they wonder. "I could get better at what I'm doing," they think, "but where will it take me?" For seasoned executives who have made a series of S-curve climbs, the dominant concern is a loss of legacy. Having built a sterling reputation and had a storied impact during the course of their careers, they now wonder if those can be sustained.

It is on the plateau that the summit syndrome can trigger the first subtle shifts in performance. More effort is required to achieve the same results, even as the commitment to deliver those results diminishes. Headhunters' calls are more welcome – or even solicited. As overachievers struggle to cope, greater distractions are embraced, even sought: Sudoku

Symptoms of a Summit Crisis

SUMMIT PHASE	INTERNAL SYMPTOMS	EXTERNAL SYMPTOMS
Approaching	• Low-level discontent • Premonitions about loss of traction • "What happened to the excitement?"	• Subtle loss of edge • Emerging distractions - Hobby obsessions - Heightened appetite for stimulation - Daydreaming • Attraction to unsolicited offers
Plateauing	• Loss of enthusiasm • Fearing loss of career momentum and legacy • "What happened to my goals?"	• Working harder to do the basics • More serious distractions - Climbing Mount Everest–type adventures beckon - Intensive curiosity about alternative lifestyles and intimate relationships - More vacations • Unorthodox career choices attract disproportionate consideration
Descending	• Feeling lost • Cynicism, anger, frustration near the surface • "What happened to my career?"	• Working harder to conceal disengagement • Severe distractions - Substance abuse - Sexual indiscretions - Malfeasance - Unconscious career sabotage • Bailing out

finds its way into the daytime routine, row-the-Atlantic type excursions beckon, and sexual indiscretions are more tempting. People are more likely to make precipitous career choices, seeking a way out of the discomfort.

Descending. This is the fall from grace. Victims are in such turmoil it becomes obvious to others that something has gone terribly wrong. Their careers are now in crisis. Self-inflicted career sabotage and stress-related health problems are common. The typically unhappy ending: a radical change made for all the wrong reasons or a forced lateral move or demotion.

Consider Roberta Simms (real person, fake name), a 34-year-old executive who had spent her entire working life at a regional health care company in the United States. By skillfully driving initiatives to improve the quality of care and reduce costs, she had earned a reputation as an operational genius and rapidly rose to become CEO of a midsized medical center. As she soared to the peak of that job, she ignored the indicators of the summit syndrome. At first, in an attempt to quash her growing restlessness, she simply worked harder, to no avail. She found herself becoming increasingly cynical and disenchanted with the parent company. It became more difficult for her to maintain her composure in the face of bureaucratic hassles. She picked the wrong fights and became critical of direct reports. Her personal life began to suffer, and she found it hard to focus on the mounting challenge from local competitors. As Simms's performance started to slip – excessive growth in employee head count and a declining number of patients were some of the first signs – corporate executives began to lose respect for her. Soon they no longer saw her as a rising star. Only two years earlier, Simms had envisioned staying with the company for at least ten years, if not the rest of her career. Now, unsure of what she really wanted, she began to interview in an aimless fashion for lateral positions with small companies in neighboring states.

The lesson is stark. If the syndrome is caught early, preparation for the next climb is straightforward. If it is tackled after things begin to unravel – after performance has clearly begun to decline or the person has jumped ship – much more is required to repair the damage to reputation, relationships, and personal well-being.

Overcoming the Confusion

After recognizing indicators of the summit syndrome, the next step in addressing it is to understand the sources of the disorientation. There are two of them: an erosion in the effectiveness of one's formula for excelling at work and a disconnect between career and life's grand purpose.

Winning formula. A winning formula is each person's distinctive way of making a difference. Tracy Goss, an authority on how executives can reinvent themselves and their companies, has described the winning formula as a combination of aptitude and behavior that determines what unique contributions we make on the job and in personal situations.

Winning formulas have two essential components: what you pay attention to and what you do about it. Some people focus on the unexpressed needs of key players and become the "go-to guy" for solving problems. Others concentrate on what's missing or flawed in an endeavor and act as the watchdogs for errors or potential train wrecks in their organizations. Still others look for the possibilities in a situation – the new idea or the biggest prize to be pursued – and establish themselves as persuasive advocates for new directions. Some ask themselves, "What's the goal here?" and then mobilize others to achieve desired outcomes. And so forth. The variations are practically infinite.

With some earnest introspection, most of us can describe our winning formula and articulate the well-honed skills that support it. Andrew Thompson's was to listen for his client's unexpressed needs, identify the biggest potential opportunity to fulfill those needs, and then capitalize on his extraordinary talent for selling this solution to the client. More specifically, he succeeded by spotting discontinuities in financial markets that caused assets to be either under- or overpriced, using analysis and insight to realize economic gains. He was adept at marshaling the evidence to persuade high-net-worth individuals interested in such opportunities to invest ahead of the pack. He was diligent in maintaining hands-on oversight of the work and in sustaining personal ownership of relationships with all major clients so they would call him first.

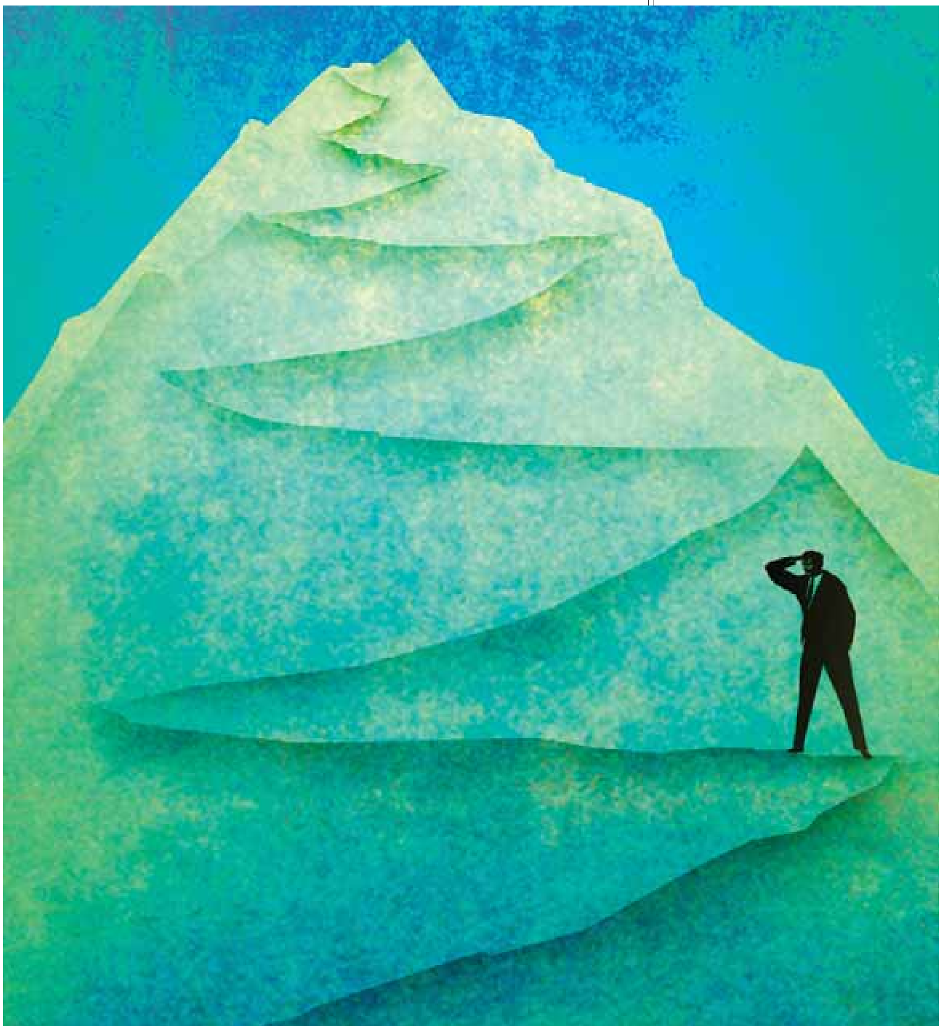
A winning formula that works well on the way up can rapidly become less and less useful as one approaches the summit. By that time, it is automatic and subconscious, leading the unwary to do more of the same at a stage when enthusiasm for "the same" is waning.

With some reflection, Thompson could see how the formula that had helped him excel was now a handicap. Elements that had worked in sync early in the climb, when he had 20 major clients and $1 billion of assets under management, were constraints on growth and performance now that he had 80 clients and $4 billion under management. Yes, his formula had secured his niche as a key player in the enterprise, turning him, as he put it, into an "in-the-limelight" producer. But it had also led him to fail to delegate and to dramatically underutilize the talents of his six-person team as his client base grew. He was a solutions soloist rather than a composer and conductor of an elite ensemble. Instead of fueling growth, his winning formula was now imposing a ceiling on him and his team. When he looked at his winning formula in this light, Thompson could see that he must reinvent it.

A winning formula that works well on the way up can rapidly become less and less useful as one approaches the summit.

Life's grand purpose. At the same time that the effectiveness of the winning formula dwindles, a profound disconnect often begins to manifest itself: a sense that life's grand purpose has somehow been lost. Totally immersed in mastering a job, an overachiever can easily lose touch with fundamental values, aspirations, and "how my career fits into what I want out of life." However, once the job is no longer all encompassing, this issue begins to surface, adding to confusion and making it all the more difficult to discern the right path.

To address this void, Thompson worked with a coach to prepare a series of lists identifying the things that were most important to him: career aspirations, past work contributions, core values and beliefs, personal attributes, and the people who mattered most in his life. He transferred each item from his lists to index cards. They captured memories, thoughts about possible second or third careers, reflections on his life mission, and the influence of mentors. He sorted the cards into clusters on a large table, talking through meanings and connections as he arranged them. This exercise helped him recognize how he had strayed from his ideals and how his ambitions had changed. Among the insights Thompson took away were these:



• He had become overly involved in the day-to-day management of clients and their investment portfolios. He had let himself get sucked into micromanaging details that could have readily been delegated to his team members and their support staff.
• He had allowed himself to become isolated from valued mentors who once had provided their perspectives and counsel in tough times.
• He had lost a personal attribute that had been the hallmark of earlier climbs: taking himself with a grain of salt and not allowing a job to become all consuming.
• His ambitions had shifted. A stellar solo performer, he was increasingly attracted to the idea of leading a larger organization and testing his executive skills.
• Buried in work, he was losing his connection with his wife and children.
• He had long neglected his interest in community work. (He had formerly volunteered at a shelter for the homeless and served on the board of a nonprofit that supported victims of abuse.)
• A love of teaching and mentoring had given way to a self-absorbed drive to personally produce results.

As he contemplated these conclusions, Thompson was drawn inevitably to ask the big question: What did he want to accomplish in his working life? To help answer that question, Thompson wrote a "casket speech," a three-minute eulogy about his life and what it meant to those he touched along the way. Its themes included helping people discover and make the most of their professional talents, evolving his own gifts and commercial acumen as a wealth adviser, and taking them to the next level. In his eulogy, he characterized himself as a person who had excelled in his career without taking work (or himself) too seriously, someone who had always maintained humor and grace. It described a man who had left the places he served better than he had found them. Standing in the future and looking back across his life helped him clarify his professional goals.

At this point, he was in a position to articulate what he wanted out of his current job and future ones. He could now describe the special characteristics that would capture his heart and imagination. Rather than seek a new position, Thompson decided, he would strive to build his current wealth management franchise at a much faster pace by tapping the skills of his colleagues and by fostering better teamwork. He would broaden his focus beyond financial markets and investment opportunities to develop the people around him by spotting and nurturing their growth potential. He would seek to influence the firm's strategic direction by volunteering to serve on task forces devoted to expanding the firm's suite of investment products and services. Achieving these professional ambitions, however, would *not* come at the expense of all that was near and dear to him in his personal life; he would rebalance the work/life equation so that he could devote more time to his family and to nonprofit projects. To do all this, he would need to learn to work differently, not harder.

Moving Off the Summit

Having regained his footing, Thompson could now begin the task of building new leadership muscles: identifying the capabilities he needed to meet the demands of his recast job description. This involved revisiting five sets of competencies (we call them "domains") that are critical to expanding one's capacity to lead.

The power domain. During the course of their careers, leaders must learn how to use power in different ways. It's common for people in early management positions to achieve results through the force of their authority or their expertise (by taking a hands-on approach to leading a team charged with a particular task, for example). As leaders develop, however, the initial goal of achieving power evolves into a goal of empowering others to produce extraordinary outcomes. Leaders learn how to share or transfer power within the organization and eventually to release the power of others, usually through forms of delegation, such as the creation of ad hoc initiatives or new lines of business. This journey requires leaders to overcome a fundamental challenge: to embrace the counterintuitive lesson that in order to be more powerful, they must give up their need to control. Accordingly, they must, for instance, learn how to strike the optimal balance between the freedom and the oversight they provide subordinates. They must figure out how to pick the members of a team so the strengths of some compensate for the weaknesses of others. They must learn how to help people discover for themselves the solutions to problems.

The conflict domain. Early in their careers, leaders learn how to face into conflict and manage it, rather than avoid it. Still, they view conflict as an indicator that something is wrong and try to defuse it quickly to minimize its negative impact. In time, leaders learn how to use conflict as a means to an end and might even seek to create it – for example, provoking an organization to consider several competing views, address complex challenges, or move beyond obsolete beliefs, behaviors, and practices. Stimulating and guiding the right conflicts requires leaders to learn how to design and facilitate meetings where vigorous debate is the order of the day. Among other things, this means avoiding the subtle ways their own behavior can stifle an important exchange and modulating the amount of tension in the conflict so that a more robust debate of ideas can produce breakthroughs.

The relationship domain. As leaders master this domain, they deepen their ability to understand, appreciate, and relate to a broad spectrum of individuals with different styles and beliefs. This makes them increasingly effective in influencing people. Early in their careers, leaders must learn to resist the natural tendency to select direct reports whose background and approach are like their own. Recruiting a diverse team is particularly important when the markets or customers the team serves are themselves diverse. Later, leaders must learn how to think politically and plot a sequence of moves to break current interpersonal or organizational impasses.

The future domain. Starting out, most managers focus on attaining immediate goals – usually specific production, financial, or market share targets. As their careers progress, they learn to shape larger visions and strategies – redefining the nature of service delivery to customers, for example, or reinventing products that will establish new performance benchmarks. One of the most difficult lessons for leaders is realizing that although they need to be able to recognize a resonant vision, they do not have to create it themselves. By listening to and consulting with others, they can produce a picture of the future that speaks to people throughout the organization. To paraphrase Fritz Roethlisberger, a pioneer in human relations and organizational behavior: Most people think of what they're doing in the present as the means and the resultant future as the end. In fact, the future is the *means* and the present is the *end.* Sounds a bit like a Zen koan, but it hits the nail on the head.

The learning domain. Early in their careers, overachievers usually concentrate on excelling at their craft and grasping the rudiments of managing others. (Thompson spent an hour a day studying investment strategies in his first years.) They are less likely to pay attention to what others – direct reports and peers – might need to learn. Only later in their careers do they typically evolve into coaches who have the teaching skills required to help an individual or an organization enhance performance. The greatest stumbling block along this path is mistaking mandating for coaching. In most cases, a leader and a subordinate must undertake a joint exploration to build a developmental agenda that can not only fulfill the subordinate's aspirations but also enhance the performance of the business. Leaders discover that they can show their commitment to a subordinate's success through this process. The coaching that follows this exploration accelerates the subordinate's progress and strengthens his or her ties to the organization. This process is one of the best ways to ensure leadership continuity.

Executives naturally visit these domains as they take on a new role. In other words, they automatically seek to develop the skills and insights appropriate to each job cycle. As the climb proceeds and proficiency in a role grows, however, the quest for competency becomes less urgent and may dry up altogether. This loss of appetite should serve as a wake-up call – an early indicator of the onset of the summit syndrome, signaling the need to revisit the domains. Consciously exploring the domains and identifying the next set of needed competencies enables overachievers to reinvent their winning formulas.

When Andrew Thompson did so, he realized that he needed to resist the temptation to micromanage (which unintentionally caused him to treat his colleagues as glorified personal assistants). He had to learn how to delegate. Delegation would also free up time so he could join division-wide task forces, expanding his horizons and the reach of his leadership.

Thompson understood that reorienting his six wealth advisers to maximize their unique gifts and ensure that each developed his or her own niche on the team would require plenty of coaching and mentoring and the occasional application of tough love. To help them and to better serve the growing pool of large investors, he also needed to strengthen his group's support staff. He further recognized the need to create a compelling vision for his team: to double assets under management in the next five years while affirming the team's standing as best in breed in generating extraordinary returns for clients. Finally, to attract and advise sophisticated investors would require a flow of new investment ideas and products. Accordingly, Thompson would need to expand his network and collaborate with individuals and groups outside his own division–especially those with expertise in real estate, private equity, and emerging markets.

In other words, Thompson needed to broaden his network of relationships, generate and harness conflict, learn from other units in the firm, and influence colleagues over whom he had no direct authority. In each domain, Thompson understood, he had to evolve to the next level.

• • •

This process for recognizing and treating the summit syndrome can dissipate the disorientation that often strikes overachievers as they approach or reach the crest of a job. It can dispel the confusion and create a new context for a balanced, challenging, and fulfilling working life. Once they can see and accept that their condition is not unique, that a periodic reorientation is a natural and regenerative part of the inner work of leadership, overachievers can look ahead with far greater discernment.

Generally speaking, better mental maps foster wiser choices. Ultimately, some may decide (as Andrew Thompson did) to seek a different context in which to grow and excel in their current organizations. Others may reflect, then seek greener pastures. Summit work separates signals from noise.

The compass guiding this work is a four-part inquiry: first, understanding your winning formula (how it owns you, not the other way around) and the vital part it plays in feeling stale or losing your edge; second, reconnecting with a core purpose; third, recasting your current or future job to better align your inner aspirations with the external requirements of your work; and fourth, creating a developmental path to take a handful of core leadership competencies appropriate to the demands of the new situation to the next level.

None of this is easy, but for talented individuals and the organizations that rely on them, the vaccine of preventive awareness is far better than gambling on an after-the-fact cure once the crisis has fully manifested itself. Those who manage high performers can play a role by remaining alert to early symptoms of ennui and by using formal review conversations to bring to light the latent signs of emerging boredom.

Organizations can help in several other formal ways. They can educate high performers and their managers about the summit syndrome as part of leadership development programs. They can create opportunities for those most vulnerable to get a pulse check through brief outside assessments, online self-evaluations, or structured interviews conducted by trained senior mentors. Some of these approaches can be built into traditional performance review systems.

All parties – senior managers, human resource departments, and high performers themselves – must remember that a successful career is not a straight line to the top; it is a series of S-curves, each of which begins with a major promotion or job redefinition. Confusion and loss of bearings come with the territory, but they do not have to derail promising careers. Anticipating the summit syndrome, recognizing its onset, and dealing with it in its earliest stages can revitalize careers and propel talented leaders to greater heights.

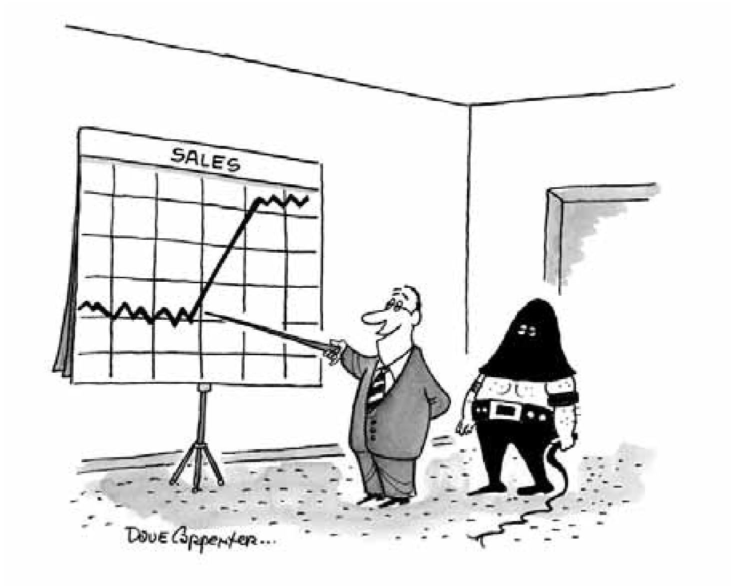
The vaccine of preventive awareness is far better than gambling on an after-the-fact cure once the crisis has fully manifested itself.

Reprint R0703E
To order, see page 145.

Taking Up the Slack

"A fundamental rule of management is that you can't change people's character; you can't even control their actions most of the time."

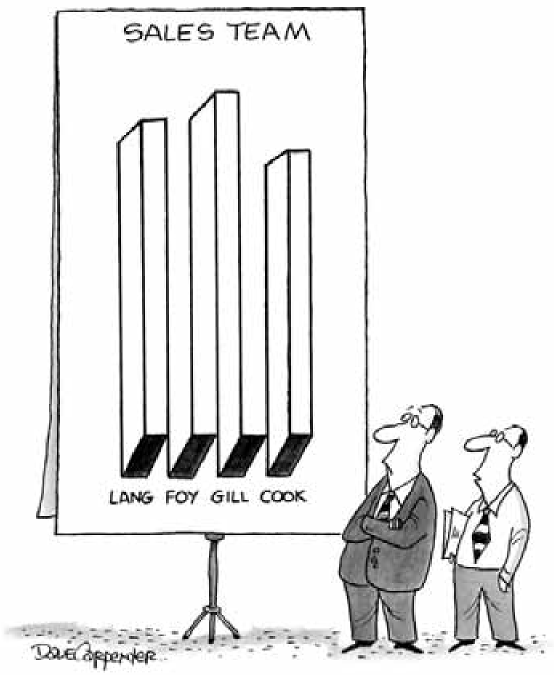
Nigel Nicholson
"How to Motivate Your Problem People"
Harvard Business Review
January 2003



"It was about here, wasn't it, Ed, when you came on board as sales manager?"

"If they staged a slowdown, how would we know?"

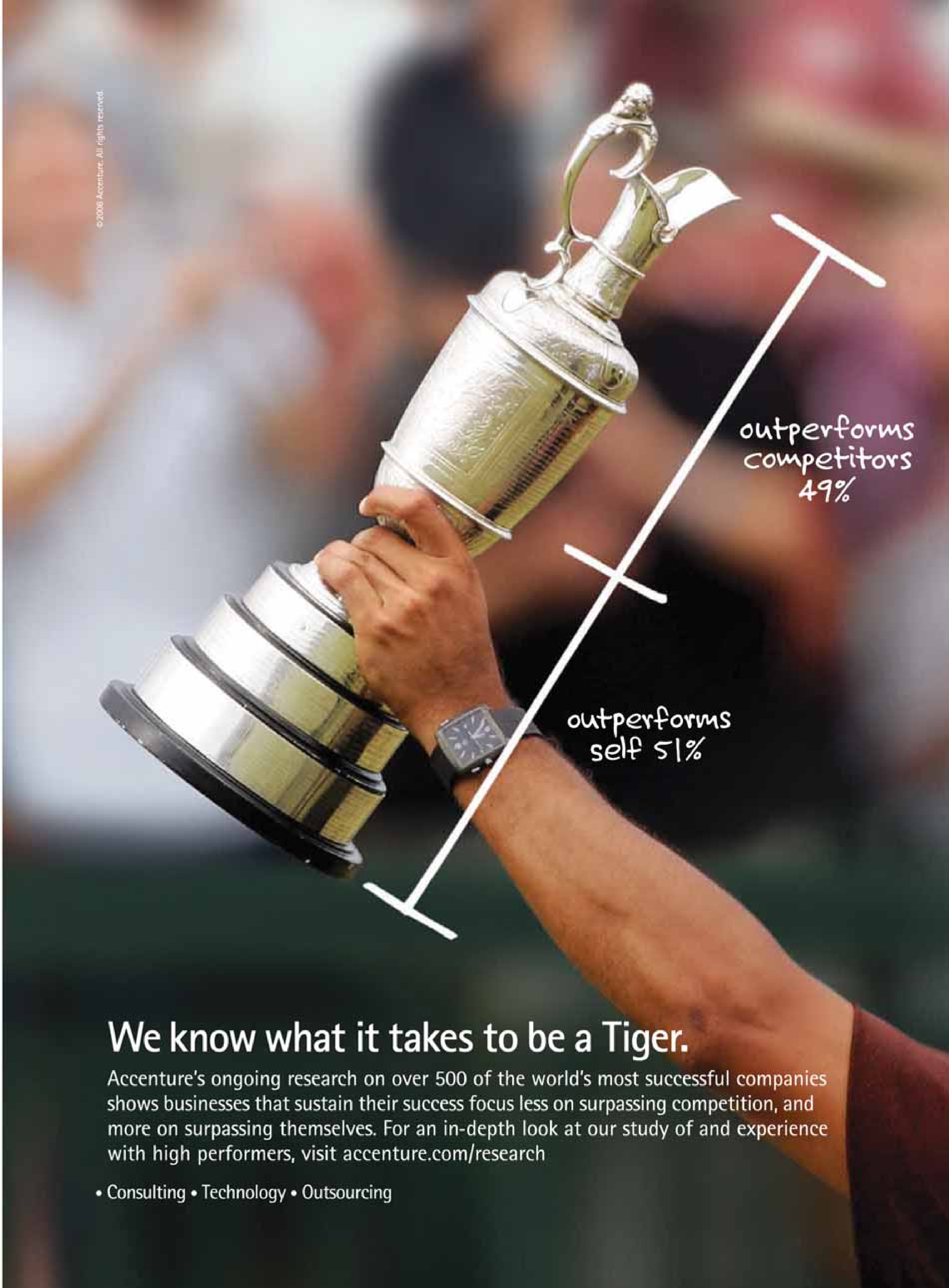
Dave Carpenter, Roy Delgado, Mike Lynch, and P.C. Vey



"We're not sure, but we think Foy just disappeared into the bureaucracy."

"He's bluffing."

"Note to managers: no more face-painting Fridays."



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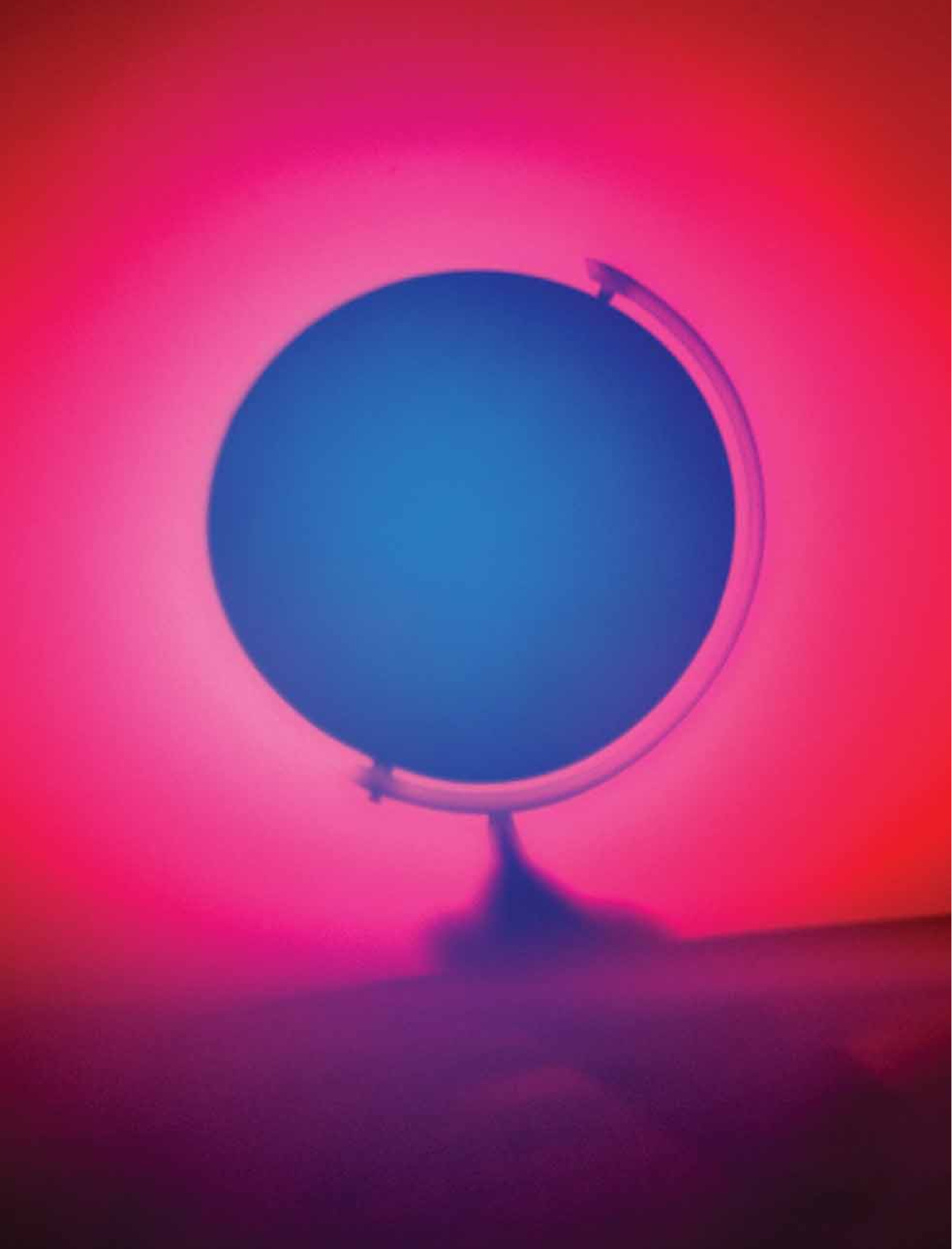

Climate change affects your company's competitive landscape in ways you might not realize. Here's how to map your risks – and opportunities.

COMPETITIVE ADVANTAGE ON A WARMING PLANET

by Jonathan Lash and Fred Wellington

WHETHER YOU'RE IN A TRADITIONAL smokestack industry or a "clean" business like investment banking, your company will increasingly feel the effects of climate change. Even people skeptical of the dangers of global warming are recognizing that simply because so many others are concerned, the phenomenon has wide-ranging implications.

Investors already are discounting share prices of companies poorly positioned to compete in a warming world. Many businesses face higher raw material and energy costs as governments around the globe increasingly enact policies placing a cost on emissions. Consumers are taking into account a company's environmental record when making purchasing decisions. There's a burgeoning market in greenhouse gas emission allowances (the so-called carbon market), with annual trading in these assets valued at tens of billions of dollars. Even in the United States, which has lagged the rest of the developed world in the regulation of greenhouse gas emissions, the debate is rapidly shifting from whether climate change legislation should be enacted to when and in what form.

Companies that manage and mitigate their exposure to climate-change risks while seeking new opportunities for profit will generate a competitive advantage over rivals in a carbon-constrained future. We offer here a guide for identifying the ways in which climate change can affect your business and for creating a strategy that will help you manage the risks and pursue the opportunities. We cite examples of very different companies – from Caterpillar to Wal-Mart to Goldman Sachs – that are responding to the various forces unleashed by the growing awareness among business leaders and consumers of the importance of climate change. Our message: It's not enough to do something; you have to do it better – and more quickly – than your competitors.

The Effects of Climate Change on the Planet

Let us stop here for a second and state our belief that climate change does in fact pose a serious problem for the world. The buildup of greenhouse gases in the atmosphere is changing the earth's climate at a rate unprecedented in history. The year 2005 was the warmest on record, and the ten warmest years have all occurred since 1980. Ice in the Arctic, the Antarctic, and Greenland is melting, and virtually all of the world's glaciers are shrinking.

Numerous studies suggest that the warming of the earth's oceans has resulted in more-powerful tropical storms, which generate their energy from warm ocean waters. For example, a U.S. government study released in May 2006 found that the warming of the tropical North Atlantic will contribute to more and stronger hurricanes. In fact, global data show that storms, droughts, and other weather-related disasters are growing more severe and more frequent.

These observed effects are the result of a roughly one-degree-Fahrenheit warming of the planet, an increase that would accelerate under current emission trends, thereby increasing the pace of physical and biological changes. (See the sidebar "How Much Warmer Will It Get?") Half of the fossil fuels ever burned have been used since the end of World War II, and emissions continue to rise rapidly. In order to halt the buildup of greenhouse gases in the earth's atmosphere, global emissions would have to stop growing at all in this decade and be reduced by an astonishing 60% from today's levels by 2050.

The consequences for the planet of inaction on climate change are becoming clear. But what exactly are the business implications?

The Effects of Climate Change on Your Company

Executives typically manage environmental risk as a threefold problem of regulatory compliance, potential liability from industrial accidents, and pollutant release mitigation. But climate change presents business risks that are different in kind because the impact is global, the problem is long-term, and the harm is essentially irreversible. Furthermore, U.S. government policies have offered companies operating in the United States little guidance as to how environmental policy may change in the future. Ignoring the financial and competitive consequences of climate change could lead a company to formulate an inaccurate risk profile.

While this obviously has been the case for utilities and energy-intensive industries like chemical manufacturing, it now holds true for most industries. In fact, the most important distinctions to be made when considering environmental risk assessment aren't between sectors but within sectors, where a company's climate-related risk mitigation and product strategies can create competitive advantage.

Government regulators aren't the only ones monitoring individual companies for inadequate climate-related practices. Big investors are beginning to demand more disclosure from companies. For example, the Carbon Disclosure Project, a coalition of institutional investors representing more than $31 trillion in assets, annually requests information from large multinational companies about their climate-risk positioning. Its most recent report, released in 2006, showed a marked increase not only in the awareness of climate change on the part of the respondents but also in the best practices being developed to manage exposure to climate risk.

Similarly, investor coalitions are filing shareholder resolutions requesting more climate risk disclosure from companies. More than two dozen climate-related resolutions were filed with companies in the 2004 to 2005 period, triple the number from 2000 to 2001.

As Wal-Mart CEO Lee Scott told us, a corporate focus on reducing greenhouse gases as quickly as possible is a good business strategy: "It will save money for our customers, make us a more efficient business, and help position us to compete effectively in a carbon-constrained world."

The far-reaching effects of climate change on business become clearer when you start to think about the different kinds of risk – most of which can be transformed into opportunities – and how they could affect the value of your company.

Regulatory risk. This is the most obvious area of impact, whether it takes the form of regulating emissions of the products you make (for example, automobile emission limits for

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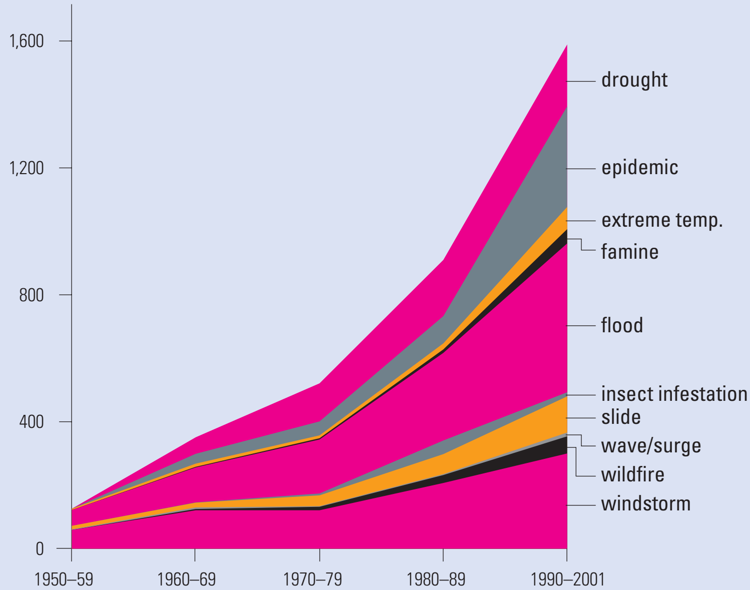
How Much Warmer Will It Get?

According to NASA, 2005 was the warmest year in over a century, and the ten warmest years have all occurred since 1980. The shrinking polar ice caps aren't the only apparent consequence: Storms, droughts, and other weather-related disasters – for example, epidemics, whose spread is correlated with temperature and moisture rates – are growing more severe and more frequent.

Frequency of weather-related disasters



Source: Swiss Re

All that, and the planet has warmed only by roughly one degree Fahrenheit. Most climate models predict a three- to eight-degree rise in global average temperatures if atmospheric concentrations of greenhouse gases reach twice preindustrial levels, something that will happen by 2050 if current trends continue. All of those models show some risk (between 5% and 15%) that the temperature will rise significantly more than that. Furthermore, there is a risk of unknown magnitude that positive feedback mechanisms in the climate system – for instance, the release of methane from melting permafrost in northern Canada, which could contribute to global warming and further melting of the permafrost – will create sudden, nonlinear accelerations in warming.

carmakers) or of the manufacturing process you use in creating those products. Companies in much of the world are already subject to the Kyoto Protocol, which aims to reduce carbon dioxide and other greenhouse gases by requiring developed countries – and, by extension, companies operating within those countries – to limit greenhouse gas emissions.

To meet Kyoto targets, the European Union's Emissions Trading Scheme, for example, grants companies *allowances* that authorize them to emit certain amounts of specified greenhouse gases. If a company's emissions are higher than its allotted allowances, it has to buy additional allowances from other companies. If its emissions are lower than its allotment, it can sell its unneeded allowances on the market. Companies can earn *credits,* which also give the holder the right to emit certain amounts of gases, by investing in emissions abatement projects outside their own organizations and even countries – as when, say, a French company invests in a wind-powered electricity generation project in Brazil. These credits can either be used to offset companies' own emissions or be sold on the market.

Even in the United States, which withdrew from the Kyoto Protocol, various regional, state, and local government policies increasingly affect companies. Seven northeastern states have adopted an agreement to cap carbon emissions from utilities and establish a carbon-trading scheme. (See the sidebar "A U.S. Carbon Market.") California has enacted regulations requiring that from 2008 to 2016, greenhouse gas emissions from new cars be reduced by 30% and has passed legislation to reduce total emissions to 1990 levels by 2020. A 2007 executive order also requires a reduction in the carbon content in motor fuels. Twenty states require utilities to obtain a percentage of the power they sell from renewable sources, and more than 218 U.S. cities have adopted programs to reduce emissions.

The U.S. government seems increasingly likely to take some sort of action, possibly in the near future. One 30-country survey, conducted by GlobeScan, shows that 76% of Americans believe global warming is a serious problem, and half believe it is a very serious one. (All the other countries surveyed except Kenya and South Africa reported even greater concern on the part of residents.) Numerous emission-reduction bills have been introduced in the U.S. Congress, and, although federal legislation is still at least several years away, U.S. companies' investments in capital equipment – from power plants to new buildings – represent financial commitments to carbon dioxide emissions that may become very costly under future regulatory regimes.

For most businesses, a comprehensive federal policy concerning climate change is preferable to a patchwork of state and local regulations. Consequently, U.S. companies are beginning to shift their political position; more than 40 *Fortune* 500 companies have announced that they favor mandatory federal regulation of greenhouse gases. In January 2007, a group of leading companies, including Lehman Brothers, Alcoa, and Pacific Gas and Electric, called for rapid enactment of mandatory, economy-wide regulatory programs to support a 10% to 30% reduction of greenhouse gases over 15 years in the U.S. At a Senate hearing in 2006, representatives of companies such as General Electric, Duke Energy, and Exelon made the case that it was time to move forward with legislation. They would rather know the rules soon, they said, than be surprised by sudden political urgency.

By immediately initiating an assessment of how future legislation might affect them, companies can manage the regulatory risk and, crucially, gain an advantage over less prescient rivals.

Supply chain risk. As they assess their susceptibility to future regulations, companies should also evaluate the vulnerability of their suppliers, which could lead to higher component and energy costs as suppliers pass along increasing carbon-related costs to their customers. Auto manufacturing, for instance, relies heavily on suppliers of steel, aluminum, glass, rubber, and plastics, all of whom are likely to be seriously affected by emissions regulations or – as in the case of aluminum manufacturing, a big consumer of energy – by regulations on their suppliers' suppliers.

A company should also take into account the geographical distribution of its supplier network. Executives should be aware of how many of their suppliers operate in, say, the European Union, where regulatory structures are already in place. In addition, executives must be mindful that the other climate-related risks discussed here could affect not just their own companies but their suppliers as well.

Product and technology risk. Some companies will fare better than others in a carbon-constrained future, depending on their ability to identify ways to exploit new market opportunities for climate-friendly products and services.

For example, a technology for converting coal into energy (IGCC, or integrated gasification combined cycle), while currently more expensive than traditional methods used in pulverized-coal plants, can lower aggregate carbon emissions through better efficiency and possibly carbon dioxide capture and storage. In doing so, IGCC would reduce the significant costs that coal-fired plants would face under stricter emissions standards. Companies at the forefront of commercializing such technologies could see significant revenue growth as demand for low-carbon products increases.

Opportunities are not limited to the manufacturing sector. An investment management firm in the United Kingdom, Generation Investment Management, offers investment products that factor in the climate risks facing companies held in its portfolios. The insurance company AIG offers brokerage and greenhouse gas management services to clients participating in markets, such as the one operating in the European Union, for the buying and selling of greenhouse gas emissions allowances and credits.

Indeed, these new carbon markets create all kinds of opportunities for professional services firms, particularly financial institutions. Among other things, financial services firms can help companies craft the complex hedging and trading strategies needed to minimize costs in such markets.

Litigation risk. Companies that generate significant carbon emissions face the threat of lawsuits similar to those common in the tobacco, pharmaceutical, and asbestos industries. For instance, in an unprecedented case spearheaded by the former New York attorney general Eliot Spitzer and currently being considered by the U.S. Second Circuit Court of Appeals, eight states and New York City have sued five of America's largest power companies, demanding that they cut carbon emissions. In a federal district court case in Mississippi, plaintiffs are suing oil and coal companies for greenhouse gas emissions, arguing that they contributed to the severity of Hurricane Katrina. The claims in that case include unjust enrichment, civil conspiracy (against the American Petroleum Institute), public and private nuisance, trespass, negligence, and fraudulent misrepresentation.

Companies that don't adequately address the issue of climate change also can create personal liabilities for directors and officers who become vulnerable to shareholder-related litigation. Swiss Re, for example, has found that such suits constitute a potential exposure in the company's directors and officers insurance portfolio.

Reputational risk. Companies also face judgment in the court of public opinion, where they can be found guilty of

A U.S. Carbon Market

The European Union's market that allows companies to buy and sell greenhouse gas emission credits granted under the Kyoto Protocol has received considerable attention. A similar kind of GHG market is beginning to form in the United States, at least on a regional basis, largely owing to the success of long-standing emissions trading systems for other kinds of air and water pollutants. The Regional Greenhouse Gas Initiative is a multistate government program aimed at reducing carbon dioxide emissions from power plants in the northeastern U.S. through a mix of emissions caps and the trading of emissions allowances. The initiative will govern GHG emissions from most electricity-generating units in the region that use more than 50% fossil fuel. Starting in 2009, and at the end of each three-year compliance period thereafter, each regulated source must own allowances equaling its aggregate carbon dioxide emissions during the period. Generating plants can buy, sell, bank, and trade allowances or purchase offset credits from other companies in ways that will keep their compliance costs as low as possible.

The consequences for the planet of inaction on climate change are becoming clear. But what exactly are the **BUSINESS IMPLICATIONS?**

selling or using products, processes, or practices that have a negative impact on the climate. The potential for consumer or shareholder backlash is particularly high in environmentally sensitive markets or in competitive sectors where brand loyalty is an important attribute of corporate value. In a recent study analyzing the impact of climate change on brand value, The Carbon Trust, an independent consultancy funded by the UK government, found that in some sectors the value of a company's brand could indeed be at risk because of negative perceptions related to climate change. As is the case in other risk areas, companies can turn reputational risk into an opportunity by leveraging practices that show them to be good citizens of the planet.

Physical risk. Finally, there is the direct risk posed by the changing climate itself: physical effects such as droughts, floods, storms, and rising sea levels. The insurance, agriculture, fisheries, forestry, real estate, and tourism industries are particularly exposed because of their dependence on the physical environment and the elements. Physical climate risk can also affect sectors such as oil and gas through higher insurance premiums paid on assets located in vulnerable areas. Munich Re, for instance, raised its rates for insuring Gulf Coast oil rigs by 400% in the days after Hurricane Katrina struck. And ripples of physical risk can extend into some unexpected areas: For instance, Coca-Cola studies the linkages between climate change and water availability and how this will impact the location of its new bottling facilities.

Because companies' exposure to each of these six aspects of climate risk differs greatly, it is essential to generate tailored climate-risk profiles and strategies to mitigate the risk. Of course, companies in a given sector will have similar exposure to certain risks. For example, regulatory risks are more important in the power sector, while supply chain risks are critical in retail industries. But there also are differences within sectors – for example, varying levels of reputational risk.

It's important to remember that for some industries there is a direct upside to climate change, because government policy and public concern will create new needs and new markets. For instance, the "green buildings" market has historically occupied a tiny niche in the construction industry. Now, rising energy prices and resurgent public concern about sustainability have transformed the markets for environmentally friendly materials and technologies into explosive growth areas. The National Association of Homebuilders, for instance, estimates that green buildings will account for 5% to 10% of housing starts in 2010, up from 2% in 2005.

The venture capitalist John Doerr was recently quoted as saying that green technology could match information technology and biotechnology as a significant money-making opportunity. He called climate change "one of the most pressing global challenges" and said that the resulting demand for innovation would create the "mother of all markets."

Improving Your Company's Climate Competitiveness

In working with firms as they assess their exposure to climate change and begin to develop climate strategies, we have found that the most successful efforts include four key steps, each of which requires strong leadership at the top and involves significant learning across the organization.

Step 1: Quantify your carbon footprint. Since you can manage only what you measure, companies need to first understand the source and level of their own greenhouse gas emissions and begin tracking those emissions over time. This quantitative and relatively straightforward task can lead to heightened consciousness of climate change issues within a company and set the stage for a broader look at the strategic risks and opportunities they pose.

In quantifying their carbon footprint, companies need to create an accurate inventory of their greenhouse gas emissions. They should differentiate between direct and indirect emissions – that is, between their own "smokestack" emissions and those resulting from their energy consumption, travel, and other activities. They should also establish and adjust emissions baselines and evaluate best practices in reporting this information. The aim is to identify and prioritize emission reduction opportunities and establish strategies for participating in greenhouse-gas-trading markets.

One method for performing this kind of accounting is the Greenhouse Gas Protocol, which our organization developed with the World Business Council for Sustainable Development. This tool, which has been taken up by the International Standards Organization, has been used by several hundred companies to measure and track their own greenhouse gas emissions and by industry groups, including the International Aluminum Institute and the International Council of Forest and Paper Associations, to develop complementary industry-specific calculation tools. (For a detailed explanation of how to use the protocol – along with a tool to help assess the value of emissions reduction initiatives and to factor climate-related costs into decisions on new capital projects – go to www.ghgprotocol.org.)

The pharmaceutical giant Pfizer has set guidelines requiring it to reduce its environmental footprint by lowering energy consumption. But that goal would be meaningless unless the company first created a systematic audit of its current activities that have a direct and indirect impact on greenhouse gas emissions. Having done that, the company can now identify possible conservation and emissions efficiency projects, which it reports through a companywide energy database. Pfizer has identified more than 600 such projects at all levels of the company.

Companies that quantify their footprints send a strong signal that they recognize the importance of climate change as a business risk – and an opportunity. We know of companies that began by conducting a carbon audit to uncover inefficient and costly energy practices and then moved on to identify opportunities for brand enhancement around the issue of climate change. As we'll see, these companies eventually leveraged their knowledge about climate-related issues to develop new and profitable products.

Step 2: Assess your carbon-related risks and opportunities. The emissions footprint tells only part of the story. After determining the direct and indirect impact your company is having on the climate, you need to broaden your analysis and think strategically about how the six risks could hurt – or offer opportunities that better position – your business.

The forest products company Weyerhaeuser, whose mills create a significant carbon footprint, has committed to reducing operational emissions by 40% by 2020. But the company should also be considering climate-related issues beyond its emissions profile. Will the transportation costs to deliver its products rise significantly in a carbon-constrained economy? Are there potential physical effects of climate change on its main raw material, trees, such as greater damage by wood beetles because of milder winters?

Another way to assess the effect that climate-related forces will have on your company is to consider their direct and indirect financial impact. You can look at the "carbon intensity" of your profits – that is, what percentage is derived from products with high carbon dioxide emissions. Or you can look at ways in which climate change could affect your revenues and costs. On the cost side, climate change may drive increases in raw material costs, direct regulatory costs, capital expenditures (for example, new facilities with lower emissions levels), insurance premiums for assets located in at-risk areas (such as the Gulf Coast), and possibly even new tax liabilities. Revenues will be affected by your ability to pass these costs on to customers through new pricing structures while exploiting new market opportunities and maintaining market share. (See the exhibit "Climate Change and Profitability.")

The interplay among the various elements of climate-related risk affects a firm's cost of capital and ultimately its valuation. Investors will factor a company's climate exposure into estimates of its future cash flow streams. The degree to which cash flow is sensitive to climate risk will also affect how much cash is available for interest expense and amortization of a company's debt, ultimately affecting its ratings on bonds and bank debt. Calculating the impact of climate risk on cash flows and costs of capital is critical to understanding your company's ability to compete in a carbon-constrained future.

Climate Change and Profitability

One way to look at how climate-related forces will affect your company is to consider their impact on both costs and revenue. A company's ability to find opportunities in a carbon-constrained world will depend on its skill at hedging against physical climate risk, mitigating regulatory costs, avoiding expensive litigation and other threats to corporate reputation, managing climate risk in the supply chain, investing capital in low-carbon assets, and innovating around new technology and product opportunities.

Here are some prototype questions companies might ask themselves.

Potential Revenue Drivers

- How will changes in customer demand patterns affect pricing?
- What percentage of climate-related costs will we be able to pass through to customers?
- How can we generate streams of revenue from new low-carbon products?
- What new forms of income (for example, carbon credits) will become available?
- What threats do we face from low-carbon substitute products?
- What will be the impact of weather patterns on revenue?

Potential Cost Drivers

- How will regulatory policy affect our costs? (Will we need to purchase emissions allowances?)
- Is there a chance that emissions will also, or alternatively, be taxed?
- What capital expenditures do we face as a result of emissions-reduction plans?
- How much will our raw materials costs escalate? How much will those of our suppliers escalate?
- How much will our energy costs rise?
- How will our risk profile affect our insurance premiums?

Step 3: Adapt your business in response to the risks and opportunities. Having assessed the ways in which climate change could affect your company, you will be prepared to develop strategies and make moves based on that knowledge. Those moves range from the obvious reductions in energy consumption and carbon emissions to sometimes wholesale reinventions of parts of your business.

Caterpillar is investing in making its already relatively low-emission diesel engines more efficient. It also has found opportunity in the risk of greater regulation by building a new business that makes particulate filter systems to be retrofitted on its own and others' engines. The company is studying turbines that run on alternative fuels, as well as combined heat and power generation turbines that recover waste heat. It is poised to commit significant R&D funds to these projects as soon as U.S. regulations put a cost on carbon emissions, thus making alternative fuels and technologies more attractive.

Creative moves aren't restricted to heavy manufacturing and other industries traditionally unfriendly to the environment. Wal-Mart is in the middle of a three-year plan to reduce energy use at its stores by up to 30%. The initiative, part of a highly publicized plan to boost energy efficiency, cut down on waste, and reduce greenhouse gas emissions, was launched not only to meet current or anticipated regulations but to burnish the company's reputation in an area where it had been attacked by critics.

In a lower-emissions sector, financial services, another industry in which reputation is important, Goldman Sachs has implemented a coordinated environmental-policy framework that, among other things, requires the measurement and reporting of greenhouse gas emissions attributable to its internal operations. The firm also is active in the burgeoning market for carbon allowances and has a team dedicated to doing research for clients on how environmental issues such as climate change can affect stock market valuations. The company's stated aim for these programs: to boost earnings.

"We're committing people, capital, and ideas to find effective market-based solutions to some of the most critical challenges facing the planet," Mark Tercek, the managing director of the Goldman Sachs Center for Environmental Markets, told us. "We see this as being entirely consistent with our central business objective of serving our clients and creating long-term value for our shareholders."

Step 4: Do it better than your competitors. If Tercek is to be proved right, though, a "doing well by doing good" approach won't be enough: You have to be better at it than your competitors. And that means beating them in both areas: reducing exposure to climate-related risks and finding business opportunities within those risks.

Take the auto industry, which we have studied in detail. Consumer concerns about national energy security, climate change, local air pollution, and the cost of filling up at the pump are shaping the competitive dynamics within the industry. In mapping the climate competitiveness of the major automakers three years ago, we looked at two things: how well they were positioned vis-à-vis climate risk and how they were managing climate opportunities. The analysis found that Honda and Toyota were best positioned to sell cars in a carbon-constrained economy, not only because their current fleets were more fuel efficient than most of their rivals' but also because they were leaders in the commercialization of hybrid vehicles. GM and Ford were burdened with above-average cost exposure because of the high proportion of fuel inefficient vehicles like SUVs and pickup trucks in their product lines. (Even among these gas-guzzlers, carbon emissions vary by as much as 40%, with the U.S. automakers' models being the least fuel efficient.) Detroit's failure to develop innovative low-carbon technologies may be the greatest obstacle to their recovery. (For a look at how other automakers performed, using a matrix that could be applied to any industry, see the exhibit "Plotting Your Climate Competitiveness.")

General Electric has actively pursued competitive advantage through its climate policies. In 2003, it began using the Greenhouse Gas Protocol to construct an emissions inventory, allowing it to quantify its regulatory risk. It also joined a group of companies from different economic sectors – including Bristol-Myers Squibb, Citigroup, Con Edison, Johnson & Johnson, and Staples – to discuss climate strategies and learn from peers.

GE then began to think more strategically about how climate change could affect its business and that of its customers. In 2005, the company launched what it called Ecomagination, a coordinated product offering that features clean technologies that serve the transportation, energy, water, and consumer product sectors. GE's goals for the program were to double its annual investment in clean technologies to

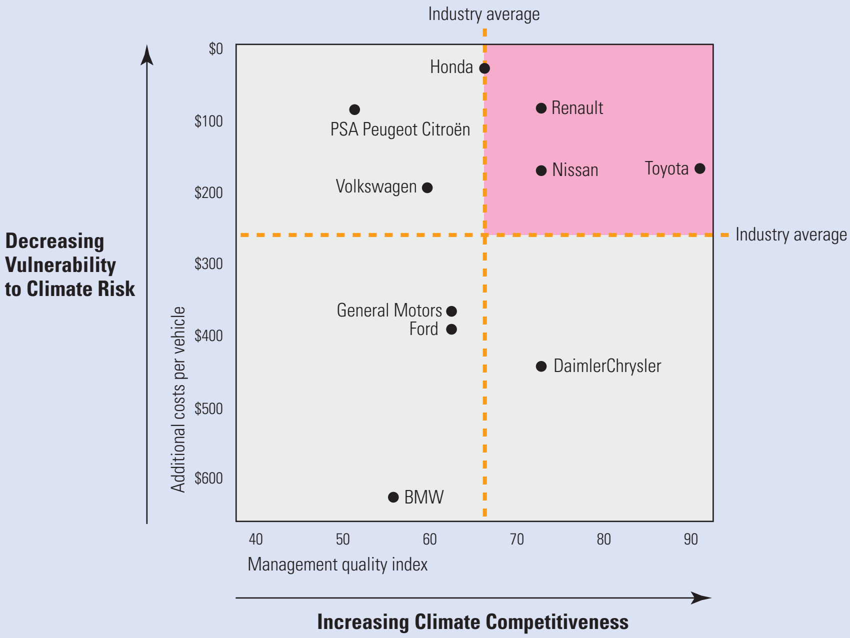
YOUR COMPANY NEEDS TO BEAT COMPETITORS IN TWO AREAS: reducing exposure to climate-related risks and finding business opportunities within those risks.

Plotting Your Climate Competitiveness

Reducing your exposure to climate risk and creating new opportunities for profit are both important steps in building your climate competitiveness. But if your competitors are doing these things better, your company is losing ground.

In 2003, we mapped the climate competitiveness of the ten largest global automakers, looking at their vulnerability to risks and their ability to seize opportunities. Our analysis was conducted with Sustainable Asset Management, an investment management firm. Specifically, we evaluated the vulnerability of each automaker's current product line to further fuel-economy regulation by calculating the estimated cost per vehicle to meet new emissions standards during the following decade. We also analyzed how well the companies were managing climate opportunities. Using a zero-to-100 scale, we qualitatively assessed how advanced each automaker was in its ability to commercialize, market, and mass-produce vehicles using one or more low-carbon technologies – hybrid battery-and-gasoline, for example, or fuel-cell technology. Perhaps not surprisingly, we found that Honda and Toyota were best positioned to sell cars in a carbon-constrained economy, both because their current fleets were relatively fuel efficient and because they were ahead of rivals in commercializing new technologies.

To determine where your company stands with respect to your competitors, you can map your own industry using these two variables – positioning against risks and preparedness to seize opportunities. In doing so, you are likely to uncover ideas on how to move to a position of competitive advantage.



$1.5 billion by 2010 and to increase to at least $20 billion the revenue generated from products and services that offer customers measurable environmental performance advantages.

GE is already well on its way to reaching perhaps the most critical element of this strategy: increasing profits. Revenues from Ecomagination products reached $10.1 billion in 2005, with orders and commitments nearing $17 billion. And the R&D program is already paying off, with a 75% increase in certified Ecomagination products brought to market.

The aggressive moves by GE and other forward-looking companies show that climate change isn't a topic to repeatedly table until next year's meeting. It is already influencing the competitive dynamics in markets all over the world. As GE chairman and CEO Jeffrey Immelt recently commented, "Our customers have made it clear that providing solutions to environmental challenges like climate change is essential to society's well-being, and a clear growth opportunity for GE. Companies with the technology and vision to provide products and services that address climate and other pressing issues will enjoy a competitive advantage." Or, to put it differently, they will do not just well but *better* by doing good.

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To order, see page 145.

Every company needs a "signature experience" that sets it apart. By explicitly communicating what makes your firm unique, you can dramatically improve employee engagement and performance.

What It Means to Work Here

by Tamara J. Erickson and Lynda Gratton

IT'S THE HR EQUIVALENT OF KEEPING UP with the Joneses: In their quest to find and retain top talent, businesses often try to match competitors' offers, ensuring that their compensation schemes, health care benefits, training programs, and other talent-management practices are in line with the rest of the industry's. While this strategy may be useful for bringing job candidates to the door, it's not necessarily the most effective way to usher the right people across the threshold – great employees who will be enthusiastic about their work and fiercely loyal to the organization and its mission.

Jason Greenberg

Nor does marching in lockstep with industry standards prompt companies to consider what's unique about their histories and values or potential employees' attitudes about work. Certainly, reasonable pay and a breadth of health care options matter to prospective hires, as do the tasks they'll have to perform. But people also choose jobs – and, more important, become engaged with their work – on the basis of how well their preferences and aspirations mesh with those of the organization.

Imagine yours is one of three job offers a talented candidate is mulling over. She hears a little about the orientation program at each firm. At your company, the first three months are probationary: As a new hire, the candidate would work closely with an assigned team, and when 90 days are up, the team members would vote on whether she stays or goes. Management won't have the final say. At the second company, the candidate would work on a series of fast-paced, creative projects during her first three months, under the close scrutiny of senior management. At the end of that period, she'd be expected to find a project that matched her skills. In the third company, the new hire would undergo intensive training during the first three months, learning the organization's well-defined ways of doing business; after that, she would apprentice for an extended period with one of the firm's strongest performers.

None of these orientation experiences is inherently better than the others; the prospect will pick the company whose entry program most closely reflects her own values and preferences. If she loves risk and can put up with ambiguity, she might relish the challenges and the pace of the second company but would probably be miserable with the constraints of the third. If she enjoys collaborative work, she might gravitate toward your company.

These examples underscore the importance of employee preferences in the war for talent. Unfortunately, they are often overlooked. What truly makes good companies great is their ability to attract and retain the right people – employees who are excited by what they're doing and the environment they're operating in. Such people are more likely to be deeply engaged in their work and less likely to chase after slightly better salaries or benefits. They will find ways to satisfy their own preferences and aspirations while meeting the organization's need to come up with creative and productive solutions to business problems. Their commitment becomes contagious, infecting customers and prospective employees. Indeed, engaged employees are the antithesis of hired guns rotating in and out of critical roles – they're productive for the long term.

Companies that successfully create and communicate signature experiences understand that different types of people will excel at different companies, and that not all workers want the same things.

You won't find and keep such individuals simply by aping other companies' best practices or talent-management moves, however. You need to be able to tell new and prospective hires what it's like to work at your company, to articulate the values and attributes that make working at your firm unique. You need to provide a "signature experience" that tells the right story about your company. In the process, you'll empower the people who share your values and enthusiasm for work to self-select into your firm, thereby creating the foundation for highly productive employee-employer relationships.

Bringing Distinctiveness to Life

A signature experience is a visible, distinctive element of an organization's overall employee experience. In and of itself, it creates value for the firm, but it also serves as a powerful and constant symbol of the organization's culture and values. The experience is created by a bundle of everyday routines, or signature processes, which are tricky for competitors to imitate precisely because they have evolved in-house and reflect the company's heritage and the leadership team's ethos.

The concept of signature experiences grew out of organizational research we've conducted during the past five

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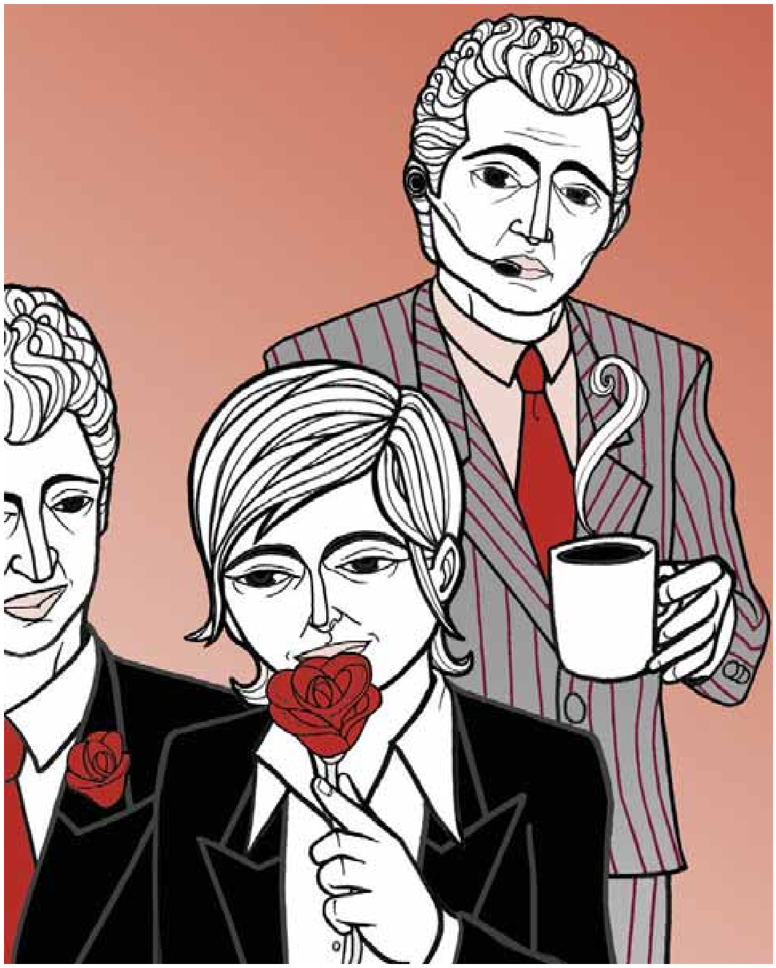
years. Initially, we looked closely at companies with highly engaged employees (as measured by workplace surveys and other tools) and set out to compile a checklist of the common practices these businesses used to foster enthusiastic, committed, mission-aware employees at all levels. Surprisingly, their approaches to talent management varied greatly. For instance, some firms paid well above the mean while others paid below it. Some boasted highly flexible, self-scheduling work groups; others featured more structured, "all hands on deck" environments. The companies' underlying philosophies about the employer-employee relationship also varied, from paternalistic to hands-off.



The more we looked, the more we realized that the variation in practices was not just noise in the system; it was, in fact, a critical element of the companies' ability to achieve high levels of employee engagement. These organizations excel at expressing what makes them unique. They know what they are, and it's not all things to all people. They understand their current and future employees as clearly as most companies understand their current and future customers. They recognize that individuals work for different reasons and accomplish tasks in different ways. And they demonstrate what they are vividly, with stories of actual practices and events, not through slogans on the wall or laminated values cards on every desk. As a consequence, these companies hire people who easily and enthusiastically fit in, and thereby cultivate a more committed workforce. To understand how these companies attract, engage, and retain the right kind of talent, let's take a closer look at the three signature orientation experiences we described earlier.

Whole Foods Market. The first signature experience – team-based hiring – is similar to the orientation experience at Austin, Texas–based Whole Foods Market. Potential hires are informed that each department in each store (meat, vegetables, bakery, and so on) comprises a small, decentralized entrepreneurial team whose members have complete control over who joins the group. After a four-week trial period, team members vote on whether a new hire stays or goes; the trainee needs two-thirds of the team's support in order to join the staff permanently. This signature experience is in line with Whole Foods' profit-sharing program. Thirteen times a year, the company calculates the performance of each team. Members of the teams that do well receive up to $2 per hour extra in their paychecks. That bonus pay is explicitly linked to group rather than individual performance, so team members choose their trainees carefully – they want workers, not buddies. This entry into the company undoubtedly weeds out lone wolves and conveys a strong message about the firm's core values of collaboration and decentralization. This signature experience seems to be working: Whole Foods has appeared on *Fortune*'s list of the 100 Best Companies to Work For nine years in a row.

Trilogy Software. The second orientation experience described earlier – trial under fire – is patterned after the signature experience at Trilogy Software, a rapidly growing software and services provider also based in Austin, Texas. New employees go through an exhausting three-month immersion process, a sort of organizational boot camp, in which top management, including the CEO, oversees their every step. In the first month, new recruits participate in fast-paced creative projects, in teams of about 20, under the mentorship of more-experienced colleagues called section leaders. In the second month, the project teams are shuffled and split into smaller "breakthrough teams" charged with inventing product or service ideas, creating business models, building prototypes, and developing marketing plans – all in hyperaccelerated fashion. In the third month, the recruits have to demonstrate their capacity for personal initiative. Some continue working on their breakthrough teams; others find sponsors elsewhere in the company and work on their projects. Upon completion of the program, candidates undergo rigorous evaluation and receive detailed feedback on their performance from colleagues, section leaders, and senior management. The new hires are sent to different parts of the organization, but the bonds they develop during this extreme orientation period remain strong throughout their careers.

Trilogy's signature orientation experience serves as the company's primary R&D engine: Recruits' projects have produced more than $25 million direct revenues and have formed the basis for more than $100 million in new business. The experience also serves as a proving ground for Trilogy's next generation of leaders: the mentors and coaches who guide the members of the breakthrough teams as well as the new hires themselves. Most important, Trilogy's orientation experience provides a compelling illustration of life in the firm. A candidate who prefers a clear-cut, well-defined work environment will almost certainly decline after hearing the details of the immersion process. But a candidate who likes intense challenges and can tolerate some ambiguity early on will probably jump right in.

The Container Store. The third orientation experience – extensive training and indoctrination in a proven approach – is from the Container Store, a Dallas-based retailer of storage solutions ranging from the basic (Tupperware) to the sophisticated (customized shelving systems). Some of its products are quite expensive – a single custom-designed closet system, for instance, may cost several thousand dollars – so the floor staff's ability to meet customers' expectations can have huge financial implications. Because the company depends on employees to be capable of suggesting storage options that will match a customer's requirements, its induction process consists of immediate and intense training. All new hires in the stores, distribution centers, and headquarters (full-time and seasonal employees) go through Foundation Week – five days dedicated to absorbing information about the Container Store's products, processes, and values, plus extracurricular HR paperwork and reading. New employees assume regular work schedules only after having completed the five full days of training – and even then they usually apprentice for a while with some of the company's star performers. The employee education doesn't stop there: In their first year at the Container Store, all staffers receive at least 235 hours of formal training, compared with an average of about seven hours in the retail industry overall. Employees spend time in different functions and units to gain a broader perspective and to learn about the company's strategic challenges.

The Container Store's signature experience sends the right messages about employee fit and long-term opportunities: More than 40% of new employees are recommended by friends who work for the company. Employee surveys reveal that, on average, 97% of them agree with the statement, "People care about each other here." And employee turnover is less than 30%, significantly lower than the industry average. Obviously, some job applicants will be impressed with the clarity and rigor of the Container Store's commitment to

A Job by Any Other Name

As many societies become increasingly affluent, more and more people have the luxury of allowing work to fill a variety of roles in their lives. Studies conducted by Tamara Erickson and researchers Ken Dychtwald and Bob Morison suggest that work plays six general roles, which correspond to six types of employees, based on psychodemographic characteristics. Each worker segment cares deeply about several aspects of the employee-employer relationship and little about the others.

Employee Type	Expressive Legacy	Secure Progress
The Role of Work	*Work is about creating something with lasting value.*	*Work is about improving one's lot in life and finding a predictable path.*
What Appeals and Engages	Autonomy Entrepreneurial opportunities Creative opportunities Stimulating tasks that enable continual learning and growth	Fair, predictable rewards Concrete compensation, solid benefits and retirement package Stability Structure and routine Career training

training; others won't. But a hiring manager's description of this intense orientation experience certainly sends a clear signal to a potential employee about what it takes to succeed at the company.

By defining and communicating their core values and distinctive attributes in unique and memorable ways, Whole Foods Market, Trilogy Software, and the Container Store empower potential hires to make well-informed employment choices. These companies likewise are increasing the probability that they're bringing aboard highly engaged and highly motivated workers.

Finding Your Signature

Companies that successfully create and communicate signature experiences understand that different types of people will excel at different companies, and that not all workers want the same things. In a series of studies conducted jointly with researchers Ken Dychtwald and Bob Morison, Tamara Erickson categorized workers into six segments on the basis of why and how they like to work. Some care deeply about the social connections and friendships formed in the workplace, for instance. Others just want to make as much money with as much flexibility and as little commitment as possible. Some have an appetite for risk. Others crave the steadiness of a well-structured, long-term climb up the career ladder. (See the exhibit, "A Job by Any Other Name.)

The firms we've studied that have engendered highly productive, highly engaged workforces acknowledge and address these differences more effectively than their competitors. Specifically, they follow some general principles for creating, supporting, and preserving their unique employee experiences:

Target a segment of potential employees. Most executives can tell you which consumers will buy their products or services. Few have the same insight into which job candidates will buy into the organization's culture and adapt to its workflow. Companies that target potential employees as methodically as they do potential customers can gain a sustainable market advantage. That's been the case at JetBlue. Since its launch in 1999, the airline has defied many common industry practices, including the traditional approach to flight reservations. When most airlines were using standard call centers, JetBlue devised a system based entirely out of employees' homes. This has become one of the airline's signature experiences and part of its organizational lore, attracting a strong and productive base of employees who find flexible schedules more valuable than above-average compensation.

According to founder and CEO David Neeleman, it was more than cost savings that prompted the company to create this signature experience. Like the flight crew, the reservations agents are the face of JetBlue, responsible for ensuring high levels of customer satisfaction that will translate into increased revenues. The company couldn't afford to pay the agents huge salaries, however, so senior management decided to appeal to them in a different way – by letting them work from their homes. "We train them, send them home, and they are happy," Neeleman says.

Individual Expertise and Team Success	Risk and Reward	Flexible Support	Low Obligation and Easy Income
Work is about being a valuable part of a winning team.	*Work is one of multiple opportunities to live a life filled with change and excitement.*	*Work is a source of livelihood but not yet (or not currently) a priority.*	*Work is a source of immediate economic gain.*
Collaboration Fun Stability and structure Opportunity to gain competence Opportunity to leverage personal strengths	Opportunity to improve personal finances Flexibility Opportunity to choose tasks and positions from a long menu of options Open-ended tasks and approaches to getting work done	Flexibility Well-defined vacation and family benefits Well-defined work routines – the ability to plug in and out of tasks and assignments with ease Virtual, asynchronous tasks and assignments Fun	Jobs that are relatively easy to come by Well-defined work routines Lucrative compensation and benefits packages Stability and security Recognition

Source: A statistical survey of the U.S. workforce conducted jointly by the Concours Institute and Age Wave, a research and communications company, and funded by 24 major corporations.

JetBlue tries to accommodate call center agents' varied scheduling requirements – some may work only 20 hours a week, for instance, or may need to swap shifts at the last minute – but the airline balances those preferences against its business objectives. Employees have unlimited shift-trading privileges, which they can negotiate using an online community board. This self-scheduling process keeps employees motivated and satisfied, which means they're more likely to provide better customer care. For its part, JetBlue has enjoyed a 30% boost in agent productivity, a 38% increase in customer-service levels, and a 50% decrease in management workload per agent, compared with industry norms.

Most executives can tell you which consumers will buy their products or services. Few have the same insight into which job candidates will buy into the organization's culture and adapt to its workflow.

Bright Horizons, a leading provider of employer-sponsored child care, has crafted a signature experience that also begins with the reconceptualization of a critical organizational role – that of the classroom teachers in its centers. These individuals are never referred to by common terms such as "child care worker" or "babysitter." Instead, Bright Horizons hires "early childhood educators" for its classrooms, thereby attracting people who see themselves as long-term professionals in a field full of temp workers. This important shift sets the stage for an employee experience in line with the firm's mission statement, which, among other things, pledges to "nurture each child's unique qualities and potential" and to "create a work environment that encourages professionalism." Reinforcing this signature experience are the company's team-based approach to hiring; a welcome program that makes it clear to new hires (and their families) that they have joined an organization that is serious about excellence and professionalism; and strong skills-based training and promotion opportunities. In an industry known for high turnover – the average is about 50% – Bright Horizon's turnover runs from 20% to 22%.

Address specific business needs. Some companies' signature experiences stem from critical business needs. For instance, several years ago Lord John Browne, the CEO of BP, was faced with the daunting task of bringing together five oil companies BP had recently acquired. The challenge was to create a culture of learning across the company's 120 business units; without such integration, none of the anticipated cost-benefit synergies would materialize. At the time, many of the business unit heads were adept at competing, but few were adept at collaborating. To address this gap, Browne and his colleagues developed a signature experience called "peer assist." The business unit heads are assigned to peer groups representing as many as 13 units, and the members are required to exchange ideas and information about what is and is not working in their businesses. (To encourage knowledge sharing, much of each business unit leader's bonus pay depends on the performance of the whole peer group.) Employees are learning from one another. Thanks in part to these cross-platform groups, BP has met its financial targets and talent-management criteria. The beauty of this signature experience is that it clearly demonstrates Browne's basic operational philosophy: Peers working together will be the foundation of BP's success. Managers who can't buy into the signature experience won't waste their time or the organization's.

Identify and preserve your history. The seed of a signature experience already exists in many companies. Their challenge is to find it, extend or shape it to the needs of today's business, and protect it. Consider Royal Bank of Scotland, which can credit its rise from a small national bank to one of the largest financial institutions in the world to a work environment that values action and speed. Those who do best in the bank deliver high-quality results quickly and under intense pressure – which is why prospects need to hear about RBS's historic signature experience.

In the eighteenth century, when the financial institution was founded, banking was a gentleman's pursuit. The day's business was usually completed by lunchtime so that businessmen could get on to more important matters in the afternoon – fishing, hunting, and the like. That schedule was made possible by the morning meeting. Now, of course, banking is a 24-hour business, and there's much less time for afternoon jaunts through the Scottish hills. But the morning meeting lives on. Successive RBS CEOs have adopted this practice and made it their own. The current executive team meets with the chief executive, Sir Fred Goodwin, every morning between 8 and 9 to talk about the previous day's events, go over that day's agenda, and plan for the future. The sessions force employees to think about speed to market; RBS talks about completing projects within 30, 60, or 90 days – there is no mention of weeks or months. The morning meetings reinforce the collective accountability of the senior team.

RBS knows that early morning meetings and short-term, fast-paced projects won't appeal to everyone. So its signature experience sends an explicit message to potential hires: There are plenty of jobs out there for those who need a caffeine jolt and a few minutes with the *Times* before making a decision – just not at RBS.

Another firm with a signature experience rooted in its history is W.L. Gore & Associates, a private firm headquartered in Delaware. The company's best-known product, Gore-Tex, is used in clothing worn by adventurers the world over. W.L. Gore attributes its steady growth to an employee experience built around the so-called "lattice" system of management – no hierarchies, no predetermined channels of communication, and no defined jobs locking associates (they're never called employees) into particular tasks. This approach, which founder Bill Gore introduced more than 40 years ago, has been protected and reinforced ever since. Associates have sponsors, not bosses. They don't have jobs; they make voluntary promises to meet general expectations within functional areas – running a particular machine, for instance, or crunching numbers. For their part, sponsors commit to helping new associates find "quick wins" – projects that put the recruits on a fast track for success while acclimatizing them to the organization.

W.L. Gore's general processes uphold this signature experience. For instance, associates are compensated on the basis of the quantity, quality, and financial outcomes of their work. Performance is reviewed twice each year, and peers and sponsors get to weigh in on their colleagues' work. They share their feedback with a compensation committee – there are about 15 such committees within the company, one for each functional area of the business – that then ranks people who handle a particular function from the highest contributor to the lowest. (The associate's rank is determined by contributions to the success of the business, not just personal achievements.) Using guidelines based on external salary data, the company pays the associates at the top of the list more than those at the bottom. The objective is to be internally fair and externally competitive.

Employees who want clear definition in their work would probably hate W.L. Gore's emphasis on personal ownership and commitment; those who are comfortable in a high-reward but somewhat uncertain environment would be likely to thrive.

Share your stories. One of the legends any MBA student is likely to hear is that of Goldman Sachs's signature recruitment experience. Successive cohorts of B-school students worldwide pass along the tale of the MBA student who went through 60 interviews before being hired. That story isn't an urban myth. The selection process is truly an endurance test, requiring enormous resources. In a given year, about 5,000 applicants speak to ten members of the firm, and the top 2,500 speak to more than 30. Each year, Goldman Sachs invests more than 100,000 man-hours in conversations with prospective employees.

The seemingly endless interviews are not designed to ferret out candidates' intellectual prowess or previous work experiences – that's what the GMAT scores and application forms are for. The process is a reflection of the company's deep commitment to internal collaboration and networking and serves as a preview of life in the firm. At Goldman Sachs, there is no room for individual stars. Prospective candidates who hear the stories and enjoy meeting partners in the myriad interview sessions are exactly those, the firm believes, who will be capable of building networks and strong collaborative relationships.

Employees at Starbucks have their own tales to pass on. When recruiting baristas, the company looks for people with outgoing personalities and strong social skills. To convey these attributes and prompt customer-savvy individuals to self-select into the firm, Starbucks tells all prospective hires about its mandatory in-store immersion process. Every new Starbucks employee – even at the corporate level – goes through a 24-hour paid training module called First Impressions. The standardized curriculum focuses on learning about coffee and creating a positive customer experience. This is followed by in-store training – employees spend time making beverages, talking to customers, and learning the business on the floor. Employees at all levels say this hands-on experience is essential preparation for any role within the company. And they swap stories about candidates who ditched the process early on, just because they didn't want to spend weeks working in the stores. Indeed, the satisfied lot who stuck with it and poured lattes for a while tell these tales with great pride.

Elements of Engagement

To foster deeply committed employees, you need the following:

- A comprehensive understanding of the types of people who will be productive in your organization over the long term. What kinds of skills should they have? What should be their attitudes toward work?
- A well-defined, well-communicated signature experience that conveys for potential hires and reinforces for employees the attributes and values of the organization.
- A coherent employee experience – none of your company's environmental elements misrepresents what it's really like to work there.

Strive for consistency. A signature experience must be buttressed by processes that send consistent messages to employees. Our research shows that one of the most common causes of low engagement in organizations is employees' perception that some elements of the work experience aren't exactly as they were advertised. How many times have we all heard people, six months into a job, say, "It's just not what I expected or wanted."

Several years ago, a large industrial company asked us to help redesign its orientation process, which executives at the firm felt was turning people off and driving them away. When we took a close look, we concluded that the orientation process wasn't the problem; it accurately reflected the highly structured, tightly managed nature of the organization. The problem was occurring much earlier, during recruitment, when the company promised prospective employees a flexible work environment full of excitement and innovation. This company was not a bad place to work, but it was doing a poor job of targeting and attracting people who would thrive there. It needed to change either the pitch it used with job candidates or the experience of working at the firm.

Whole Foods backs up its team-based induction process with compensation practices, employee rewards and recognition, and promotion criteria that are also strongly team based. All elements of the overall employee experience are aligned. Likewise, Goldman Sachs's commitment to cooperative networks and its "one firm" mentality are reinforced in multiple ways, including through its promotion practices. Attention is given not only to an individual's commercial acumen but also to the extent to which he or she is a culture carrier for the company. Representatives across the company, not just within specific divisions or product lines, participate in the evaluation and selection of partners.

Have the courage of your convictions. Companies – even very large ones – don't need to be all things to all people. In fact, they shouldn't try to be. No matter the content of your signature experience, you can attract people who are suited to your organization's culture and interested in furthering its goals. Conversely, you must be willing to accept that your employment proposition won't appeal to everyone. Exxon Mobil, for instance, readily acknowledges that its highly structured environment isn't for everyone, and a number of employees choose to leave early in their tenures. The company's demands are exacting; employees are expected to follow clear communication protocols and strict security regulations – as you might expect in an industry in which safety is a high priority. Interestingly, however, attrition among employees who make it past the five-year mark is almost nil, and the level of engagement among them is very high. Perhaps there's a more effective way for the company to communicate the structured nature of its work experience to prospective hires, but Exxon Mobil's signature experience is strong enough and cohesive enough to retain those who are likely to be engaged and productive in the firm for the long term.

The company's executives calmly recognize their plight. "The suit was too tight," they say, as they describe those who departed early on. That statement serves as a polite but powerful reminder that Exxon Mobil's employee experience is unlikely to flex on the basis of one individual's preferences and that opting out is an acceptable path. Management understands that the company's signature experience won't necessarily map to every stage of the employee life cycle. And management carefully and sensitively protects the processes that contribute to this secure, structured experience. For example, the company recently considered switching from a defined benefits plan to a defined contribution plan, which the majority of companies today favor for their employees. In the end, it concluded that the security the defined benefits plan provides is more in sync with the values of the employees the company hopes to retain.

Companies – even very large ones – don't need to be all things to all people. In fact, they shouldn't try to be.

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People will become long-term, deeply engaged employees of your company if their work experience is what they expect it to be and if your firm's values and attributes match theirs. You do a disservice to your organization – and to prospective employees – if you try to be all things to all people. The best strategy for coming out ahead in the war for talent isn't to scoop up everyone in sight, unless you want to deal with the fallout: high turnover, high recruitment and training costs, and disengaged, unproductive employees. Instead, you need to convince the right people – those who are intrigued and excited by the work environment you can realistically offer and who will reward you with their loyalty – to choose you.

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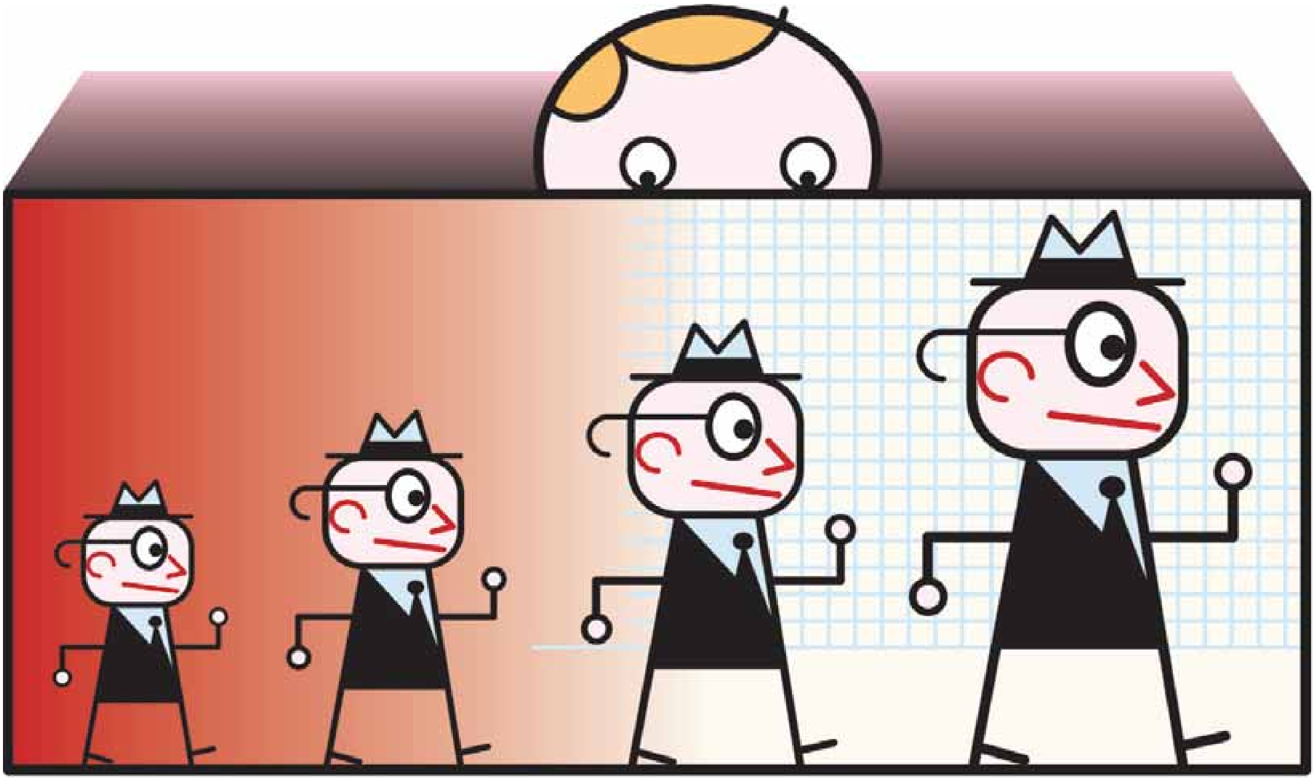

J.D. King

Maximizing Your Return on People

New tools can show you which investments in employees are driving company performance now and which you should emphasize to advance your strategic goals.

by Laurie Bassi and Daniel McMurrer

MANAGERS ARE FOND OF THE MAXIM "Employees are our most important asset." Yet beneath the rhetoric, too many executives still regard – and manage – employees as costs. That's dangerous because, for many companies, people are the only source of long-term competitive advantage. Companies that fail to invest in employees jeopardize their own success and even survival. In part, this practice has lingered for lack of alternatives. Until recently, there simply weren't robust methods for measuring the bottom-line contributions of investments in human capital management (HCM) – things like leadership development, job design, and knowledge sharing. That's changed. Over the past decade, we have worked with colleagues worldwide to develop a system for assessing HCM, predicting organizational performance, and guiding organizations' investments in people.

Using the framework we describe here has the obvious and immediate practical benefit of improving organizational performance. More broadly, though, as the links between people and performance come into focus, organizations will also begin to appreciate the long-term value of investments in human capital – and the folly of dwelling on narrow, near-term goals.

Measuring Management

When we researched the key HCM drivers of organizational performance, we found that most traditional HR metrics – such as employee turnover rate, average time to fill open positions, and total hours of training provided – don't predict organizational performance. (One important exception is training expenditure per employee, as we described in our Forethought article "How's Your Return on People?" HBR March 2004.)

After selecting the HCM best practices that had been previously identified in organizational-development, HR, and economics research literature as determinants of organizational performance, we developed employee and management surveys to measure their use by organizations. Collectively, the survey questions helped us assess overall HCM activity in dozens of organizations – ranging from service firms to manufacturers to schools – and identify which measures were most strongly associated with various aspects of organizational performance.

This empirical research has revealed a core set of HCM drivers that predict performance across a broad array of organizations and operations. These drivers fall into five major categories: leadership practices, employee engagement, knowledge accessibility, workforce optimization, and organizational learning capacity. In each of those categories, HCM practices are subdivided into at least four groups. Leadership practices, for example, include those related to managerial communication, inclusiveness, supervisory skills, executive skills, leadership development, and succession planning systems. (For more on HCM categories and practices, see the exhibit "Human Capital Drivers.")

By using rigorously designed surveys to score the organization on the range of HCM practices across the five major categories, it's possible to benchmark organizational HCM capabilities, identify HCM strengths and weakness, and link improvements or backsliding in specific HCM practices with improvements or shortcomings in organizational performance.

This process requires determining a 1 to 5 "maturity" score for each practice. A score of 1 on executive skills, for example, indicates poor performance (low maturity); a score of 5 indicates strong performance (high maturity). (For more on the HCM scoring system, see the exhibit "Your HCM Maturity Level.") Thus, with multiple surveys over time, evolving maturity scores can reveal progress or regression in each of the HCM practices and help a company decide where to focus improvement efforts that will have a direct impact on performance.

We've used this tool to analyze and improve the performance of 42 organizations over the past five years. Our work shows that although organizations should generally strive toward superior HCM across the board, the practices that have the greatest effect can vary within and across organizations and change with time.

Like Six Sigma techniques, which reduce defects by managing manufacturing process variations, our HCM methodology can be used to identify and manage process variations in human capital management that negatively affect organizational performance. It's time for HR departments to move beyond their usual focus on activities and process efficiency, such as the number of training courses offered or how long it takes to fill a vacant position. With HCM measurement tools, HR can start gauging how well people are managed and developed throughout the organization. In this role, HR departments can take on strategic responsibility, acting as coaching, mentoring, and monitoring agencies to ensure that superior management of human capital becomes a central part of the organization's culture.

Most traditional HR performance metrics – such as employee turnover rates, average time to fill open positions, and total hours of training provided – don't predict organizational performance.

Article at a Glance

Investments in human capital management (HCM) – things like leadership development, job design, and knowledge sharing – can be directly linked to improvements in organizational performance, whether the measure is sales revenues, factory safety, student scores on standardized tests, or stock-market returns.

Employee and management surveys can be used to gauge and help improve organizations' capabilities across 23 HCM practices in five HCM driver categories: leadership practices, employee engagement, knowledge accessibility, workforce optimization, and learning capacity.

There is no one-size-fits-all approach to improving organizational performance with human capital management. The HCM practices that have the biggest impact on performance will vary between and within organizations and can change over time. Thus, ongoing evaluation of HCM practices is essential.

Managers can use the survey in this article to quickly assess their organizations' HCM strengths and weaknesses.

Human Capital Drivers

Organizations' strengths and weaknesses in human capital management (HCM) can be assessed by monitoring the performance of each of 23 HCM practices that fall within five broad HCM driver categories. In general, improvements or declines in organizational performance can be tied directly to improvements or declines in HCM practices.

HCM Drivers	Leadership Practices	Employee Engagement	Knowledge Accessibility	Workforce Optimization	Learning Capacity
HCM Practices	*Communication* Management's communication is open and effective.	*Job Design* Work is well organized and taps employees' skills.	*Availability* Job-related information and training are readily available.	*Processes* Work processes are well defined, and training is effective.	*Innovation* New ideas are welcome.
	Inclusiveness Management collaborates with employees and invites input.	*Commitment* Jobs are secure, employees are recognized, and advancement is possible.	*Collaboration* Teamwork is encouraged and enabled.	*Conditions* Working conditions support high performance.	*Training* Training is practical and supports organizational goals.
	Supervisory skills Managers eliminate barriers, provide feedback, and inspire confidence.	*Time* Workload allows employees to do jobs well and enables good work/life balance.	*Information sharing* Best practices are shared and improved.	*Accountability* High performance is expected and rewarded.	*Development* Employees have formal career development plans.
	Executive skills Senior executives eliminate barriers, provide feedback, and inspire confidence.	*Systems* Employee engagement is continually evaluated.	*Systems* Collection systems make information easily available.	*Hiring* Hires are chosen on the basis of skill; new hires complete a thorough orientation.	*Value and support* Leaders demonstrate that learning is valued.
	Systems Leadership-development and transition systems are effective.			*Systems* Employee performance management systems are effective.	*Systems* A learning management system automates aspects of training.

Proof in the Performance

The power of HCM improvements to drive performance can be seen in a diverse array of organizations. Consider the following cases, involving a large manufacturer, a public school system, and a group of financial services firms. In each case, HCM maturity scores are directly linked to a range of performance outcomes.

Improving sales and safety at American Standard Companies. Over the past four years, we have worked with American Standard – a manufacturer of global air-conditioning systems, bath and kitchen products, and vehicle control systems – to track and improve its HCM performance across business units. Our analysis has enabled us to pinpoint the HCM practices that most consistently predict sales productivity and factory safety.

In the exhibit "Improved HCM Scores at American Standard Companies…" the top chart shows a comparison between the average three-year compound annual growth rate in income for the 50% of sales offices in the

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major business unit that boasted the largest maturity-score improvements with the income growth rate for the 50% of offices that had the smallest. In four out of the five categories, the growth rate for the higher-scoring offices ranged between about 60% and 130% above the growth rate for the offices with smaller improvements (or declines) in HCM maturity.

maturity scores in the top 50% of each of the five major categories with those of plants whose scores were in the bottom 50% (see the bottom chart in the exhibit "Improved HCM Scores at American Standard Companies…"). As the exhibit shows, the mean accident rates for plants with high HCM maturity scores were between about 10% and 30% lower than the rates for plants with

Like Six Sigma techniques, our methodology can be used to identify variations in human capital management that negatively affect performance.

Further analysis identified several specific HCM factors for which high maturity scores were most closely associated with high sales performance, including executive and supervisory skills (both in the leadership practices category), information sharing (in the knowledge accessibility category), and innovation (in the learning capacity category). Interestingly, in the employee engagement category, higher maturity scores were associated with a *lower* sales growth rate. This counterintuitive result highlights how idiosyncratic the relation between HCM practices and organizational performance can be; there is no one-size-fits-all HCM approach. In American Standard's case, it seems clear that an excessive focus on employee engagement at the expense of the other four categories would have been a mistake.

Armed with this analysis and the specific measures of HCM strengths and weaknesses for more than 300 locations, American Standard's HR staff developed prioritized action plans to close the most critical gaps in HCM maturity at each location, resulting in overall improvement in sales growth rates.

A similar study in American Standard manufacturing plants revealed a strong relationship between HCM practices and accident rates. One year after our initial analysis, we compared the mean accident rates of plants with HCM

low scores. Thus, high HCM maturity scores in plants, indicating above average human capital management practices, predicted low accident rates the following year.

An analysis of which HCM practices were most closely associated with low accident rates found that the safer plants excelled in three areas: supervisory skills (in the leadership practices category), information sharing (in the knowledge accessibility category) and supporting employee skill development (in the learning capacity category).

Using this information, American Standard's safety staff prioritized its efforts, addressing the specific HCM issues that were creating the greatest safety risks at the locations with the lowest HCM scores. In particular, the staff provided additional targeted training to thousands of workers on safety issues, focused on improving the organization's overall safety processes, and conducted more than a dozen global workshops that emphasized the importance of leadership at all levels in reducing accidents.

Raising test scores in South Carolina schools. South Carolina's Beaufort County School District (BCSD) is the largest employer in its county, providing jobs for more than 1,500 instructional staff members and 1,200 other staff members to serve a growing, economically and racially diverse, student population of 19,000. Located in one of the wealthiest counties in the state (albeit one with pockets of high poverty), the district has not been lacking for funds. Yet, for years, the average scores of BCSD's student state achievement tests lagged behind the averages for similar school districts in the state.

To the great annoyance of many parents, teachers, and school district leaders, the students' lackluster performance often was attributed to the students themselves: Many come from low-income families, and the district serves a large number of Latino and African-American youngsters. As a result, some educators suggested in interviews that the county's schools were doing as well as they could, given the population they served.

Your HCM Maturity Level

Level 1
Organization makes little or no attempt to address the stated HCM area or factor.

Level 2
Organization makes cursory, non-systematic attempts to address at least some component of the stated HCM area or factor.

Level 3
Organization demonstrates adequate, or baseline, capability that forms a good foundation for improvement in the stated HCM area or factor.

Level 4
Organization is beginning to systematically extend capability in the stated HCM area or factor.

Level 5
Organization consistently demonstrates superior capability in optimizing its human capital management in the stated HCM area or factor.

Getting past the excuses and improving students' performance became a priority for BCSD leaders. To that end, we have worked with BCSD for the past four years to help its schools identify and manage the HCM practices that created the biggest impact on student achievement. Our initial audit in 2002 revealed wide disparities on the HCM maturity scale among schools, although, when combined, the schools received a disappointing average maturity score of 2. On some measures, such as team leadership and leadership capability, many schools received a score of 1, indicating wholly inadequate HCM practices. It was difficult for district leaders to acknowledge these results and even harder for school leaders to accept them. But they couldn't ignore the correlations we found between HCM maturity scores and scores for individual schools on South Carolina's mandatory Palmetto Achievement Challenge Tests (PACT).

Put simply, the students who attended schools with high HCM maturity scores in key areas (such as employees' learning culture and work design) performed better, on average, on state achievement tests than their peers in other schools, even after controlling for socioeconomic status. What's more, a high maturity score on "teaching to standards" – a customized set of questions that we created for BCSD to respond to its initial interest in that issue – had a lower correlation to student achievement than did high scores in any of the five standard human capital management categories. Schools with the biggest gains in HCM maturity scores have, on average, experienced the greatest increases in student achievement. The exhibit "Higher HCM Scores Improve Students' Test Performance" shows the relationship between those schools' HCM maturity scores and growth in students' achievement in math.

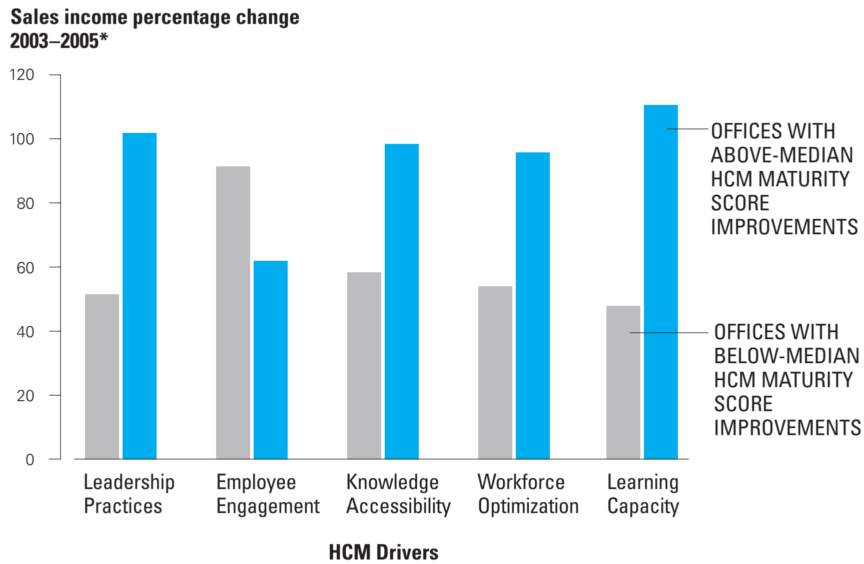
Our results revealed that the school district's traditional emphasis on teaching to state standards had less to do

continued on page 122

Improved HCM Scores at American Standard Companies…

Drive Sales Income Growth

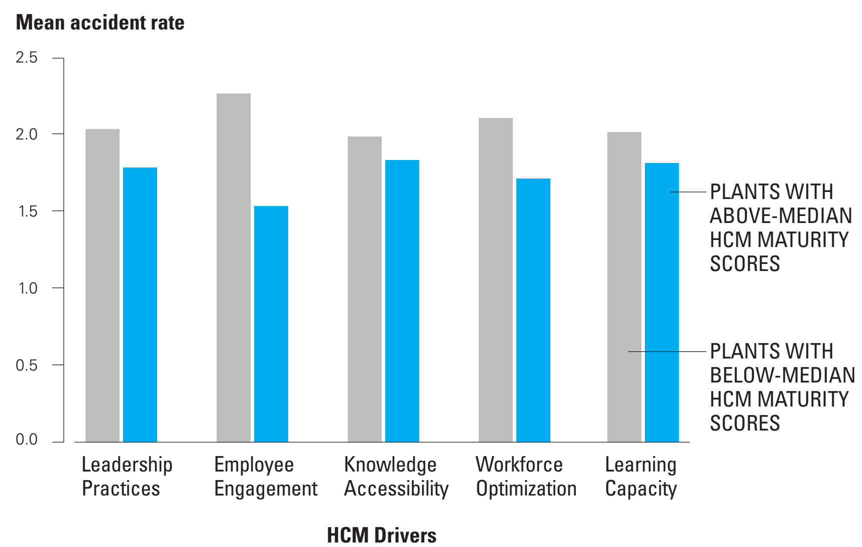
In four of five human capital management (HCM) driver categories, American Standard sales offices whose HCM score improvements were above the median had greater income growth rates than offices whose scores were below the median.



*Mean 3-year compounded annual growth rate (%) in segment income, by sales office, January 2003 to December 2005.

Reduce Plant Accidents

American Standard plants with above-median HCM scores in each of the five HCM driver categories on initial assessment had lower accident rates a year later than plants with below-median scores. (The accident rate reflects the number of recordable safety incidents per 100 employees over a given period.)



HCM Survey

Rate your organization on each statement, using a 1-to-5 scale (1, strongly disagree; 2, disagree; 3, neutral; 4, agree; 5, strongly agree). Offer your best guess for any item that you are uncertain about, and make sure to check the "Not Sure/Don't Know" box that corresponds to it. Then, follow the instructions at the end of the survey to estimate your organization's HCM effectiveness.

	Score (1 to 5)	Not Sure/ Don't Know
Leadership Practices		
Communication. Senior executives and managers are open and honest in their communications; have an effective process in place for communicating news, strategies, and goals to employees; and ensure that employees know what is expected of them.		
Inclusiveness. Senior executives and managers seek and use employee input, work in partnership with employees, and treat them with respect.		
Supervisory skills. Managers demonstrate organizational values, eliminate unnecessary barriers to getting work done, offer constructive feedback, provide employees with performance appraisals, and inspire confidence.		
Executive skills. Senior executives demonstrate organizational values, eliminate unnecessary barriers to getting work done, offer constructive feedback, and inspire confidence.		
Systems. Highly effective systems and processes are in place to identify and develop the next generation of leaders and ensure smooth leadership transitions.		
Add items in above section, then multiply by 0.8 for **Subtotal**		
Employee Engagement		
Job design. Work is effectively organized, makes good use of employees' talents and skills, and is interesting and meaningful. Employees have appropriate responsibility to determine how best to do their work, and creative job designs help make jobs fit employees' needs.		
Commitment to employees. Employees are secure in their jobs, recognized for their accomplishments, and provided with opportunities for advancement.		
Time. The workload allows employees to do their jobs well, make thoughtful decisions, and achieve an appropriate balance between work and home.		
Systems. Systems help retain good performers by continually evaluating trends in employee engagement and providing information that can be used to determine the key drivers of productivity and customer satisfaction.		
Add items in above section for **Subtotal**		
Knowledge Accessibility		
Availability. People have the necessary manuals, tools, and information they need to do their jobs, and there are procedures in place that enable employees to access training when they need it.		
Collaboration and teamwork. Teamwork is encouraged and facilitated; there are places for people to meet informally; and time is set aside for people to share with and learn from one another.		
Information sharing. Best practices and tips are shared, improved, and circulated across departments.		
Systems. Effective systems are in place to collect and store information and make it available to all employees.		
Add items in above section for **Subtotal**		

	Score (1 to 5)	Not Sure/ Don't Know
Workforce Optimization		
Processes. Processes for getting work done are well defined and continually improved, and employees are well trained in how to use them.		
Conditions. Employees have access to the materials and technologies they need, and working conditions contribute to good performance.		
Accountability. Employees are held accountable for producing high-quality work; promotion is based on competence; poor performers are terminated; and employees trust their coworkers to get the job done.		
Hiring decisions. Selection is based on skill requirements; new hires receive adequate orientation, induction, and description of required skills; and employees provide input into hiring decisions.		
Systems. Highly effective systems and processes are used to manage employees' performance and talents, view the overall proficiency of the workforce, help employees realize their full performance potential in their current jobs, identify development opportunities for those experiencing performance difficulties, and prepare motivated employees to progress in their careers.		
Add items in above section, then multiply by 0.8 for **Subtotal**		
Learning Capacity		
Innovation. New ideas are welcomed; employees are encouraged to find new and better ways to do work; and employees' input is sought in solving problems.		
Training. Training is practical, supports organizational goals, and is provided for employees on work-related technologies.		
Development. Employees have formal development plans in place, and they use those plans to achieve their career goals.		
Value and support. Leadership behavior consistently demonstrates that learning is valued, and managers consistently make learning a priority.		
Systems. A learning management system automates the administration of all aspects of training and learning events, provides reports to management, and includes features such as content management and skill or competency management.		
Add items in above section, then multiply by 0.8 for **Subtotal**		

TOTAL (Sum of five section subtotals above)

Scoring

Take the sum of the five subtotals from the sections above (note that the sections with five categories are multiplied by 0.8 in order to weight them equally with the sections that have four categories), then refer to the chart below for interpretation. The interpretation will be accurate only if your answers are honest and if others in the organization would agree with your assessment.

Total score	Your HCM is:
90 to 100	Superior
80 to 89	Adequate
70 to 79	Marginal
69 and below	Poor

Count how many times you checked the "Not Sure/Don't Know" box, and consult the chart below.

Number of times checked "Not Sure/Don't Know"	Your HCM measurement system is:
0 to 1	**Good.** You have a measurement system in place that you can use to optimize human capital management and organizational performance.
2 to 3	**Adequate.** There are likely to be some critical holes in your measurement system.
4 or more	**Poor.** You do not have the basic information you need to improve business results by effectively managing human capital.

with student performance than did the teachers' overall work and learning culture, the schools' ability to reinforce and retain talent, and other factors relating to human capital processes. This finding challenged most people's assumptions about the way to improve achievement, the impact of student socioeconomic status, and the role of leadership in creating successful work and learning environments.

Based on this analysis, BCSD has restructured its approach to teachers' professional development, making it more centralized (as opposed to site based) and introducing greater consistency in teachers' use of proven instructional approaches. In addition, the district has expanded its focus on leadership development, restructured its HR department, and incorporated the results of the annual HCM assessment at each school into biannual performance reviews of the schools' leaders.

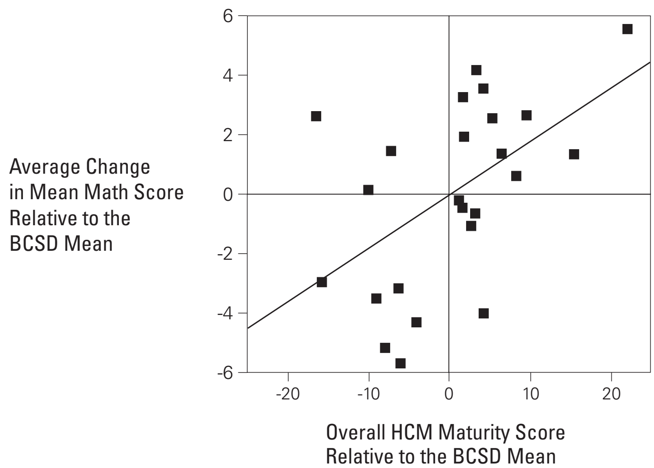
Increasing returns in financial services. The final case, in financial services, illustrates the power of HCM to drive stock performance.

In late 2004, we gathered HCM maturity data on 11 publicly traded financial-services firms. A year later, we took a look at the stock performance for each one of those firms. As the exhibit "Higher HCM Scores Predict Stock Returns for Financial Firms" demonstrates, half of the firms–which are represented by the five blue data points clustered around the center of the chart–had average HCM practice scores and subsequent stock appreciation. As a group, the three firms that scored below average on HCM maturity (the data points in red) had significantly lower subsequent stock appreciation than the three firms that measured above average on HCM maturity (the data points in green).

Though this is a small sample, and though the relationship between HCM and stock appreciation is imprecise, the case aligns with our broad findings linking HCM and performance over many years and many different types of organizations.

Higher HCM Scores Improve Students' Test Performance

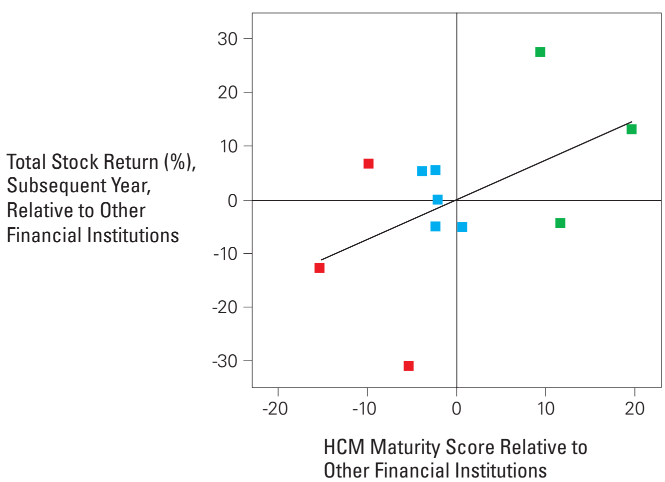
In South Carolina's Beaufort County School District, the higher a given school's human capital management (HCM) score, the greater the students' improvement on a standardized math test. (Each data point shows a single school's overall HCM maturity score on a 100-point scale and academic-year change in mean math score[1] relative to the average maturity score and change in math score for all schools in the district.)



1. Math score as assessed by the Northwest Evaluation Association's Measures of Academic Progress (MAP) in fall 2005 and spring 2006.

Higher HCM Scores Predict Stock Returns for Financial Firms

Financial services firms with higher human capital management (HCM) scores in an initial assessment trended toward higher stock-market returns a year later than firms with lower HCM scores. (Each data point represents one firm. HCM maturity scores on a 100-point scale and stock returns for each are calculated relative to the average for all 11 firms.)



Assessing Yourself

Just as Six Sigma techniques involve continuous refinement of processes based on feedback, the HCM evaluation approach is used iteratively: An initial assessment indicates the HCM changes that should positively affect performance; performance responds to the changes; HCM practices are reevaluated, leading to further rounds of suggested changes; and so on. Note that as organizations and their environments evolve, the key HCM factors that drive performance may shift. Thus, it's important to regularly measure and adjust HCM practices and correlate them with organizational outcomes.

Two types of data are necessary in order to perform such an analysis: measures collected through employee and management surveys that can be used to quantify HCM performance and measures of organizational performance. Typically, the latter comprise key business outcomes across units – either financial (such as sales productivity, profit margins, or revenue per employee) or nonfinancial (such as safety, customer satisfaction and loyalty, or employee retention) – and are usually tracked by the office of the CFO or COO. As part of the employee survey, measures of employee commitment (such as a willingness to contribute discretionary effort or to recommend the company to friends as a great place to work) may also be collected.

HCM data capture and analysis proceeds in three steps:

Step 1. Employees and managers are surveyed to quantify variations in HCM maturity across functions, business units, regions, and job categories and also to document organizational HCM strengths and weaknesses.

Step 2. Variations in HCM maturity are linked to variations in key organizational outcomes, either financial or nonfinancial. This step identifies which HCM factors are most critical to organizational performance. (For more on this process, see the sidebar "Linking HCM Scores and Outcomes.")

Step 3. Findings from the first two steps are then used to identify the HCM factors that significantly drive organizational performance as well as those that also represent areas of relative weakness. The results of this analysis will highlight where the organization should concentrate its HCM development efforts.

Alas, there is no ready-made prescription that can substitute for a thorough HCM analysis of your own organization. As the American Standard cases demonstrated, an HCM strength, such as employee engagement, that might be critical in one firm may be less relevant in another. However, managers can use a shortened version of our own survey to quickly assess their organizations' HCM maturity and detect weak areas. Turn back to page 120 to see how your company measures up.

• • •

So, where does your organization stand? Did it score in the 90 to 100 range? Did you mark fewer than two items "Not Sure/Don't Know"? Are you consistently using the three-step process outlined here to focus your HCM development activities? If you can answer an honest "yes" to the last three questions, and others in your organization would agree, your company is well positioned to compete by using its human capital advantage. But if your answer to one or more of those questions is "no," then your organization is almost certainly at risk of failing to maximize its return on people and succumbing to the forces that cause shortsightedness and an excessive focus on narrow, near-term goals. This is not a sustainable strategy.

Globalization has left only one true path to profitability for firms operating in high-wage, developed nations: to base their competitive strategy on exceptional human capital management. Any benefits that, historically, have been associated with superior technology and access to capital (both financial and physical) are now too fleeting to provide sustainable advantage. As these former sources of advantage become less relevant, managing human capital by instinct and intuition becomes not only inadequate but reckless. The most competitive companies will be those that manage their employees like the assets they are.

Linking HCM Scores and Outcomes

Identifying which HCM practices are most important to organizational performance requires statistically linking variations in maturity scores over time or across units to variations in key outcomes (such as employee commitment or financial performance). There are several different statistical techniques for doing this, ranging from the simple (looking for statistically significant differences across two units) to the complex (nonlinear multiple regression analysis). In general, the greater the number of units of analysis (whether business units or individual employees) used for statistical analysis, the more reliable the results will be.

Once you've identified the practices that are most closely associated with performance, it's important to include measures of these practices in your organization's ongoing data collection and monitoring processes – and don't waste time by waiting for future business outcomes data to become available. Use the data available for recent or current outcomes, and refine your analysis later. It is better to use approximately correct, timely insights than to hold out for precise measurements until they're too late to be useful.

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Realizing What You're Made Of

When I became permanently paralyzed, life as I knew it was over. This is the story of my journey from victim to survivor to resilient leader.

by Glenn E. Mangurian

THOSE WHO HAVE SURVIVED a traumatic, life-altering event often convey a curious sentiment: They wouldn't have it any other way. Some people emerge from adversity – whether a career crisis or a devastating breakup or a frightening diagnosis – not just changed but stronger and more content. They seem to have found new peace and even an optimism that they didn't have before. It's tempting to dismiss this sort of response as making the best of a bad situation. Not long ago, I would have done so, too.

On May 26, 2001, I suffered an unprovoked disc rupture that pressed against my spinal cord, leaving the lower half of my body permanently paralyzed. I had two lengthy operations and spent two months of my life in a Boston rehabilitation hospital and four years in physical therapy. It was the kind of experience that nobody can anticipate. I was healthy and secure in my career as a management consultant, and in an instant, my life was utterly transformed and filled with uncertainty. At first, I was mostly frightened and in serious pain. Then, I felt anger and sadness at losing the use of my legs. Compounding those emotions was the recognition that it wasn't just my own life that would be severely altered: I had a wife and two children, whose lives would change forever and who would have to give up some of their own dreams.

Becoming paralyzed is without question the worst thing that has ever happened to me. I've had some very dark days, and life is a constant struggle. But at the same time, the experience has allowed me to take stock of all that I have, rediscover some of the neglected parts of my life, and cut through the clutter to focus on what really matters. Over the course of my hospital stay, I found the will to accept that my old life was gone and decided that I would create a new and equally meaningful one, drawing on all my experiences and a caring community of family and friends. Today, I've not just returned to consulting; I've also engaged in endeavors that wouldn't have occurred to me before, such as advocating for stem cell research.

It's a cliché to say that what doesn't kill you makes you stronger, and most people can accept that it's generally true. But more content? That's harder to explain. In my case, in spite of the frustrations of being in a wheelchair, I can honestly say that my life is good and that I am more at peace than I was before. How can that be? I know I was lucky that my injury didn't kill me and that I had resources to draw on, but I also believe that we are born with a renewable capacity for resilience – a built-in power to heal, regenerate, and grow beyond our known limits.

Resilience is one of the key qualities desired in business leaders today, but many people confuse it with toughness. Toughness is an aspect of resilience, certainly, as it enables people to separate emotion from the negative consequences of difficult choices. It can be an advantage in business, but only to a point. That's because it can create an armor that deflects emotion, and it can cut you off from many of the resources needed to bounce back – notably, the people around you. Resilience, by contrast, is not about deflecting challenges but about absorbing them and rebounding stronger than before. Life-changing experiences are not something you can plan for, which is often difficult for businesspeople to accept; executives love to anticipate various scenarios and prepare their responses in advance. Instead, they tend to come out of the blue, when it's too late to prepare. However, you can live your life in a way that allows you to accept setbacks as they occur, move on, and create new possibilities.

Resilience is not about deflecting challenges but about absorbing them and rebounding stronger than before.

Since my injury, I've had the opportunity to explore resilience from my own standpoint as well as through numerous conversations with leaders and others who have been through life-altering events. My hope is that by sharing my story I can show people that they can create a new future after a crisis hits. As for those who are taking on the challenges of everyday life, perhaps they can look to some of the lessons I've learned for insights into how they might prepare for the worst.

Choose to Go Forward

Accepting adversity and moving on isn't easy and can take time. You don't have to like or somehow justify what's happened. You just have to decide that you can live with it. Pretty early on, I decided that I could live without the use of my legs, which was just as well, because I couldn't change the past. Better to focus on things over which I did have some control – for example, how would I move on and live a full life?

Everyone I know who's been through a major crisis can remember the exact moment that he or she chose to accept what had happened and to go forward. People remember where they were, what they were wearing, whom they were with, what the weather was like – every detail. For me, the defining moment came after those first few terribly bleak weeks in the hospital. I was lying in my bed, looking out the window, and I told myself that I still had a lot to offer. Although I was physically limited, my brain still worked. Because I had played various leadership roles before my injury, maybe my future could entail leading by example – that is, demonstrating the ability to bounce back after adversity. I even thought about writing an article about my experience for *Harvard Business Review.* That this particular detail came to pass is not what is important; what matters is that it was a positive and concrete image representing what could be part of my new future, even if I hadn't yet imagined how I would get there.

The primary reason I was able to let go of the past without regrets was that an outpouring of support from family and friends showed me that my old life had already proved to be of value and made a difference. All of us have been there for a family member, a friend, a colleague, or even an acquaintance in a time of need. We touch people's lives, but we don't necessarily realize how

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much. It's easy to underestimate the impact we have. But people notice and remember. In my first couple of months in the hospital, I received a few hundred cards, more than half of which came from people I had gotten to know through my 20 years of consulting work at CSC Index. The letters were humbling and rewarding. None of them simply expressed regret and support. Everyone wrote paragraphs, recounting our times together and instances of my helping them in some way – simple acts of kindness that became lasting memories for them. I had long forgotten most of these incidents. The letters recalled deeply personal conversations, some of which dated back a decade or more. One person wrote about the time he and I had been stranded together in Minnesota on business while he'd been going through a divorce; he said I had been a source of comfort to him. Another wrote that he would never forget my flying to Chicago to meet him for dinner after he was fired from his job of 20 years.

Reading those letters felt something like being present for my own eulogy. Few people get to "listen in" the way I did. I was moved, of course – but more important, it was liberating knowing that I had made a difference in others' lives and that I no longer had that to prove. And happily, I had the opportunity to bring all those experiences and relationships with me into a new life.

There is no way I could have overcome the trauma and found hope without a caring community. To survive, you need at least one true believer, someone who will have faith in your ability to recover even when you lose it yourself. I was lucky enough to have my children and my wife, whose heroics I won't detail here, because that would be a book in itself. Not everybody has strong family ties, though, and crisis does put a strain on them, particularly if they are tenuous from the start. The letters I received served as a reminder that you can create a caring community in any context, even at work. People will care about you if you authentically care about them.

Seek Perspective

When you undergo a sudden loss, your routine is interrupted, and your mind becomes preoccupied with trying to make sense of what happened. In the early days, I had a lot of time to think, and I pondered the inequities of life, which I had just experienced firsthand. Why did this happen? Why me? What could I have done to prevent this? Whom can I blame?

I was also consumed by questions about the future. Are we going to be able to continue living in our house? Will we be able to send the kids to college? What about my responsibilities at home? Will I be able to work? How much will I be able to earn? At times, my emotions distorted my sense of reality. I briefly imagined myself becoming homeless, forced to sell pencils from a tin cup on the corner.

In the end, I came to realize it's fruitless to wish you could change the past, and it's overwhelming to obsess about the future. I also came to understand that "Why me?" is a natural question but one that can't be answered. Such things can happen to anybody. So I decided to put my energy into the present: getting better. That's where I think my work experience helped me gain perspective, because I had guided executives through some pretty dramatic organizational changes. At times I saw experienced, capable people lose their jobs in the process. I saw what they went through, and I saw them rebound.

During my hospital stay, I was vividly reminded that there are always people who are worse off. I was in a rehabilitation ward with 14 other patients. Four were teenagers. When their parents came to visit, you could see the grief on their faces. One patient was a 17-year-old girl who had lost the use of her arms and legs after a diving accident. I reflected: I'm 52 years old. I've had a great career. I've been married for 20 years to a loving wife, and we have two wonderful children. Why should I feel sorry for myself?

Re-Create Your Identity

A crisis challenges your sense of identity. If you're fired, you question your professional abilities. If a loved one dies, you lose a defining relationship. A physical crisis like mine robs you of some of the basic elements of independence. One of my first tasks in building my new life was reclaiming my dignity and identity.

This is something I struggled with from day one in the hospital. I was so accustomed to my independence that it was hard for me to adjust to needing help from others – I wanted to be able to do things on my own schedule rather than at others' convenience. I certainly didn't want to become an obligation or burden to my family. I had a fleeting and degrading image of myself as the new family pet. ("Who's going to walk the dog? I did it last night; it's your turn.") It was an absurd image, but it was a visceral, emotional reaction to my diminished physical capacity.

I didn't want to limit myself to consulting on crisis but hoped to use my experience to help others fulfill their ambitions despite perceived constraints.

Adding to my frustration was overhearing people in white coats conferring about me in low tones as though I were a case study. Truth be told, after an entire career spent analyzing and talking about other people and organizations, I realized I *was* a case study. So I began to assert myself by joining the conversations and putting in my two cents, even contributing ideas about how the hospital could be run better. It was my way of saying, "I'm not just a body. I have a point of view, something to bring to the table."

Despite my optimism and determination, my first experiences in public were difficult. Most people have limited contact with the physically disabled. To some, I stand out – I feel as though a wheelchair puts a spotlight on me. But I can be easily overlooked as well. For one thing, I'm not at eye level with my peers unless they're sitting down. For another, many people have preconceived notions about those of us in wheelchairs that go beyond our physical limitations. I've learned to counterbalance my physical disadvantages by being more outgoing and assertive than I was before. I now initiate conversations all the time. I want to demonstrate that I still have something of value to offer. To this day, my energy sometimes takes others by surprise; it's hard for them to reconcile what they expect with what they see and hear.

The transition was uncomfortable at first. I had come to terms with the fact that I wouldn't be returning to my old life, but I didn't yet know who I was becoming. Still, being in between the two places was freeing. I refused to put limits on myself, even in ways I might have in the past.

The new me is driven and fearless – sometimes I feel invincible. When I see an opportunity to participate, I don't ask for permission; I just jump right in. I say to myself, "What's the worst that could happen? I've already discovered a deep bottom, and I'm OK."

Raise the Bar

I've always had an inclination to aim high. I was one of the first in my family to attend college, which opened doors previously unknown to me. Then, at CSC Index, our consulting practice constantly pushed clients to achieve ever more aggressive goals, and I witnessed some pretty astonishing results. So during my rehabilitation, I decided that I wouldn't compromise my ambitions. Instead, I would raise the bar: If I can survive this injury, what else can I do? My first victory was to survive; now I would find a new way to lead.

When I got out of the hospital, I moved as quickly as I could to reestablish myself as a professional. With 30 years of consulting experience under my belt, I knew I could still contribute something of use. It would have to be on new terms, though; I would have to take into account my physical limitations. About 18 months earlier, I had left my old company and, with a partner, launched a new firm. I'd been largely responsible for marketing, a role that requires a lot of hustle, especially at a start-up. After the injury, I didn't have the stamina to jump right back in, so my partner and I decided to put my involvement in that company on the back burner. What to do instead?

Once again, the network I had developed in my previous life proved invaluable. I made my first significant post-injury public appearance that September, at a reunion of CSC Index alumni. The person hosting the event invited me to say something, and I was happy to do so. The group got extremely quiet, and I asked everybody to sit down – which they did, mostly on the floor. I had a chance to tell everyone there how much their support had meant to me, and because they were sitting, I didn't have to look up to see their faces. It was very moving for me.

Nine months after my injury, I held two brainstorming sessions, each including eight or nine people I trusted, with one of them acting as a facilitator. The goal was to help me shape my thinking about what I could do professionally now. We began with the idea that my medical condition could be a platform that would give me access to new people and enhanced credibility in delivering a message about achievement. I didn't want to limit myself to consulting on crisis but hoped to use my experience to help others fulfill their ambitions despite perceived constraints. I also wanted to consider more traditional business opportunities. We came up with a variety of possibilities ranging from advising hospitals on how to help patients reenter the world to coaching executives to raise the level of ambition for themselves

Wisdom from Adversity

A traumatic event forces you to rethink your life and your beliefs. Since my injury, I've spoken with numerous people who have gone through crises, and certain themes have repeatedly come up. Some are truisms that we've known since childhood, but they don't really take root until you face a serious challenge to your identity. Below, I've summarized a few of the lessons I've learned.

You can't know what will happen tomorrow – and it's better that way. If we knew all the good and bad things in store for us, we would probably focus on preventing the bad. It's far more rewarding to engage with the present.

You can't control what happens, just how you respond. Successful people are accustomed to being in control, but adversity strikes unannounced. The only way to influence the outcome is by focusing on the things you have the power to control: the choices you make in response to life's events.

Adversity distorts reality but crystallizes the truth. It reinforces your fears but also puts an emphasis on what matters right now. Adversity also sheds light on your beliefs: It shows you what is important to you, who your friends are, what you are capable of, and what your true goals and ambitions are.

Loss amplifies the value of what remains. It pushes you (and may force you) to take stock of what you have, allowing you to liberate yourself from petty or irrelevant matters and celebrate your assets.

It's easier to create new dreams than to cling to broken ones. Adversity alters relationships and may even ruin them. It destroys some dreams and renders others unlikely. Certain things will be irrevocably lost, and pretending otherwise is foolish. But adversity also provides an opportunity to houseclean – to pack old dreams away and make room for new ones.

Your happiness is more important than righting injustices. Anger is a normal response to a traumatic event, but attempting to assign blame or seek justice is draining and usually futile. It's more fruitful to release the anger and move forward with your life.

and their teams, looking at each idea through the lenses of personal interest and enrichment, feasibility, and income potential.

About six months later, a former colleague called me to join a consulting project he had taken on, helping a group of senior executives launch a firm aimed at the baby boomer demographic. The work was interesting, but what mattered most to me was reengaging in the world of business. A full workday was physically exhausting at first, and just getting there – driving into downtown Boston, finding a place to park, and rolling to the office – was very stressful. But it was exhilarating to be back at work. I told myself, "I can still do this."

Since then, I've discovered many causes to which I can contribute my time and expertise. I developed an interest in the Christopher Reeve Foundation, so I got in touch with its directors. I've now done a few projects with the foundation, most recently acting as the local host of a worldwide summit for its spinal cord researchers. I also testified on behalf of stem cell research at a legislative hearing at the Massachusetts State House – and was surprised to find myself on the news that night and on the front page of the newspaper the next morning. I'm giving back to my community, as well. I sit on the boards of several not-for-profits, and I'm the executive-in-residence at the University of Massachusetts, my alma mater. Not long before my injury, I'd launched an executive breakfast program, a forum for interviewing accomplished alumni. My ties to the university were identified at the early brainstorming sessions as an important asset I should hold on to; I've missed only one breakfast, which was held while I was in the hospital. Today, the breakfast group has grown from 250 members to 1,800 since my injury. The injury has enriched my management consulting practice, too, as I can combine my recent experience with my business background to advise leaders who are facing adversity in their personal lives or at their organizations. In my new life, I am able to use all of my assets, including my paralysis, to be a new kind of leader.

• • •

Many of us underestimate our ability to withstand crisis. I certainly did. If you had asked me before my injury how I would handle being paralyzed, I would have said something to the effect of "You might as well put me in a corner and shoot me." I quickly changed my mind about that. Not that I like being in a wheelchair – I struggle every day with the additional limits and challenges that paralysis has imposed upon me.

But rather than feel sorry for myself, I've chosen to use what I accomplished in my previous life as a foundation for building a second life full of purpose and possibilities, some of which only became visible thanks to my injury. My new life's a work in progress, and I have to re-create parts of myself every day. I know that this life is full of new adventures, though, even if I don't know what all of them are yet. I may experience them sitting down, but in a way I am standing taller than ever.

Reprint R0703J
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Harvard Business Review

THE MBA GOES BACK TO SCHOOL

BUSINESS SCHOOLS ARE academia's early adopters. In their ongoing quest to stay in step with rapidly changing market demands, they are typically the first to try out a new idea, technology, or approach. While the MBA program has become the global standard for managerial education, business school deans have been adapting their programs to better suit new workplace demands. Here are some of the most innovative approaches that leading business schools are adopting.

SHORTENING THE PROGRAM

Executive MBA programs were developed to accommodate the skyrocketing number of people who wanted to attend business school while keeping their day jobs (according to some studies, nearly 80 percent of MBA students attend part-time). Later, part-time degree programs were created for students with limited time for classroom sessions. The latest trend is the "drive-through MBA," a program designed for people unwilling to invest the time or money required by existing MBA alternatives.

Outside the United States, several leading schools offer such full-time, intensive programs. At INSEAD, for instance, the drive-through MBA takes as little as 10 months; at the University of Toronto's Rotman School of Management, the executive MBA program can be completed in a year. In the United States, Drexel University does offer a one-year MBA, but the idea has yet to catch on among the top-tier American schools. Some educators at these schools argue that the fast-paced programs don't meet the needs of younger students, who typically have little exposure to the more difficult business concepts and therefore need more time to digest the material.

THE CURRICULAR RESPONSE TO GLOBALIZATION

At a 2006 roundtable meeting of 16 deans of business schools in Europe, Latin America, the United States, and China, the discussion underscored the way that globalization is changing management education. To gain a

deeper appreciation of region-specific market and business challenges, schools are forging closer ties with corporate partners, which tend to have a more granular understanding of these issues. They're also trying to diversify their case research. This is one of the reasons behind Columbia Business School's new partnership with the Indian Institute of Management in Ahmedabad. Similarly, the Kellogg School of Management at Northwestern recently announced plans to co-found an institute for research on global economic and social affairs that will be based in Bangkok.

To help students develop the international mindset that globalization requires, business schools make special efforts to recruit students who either hail from other countries or who have had significant overseas experience. At the University of Virginia's Darden School of Business, 30 percent of the student body is international; at the Tuck School of Business at Dartmouth, 34 percent of the student body comes from outside the United States. An internationally diverse student body increases graduates' networking potential—an important factor of career success in a global economy. At the University of Navarra's IESE Business School, nearly 75 percent of the students come from outside Spain; this level of diversity is partially responsible for the school's ranking as number-one in the world by the Economist Intelligence Unit last year.

In addition to requiring overseas apprenticeships and consulting work, many MBA programs offer courses on how to work collaboratively across organizational and cultural boundaries. To reinforce this learning, some even hold classes on more than one continent. Hong Kong University's full-time MBA program, offered in partnership with Columbia Business School and the London Business School, enables students to take courses in Asia and either New York or London. Hong Kong University's executive MBA, offered in conjunction with Kellogg, was ranked number-three in the world last year by the *Financial Times*. The Sloan School of Management at the Massachusetts Institute of Technology offers a joint MBA program with the School of Economics and Management (SEM) at China's Tsinghua University. SEM will also launch a dual-degree executive MBA program with France's INSEAD this June. And the Wharton School of Business at the University of Pennsylvania is seriously considering a campus in India to provide executive MBA programs.

Darden's "global business experiences," one-week courses that are held during spring break, take place in nine different countries. Harvard Business School recently launched a China educational immersion program, with 70 MBA students spending winter break traveling to Beijing, Hong Kong, Hangzhou, Shanghai, and other locations. Rotman is planning a study tour of India for MBA students in May. The Haas School of Business at the University of California, Berkeley, recently launched a 10-day trip to Israel that gave 35 MBA students the opportunity to meet with some of that country's top financial and economic leaders.

INTRODUCING: THE SPECIALIZED MBA

In response to the growing call for more specific expertise, select schools now offer concentrations in such topics as healthcare management, higher education administration, family-owned business, sports management, nonprofit management, entrepreneurship, and supply-chain studies. Last fall, Columbia launched the Program on Social Intelligence, which employs experiential learning and coaching to teach MBA students how to use emotional awareness to be better managers.

But the curricular richness doesn't stop there. Contemporary issues and concerns have prompted schools to create a cornucopia of new courses. For example, Haas and the Graduate School of Business at Stanford both offer dozens of courses on environmental sustainability. At Darden, a course in business ethics is a required part of the first-year program. Other topics that are receiving greater emphasis these days include social responsibility, decision making, leadership, creativity and innovation, design, and public policy.

DEPLOYING TECHNOLOGY IN NEW WAYS

To make room for new curricular emphases, schools are putting the more rudimentary courses in finance and accounting online. New classroom technologies are also being used to enhance learning. Podcasts, for example, enable students to listen to guest speakers from around the world. Personal clickers allow professors to immediately gauge students' comprehension of the lecture material. Photographing whiteboards and tablet PCs simplify information transfer. (The Fuqua School of Business at Duke University, a leader in piloting next-generation computing devices, has worked with more than a dozen companies to test first- and second-generation tablet PCs. The school is currently developing an online social networking application to assist students with their career searches.)

At Babson, voice-annotated spreadsheets enable students to hear professors' commentary while they study the details of the financial statements of companies that are profiled in case assignments. The school also plans to make use of wikis, which will allow professors to alter the content of online readings based on how well students are understanding the material.

LEARNING OPPORTUNITIES ACROSS THE LIFESPAN

Executive education programs are bringing MBA graduates back to campus at intervals throughout their careers. Many of these short, intensive programs focus on the more nuanced and multidisciplinary skills required for higher-level business challenges, or else more industry-specific business issues.

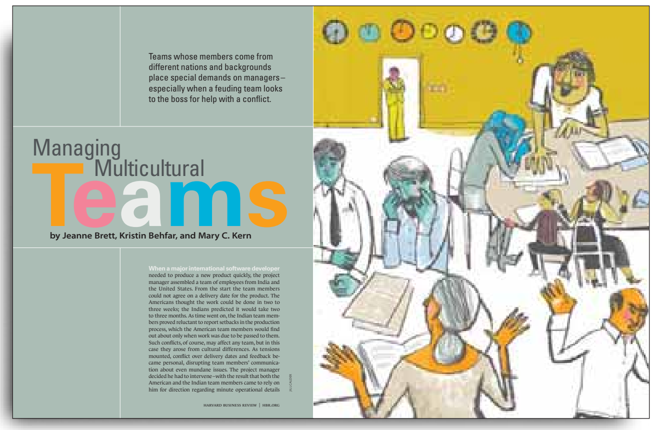
For several years now, both Rotman and Columbia have offered short courses in financial literacy and accounting essentials to corporate directors. Haas offers a similar mini-MBA course that gives corporate lawyers the accounting background they need to fulfill their obligations under Sarbanes-Oxley.

All in all, it is a time of great ferment. Which makes sense: if the pace of change in the workplace isn't slowing down, why should it be any different for business schools?

Letters to the Editor

Managing Multicultural Teams

I came away from reading Jeanne Brett, Kristin Behfar, and Mary C. Kern's "Managing Multicultural Teams" (November 2006) with the impression that tensions on multicultural teams can quickly be resolved or avoided with a little knowledge about major cultural differences. Nothing could be further from the truth. Moreover, you don't have to cross ethnic or national lines to run into the issues mentioned in the article. Many of the problems the authors identify as cross-cultural can also be found on more outwardly homogeneous teams.


Teams whose members come from different nations and backgrounds place special demands on managers–especially when a feuding team looks to the boss for help with a conflict.

Managing Multicultural Teams

by Jeanne Brett, Kristin Behfar, and Mary C. Kern

When a major international software developer needed to produce a new product quickly, the project manager assembled a team of employees from India and the United States. From the start the team members could not agree on a delivery date for the product. The Americans thought the work could be done in two to three weeks; the Indians predicted it would take two to three months. As time went on, the Indian team members proved reluctant to report setbacks in the production process, which the American team members would find out about only when work was due to be passed to them. Such conflicts, of course, may affect any team, but in this case they arose from cultural differences. As tensions mounted, conflict over delivery dates and feedback became personal, disrupting team members' communication about even mundane issues. The project manager decided he had to intervene–with the result that both the American and the Indian team members came to rely on him for direction regarding minute operational details

JILL CALDER

HARVARD BUSINESS REVIEW | HBR.ORG

Collective cultural identities can take us only so far, and a little knowledge often exacerbates a situation. In fact, preconceived notions about an individual's behavior may actually stimulate it. This is not to say we shouldn't be aware of differences among cultures. The trick is to navigate between the collective identity and the individual. Often, the inability of incompetent individuals to resolve their personal differences is incorrectly attributed to cultural differences. So while collective identities are cute and interesting and put things in nice categories, it is prudent to see individuals for who they are and not what they look like or where they come from.

For instance, I have studied and worked in the United States for more than 20 years, and nothing is more irritating than seeing others make assumptions about me based on my skin color or country of origin. As a consultant, I have worked with homogeneous teams that were dysfunctional. Members were unable to communicate effectively, and everyone had a personal agenda. I have also worked with heterogeneous teams that were able to communicate effectively. The members may have looked very different and had different backgrounds, but they were focused on achieving a shared goal.

As more cultural groups participate in the global economy, collective identity will continue to evolve. As it does, business will increasingly be transacted where many cultural identities overlap; the more global the economy becomes, the greater the overlap. Thus, what may appear to some to be a distinct and narrow cultural identity may actually be shared by all of those who operate in the global economy.

Raj Beekie
Consultant
Concordia University
St. Paul, Minnesota

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

The strength of Jeanne Brett, Kristin Behfar, and Mary C. Kern's article is its argument that the more diverse a group is, the more subtle and flexible are the management interventions required to achieve success. Its weakness is an overemphasis on national characteristics as an explanation for different personal or group responses to challenges.

A better approach would be to recognize that national background is just one of many variables. Life and work experiences also lead to different starting points and receptiveness. In this volatile world, we need to respect individuals rather than to lump people together based on national or ethnic background. "Context" is a better operational term than "culture."

Martyn Sloman
Learning, Training, and Development Adviser
Chartered Institute of Personnel and Development
Wimbledon, London

"Managing Multicultural Teams" does not go far enough. The authors mistakenly assume that multicultural management teams are always working toward the same goal – yet they are frequently beset by underlying differences in objectives, major resource imbalances, or dramatically different operating styles and environments. Under these circumstances, the solutions are likely to be even more diverse and situational than those outlined in the authors' four-strategy framework.

HBR should devote an entire issue to the complexities of multicultural management. Articles could cover triangulation, which introduces third-culture managers to mediate between two cultures; shadow managing, in which paired sets of managers from two cultures jointly perform key functions; and split management, which has been found to reduce conflicts between some business cultures, notwithstanding the "vertical silo" effect. The latter two approaches are partly contradictory, so knowing when to apply each one is critical.

Kas Kalba
President
Kalba International
New Haven, Connecticut

The Tools of Cooperation and Change

I disagree with Clayton M. Christensen, Matt Marx, and Howard H. Stevenson's assertion, in "The Tools of Cooperation and Change" (October 2006), that management can encourage people to work together by using a variety of carrots and sticks. Carrot-and-stick thinking makes it impossible to achieve real alignment. The implied threat and bribery of this approach means that those wielding the sticks and offering the carrots create disconnection and separation from those with whom they are seeking cooperation.

Emphasizing tool selection is not the route to alignment either. Those who focus on tools risk turning those with whom management seeks to align into tools as well. It is difficult to cooperate with a tool; it is easier to learn how to use a tool. The level of engagement with those you are using as tools, or using tools on, is generally not high – leading to a low level of uncoerced compliance.

Alignment occurs in conversations. When people consider their relationships with each other, with others outside their group or organization, and with what they are out to accomplish together, they can arrive at a fitting and inspiring direction for their work group or organization. By listening for connection, people can achieve an alignment that emerges from trust and mutual interest, not forced cooperation.

Lorne Armstrong
President
Armstrong Consulting Group
Surrey, British Columbia
Canada

Breaking the Trade-Off Between Efficiency and Service

The framework Frances X. Frei presents in "Breaking the Trade-Off Between Efficiency and Service" (November 2006) inadvertently perpetuates the disconnect between service providers and their customers.

Companies shape customers' experiences largely through the language they use to define their customers and services. Attaching a term like "capability variability" to customers dehumanizes them, which is exactly the opposite of what we should be doing if our goal is to understand and connect with them. Rather than make statements like, "Customers introduce subjective preference variability," why not say, "People have different tastes"? Organizations need to speak in human terms if they're going to successfully deal with very human issues.

But language isn't really where it starts. Language stems from an attitude, which, in turn, stems from a set of beliefs and values. So, before management consults Frei's strategy matrix or even begins to diagnose customer behavior, it needs to stop and really think about the company's purpose.

The extremely successful service businesses Frei mentions – Starbucks, Netflix, Southwest – did not begin with an explicit strategy for managing customer variability. They began with a mission, a belief, or a set of principles that enabled them to create coherent, consistent, and exceptional services. So, while it is helpful to identify and classify these companies' actions, it is not helpful to believe that such actions are strategies that exist in relative isolation, just waiting to be executed. They rest upon a foundation that is even more complex, fragile, and difficult to construct and manage: corporate identity.

Mark Jacobs
MBA Class of 2007
Harvard Business School
Boston

Frei responds: Mark Jacobs balks at using the language of operations to explore customer management issues for fear of losing sight of customers' humanity. I share his enthusiasm for optimizing customer experiences, but I disagree that the development of precise terms and tools to help managers threatens those experiences. In many service industries, success is intimately linked to an ability to understand and collaborate with a wide range of customers. In my experience, the insight and frameworks of the operations domain are liberating rather than constraining for service managers as they seek new ways to confront problems that – on the surface, at least – can seem impossible to solve. Conventional wisdom would have managers believe that there are inherent trade-offs between service and cost. An operations lens, customized for service settings, helps resolve this tension.

I have also been reassured that rigorous analysis does not need to come at the expense of treating customers with respect. In fact, companies that use all the tools at their disposal to address the full range of customer challenges often give their customers the most respectful of gifts: service excellence.

Get Your Act Together

Although Paul A. Argenti and Thea S. Haley's article, "Get Your Act Together" (Forethought, October 2006), made an excellent point about the importance of consistent corporate communications, it entirely missed what I would consider to be the much greater issue: ethics. The example cited in the article – Wal-Mart's publicly touting its social responsibility while internally recommending cuts to employee health care benefits – illustrates what happens when the leaders of a corporation ignore the published values of the organization. I hope that the authors and readers alike can see that when a corporation is so duplicitous that it chooses to orchestrate an integrated communications strategy rather than address its fundamental ethical issues, we are all in big trouble.

If you espouse values, then live them. If you really don't believe them, then don't adopt them. You are much better off setting the bar low and living consistently with the weak expectations you set than you are behaving inconsistently. You cannot get away with that for long in this age of transparency. All Wal-Mart shareholders should be shocked and ashamed at this ethical breach and demand that the company's executives be truly accountable to the company's stated values.

David Edwards
Owner
HEVaSOF Gallery
Spokane, Washington

Argenti and Haley respond: We agree with David Edwards that corporations should live the values they espouse, but that alone will not create the kind of strategic alignment we write about in our article. In fact, we don't believe Wal-Mart did anything unethical – or even unusual.

A call to action on ethics is important, but it is not the focus of our research. Instead, we examine how the lack of coordination between a company's senior managers and its various corporate communication functions often makes people believe that companies are doing something wrong when they are not. Sadly, many companies other than Wal-Mart suffer from the same misconceptions about their activities every day.

Disaster Relief, Inc.

I agree with the premise of Anisya Thomas and Lynn Fritz's article, "Disaster Relief, Inc." (November 2006). Global disaster relief could be improved by creating approaches that ensure aid arrives when and where it's needed most. But what do the authors advise when corrupt government officials are in charge of receiving and distributing relief?

When a major earthquake struck Gujarat in January 2001, India received aid from many countries and agencies. Politicians in Mumbai then proceeded to line their own pockets by selling these supplies to local people. It was a real shame, because blankets and food did not reach the remote areas truly in need of these essentials.

Neeraj Gulati
Toronto

Thomas and Fritz respond: To a greater or lesser extent, corruption has plagued almost every disaster relief effort in the developed as well as the developing world. It can be mitigated in one of two ways. First, the unchecked flow of unsolicited goods from well-intentioned donors must be stopped. These goods choke vital supply lines, and with no designated and credible agent to warehouse, transport, and distribute them, they often languish unsupervised and unclaimed. Their misdirection is an inevitable consequence. Second, the supply chains of the relief organizations that bring vast quantities of goods to disaster locations must be professionalized to the greatest extent possible. The development of rigorous processes supported by technology, documentation, and trained personnel has stemmed corruption in private-sector international shipping. The application of similar tools and approaches in the humanitarian sector could significantly diminish the corruption that occurs during disasters. This would also be an excellent area for partnership with private-sector organizations.

Erratum: In the article "Perspectives: Moments of Truth" in the January 2007 issue of HBR, we neglected to state that the essay by Duleep Aluwihare was adapted from a version that appeared in the December 2004 issue of *Harvard Business Review Polska*. We regret the omission.

Executive Summaries

MARCH 2007


SPECIAL: GETTING THE MOST OUT OF TOP TALENT

Harvard Business Review

www.hbr.org March 2007

DESIGNING STRATEGY
page 58

> “Companies growing their businesses outside the home market must choose one or more of three basic strategic options: adaptation, aggregation, and arbitrage.”
>
> – page 58

COVER STORY

58 | Managing Differences: The Central Challenge of Global Strategy

Pankaj Ghemawat

The main goal of any international strategy should be to manage the large differences that arise at the borders of markets. Yet executives often fail to exploit market and production discrepancies, focusing instead on the tensions between standardization and localization.

In this article, Pankaj Ghemawat presents a new framework that encompasses all three effective responses to the challenges of globalization. He calls it the AAA Triangle. The A's stand for the three distinct types of international strategy. Through *adaptation,* companies seek to boost revenues and market share by maximizing their local relevance. Through *aggregation,* they attempt to deliver economies of scale by creating regional, or sometimes global, operations. And through *arbitrage,* they exploit disparities between national or regional markets, often by locating different parts of the supply chain in different places – for instance, call centers in India, factories in China, and retail shops in Western Europe. Ghemawat draws on several examples that illustrate how organizations use and balance these strategies and describes the trade-offs they make as they do so.

Because most enterprises should draw from all three A's to some extent, the framework can be used to develop a summary scorecard indicating how well the company is globalizing. However, given the tensions among the strategies, it's not enough simply to tick off the corresponding boxes. Strategic choice requires some degree of prioritization – and the framework can help with that as well. While it is possible to make progress on all three strategies, companies usually must focus on one or two when trying to build competitive advantage.

Reprint R0703C; HBR Article Collection "Choosing the Right Global Strategy" 1866

IDEAS & TRENDS

FORETHOUGHT

20 | Take Your Third Move First
Through the coevolutionary war game, strategists can better understand the forces that influence complex competitions. Reprint F0703A

Pursuit of Happiness A social psychologist combines data from more than 100 studies involving 80,000 people to gauge countries' comparative level of well-being.

High-Tech Ways to Keep Cupboards Full Makers of nondurable goods should focus on keeping customers' – not just retailers' – shelves fully stocked. Reprint F0703B

Hidden Wealth in B2B Brands Managers consistently skimp on B2B brand building. That's an expensive mistake. Reprint F0703C

Meet the Innovation Capitalist Large firms puzzling over whether to pay for developed technology or take a risk on bleeding-edge concepts now have a third choice – a new kind of "innomediary" that identifies and refines innovations, reducing market risk in return for a share in the potential rewards. Reprint F0703D

Getting Attention for Unrecognized Brands People prefer a brand they know over one they don't – even when the familiar one is dangerous. But there are ways for unknown brands to compensate. Reprint F0703E

Novartis's Great Leap of Trust CEO Daniel Vasella explains why his company is placing a big bet on China's future as a world scientific power. Reprint F0703F

Make Your Back Office an Accelerator A new study identifies exactly how much bang for the buck a firm can get when it makes targeted cuts in back-office costs and takes steps to boost efficiency. Reprint F0703G

Beating the Market with Customer Satisfaction A growing body of research conclusively shows that higher customer satisfaction leads to higher share prices. Reprint F0703H

Reviews Featuring "Getting Ahead of the Curve: Corporate Strategies That Address Climate Change," by Andrew J. Hoffman.

ENTREPRENEURSHIP

HBR CASE STUDY

37 | Good Money After Bad?
John W. Mullins

Christian Harbinson, a young associate at the venture capital firm Scharfstein Weekes, has a difficult decision to make before the next investment committee meeting. He's been watching over SW's investment in Seven Peaks Technologies, and sales of its single product have been disappointing. Now the company's head, Jack Brandon, wants another $400,000 to pursue a new product.

Harbinson believes in Brandon and in his proprietary technology – a titanium alloy that prevents surgical instruments from sticking to tissue. Three years ago, Brandon quit his job and put $65,000 of his savings into developing a nonstick cauterizing device. Two distributors offered to carry it after they saw his demonstration at a trade show, and a couple of surgeons, quickly becoming enthusiastic, promised testimonials.

But if Brandon's cauterizer is to take off, surgeons will have to abandon the forceps they've traditionally used and switch to the Seven Peaks device – a change in behavior that will come slowly if at all. So, Brandon thinks, why not adapt his alloy to a line of forceps?

Now Harbinson wonders if he himself has become emotionally overinvested in Seven Peaks and if this decision is as much a test of his VC potential as of the actual deal. Should Scharfstein Weekes back Brandon's company with a second round of funding, or would it be a case of throwing good money after bad?

Commenting on this fictional case study are Ivan Farneti, a partner with Doughty Hanson Technology Ventures; Fred Hassan, the chairman and CEO of Schering-Plough; Robert M. Johnson, a venture partner with Delta Partners and a visiting professor at the University of Navarro's IESE Business School; and Christoph Zott, an associate professor of entrepreneurship at Insead.

Reprint R0703A
Reprint Case only R0703X
Reprint Commentary only R0703Z

LEADERSHIP

51 | The Ethical Mind

A Conversation with Psychologist Howard Gardner

Business leadership has become synonymous in the public eye with unethical behavior. Widespread scandals, massive layoffs, and inflated executive pay packages have led many to believe that corporate wrongdoing is the status quo. That's why it's more important than ever that those at the top mend relationships with customers, employees, and other stakeholders.

Professor Gardner has spent many years studying the relationship between psychology and ethics at Harvard's Graduate School of Education. In this interview with HBR senior editor Bronwyn Fryer, Gardner talks about what he calls the ethical mind, which helps individuals aspire to do good work that matters to their colleagues, companies, and society in general.

In an era when workers are overwhelmed by too much information and feel pressured to win at all costs, Gardner believes, it's easy to lose one's way. What's more, employees look to leaders for cues as to what's appropriate and what's not. So if you're a leader, what's the best way to stand up to ethical pressures and set a good example?

First and foremost, says Gardner, you must believe that retaining an ethical compass is essential to the health of your organization. Then you must state your ethical beliefs and stick to them. You should also test yourself rigorously to make sure you're adhering to your values, take time to reflect on your beliefs, find multiple mentors who aren't afraid to speak truth to your power, and confront others' egregious behavior as soon as it arises.

In the end, Gardner believes, the world hangs in the balance between right and wrong, good and bad, success and disaster. "You need to decide which side you're on," he concludes, "and do the right thing."

Reprint R0703B

HBR Spotlight LEADERSHIP

72 | Leading Clever People

Rob Goffee and Gareth Jones

In an economy driven by ideas and intellectual know-how, top executives recognize the importance of employing smart, highly creative people. But if clever people have one defining characteristic, it's that they do not want to be led. So what is a leader to do?

The authors conducted more than 100 interviews with leaders and their clever people at major organizations such as PricewaterhouseCoopers, Cisco Systems, Novartis, the BBC, and Roche. What they learned is that the psychological relationships effective leaders have with their clever people are very different from the ones they have with traditional followers. Those relationships can be shaped by seven characteristics that clever people share: They know their worth – and they know you have to employ them if you want their tacit skills. They are organizationally savvy and will seek the company context in which their interests are most generously funded. They ignore corporate hierarchy; although intellectual status is important to them, you can't lure them with promotions. They expect instant access to top management, and if they don't get it, they may think the organization doesn't take their work seriously. They are plugged into highly developed knowledge networks, which both increases their value and makes them more of a flight risk. They have a low boredom threshold, so you have to keep them challenged and committed. They won't thank you – even when you're leading them well.

The trick is to act like a benevolent guardian: to grant them the respect and recognition they demand, protect them from organizational rules and politics, and give them room to pursue private efforts and even to fail. The payoff will be a flourishing crop of creative minds that will enrich your whole organization.

Reprint R0703D; HBR Article Collection "Leading Creative People" 1867

HBR Spotlight SELF-MANAGEMENT

80 | Crisis at the Summit

George D. Parsons and Richard T. Pascale

An unrecognized affliction is striking certain gifted performers at the top of their game. Its cause, paradoxically, is success itself. These stars, who thrive on conquering new challenges, can lose their bearings and question their purpose once a job has been mastered. A vague dissatisfaction gives way to confusion and then to inner turmoil. Left unattended, this *summit syndrome* can derail promising careers.

The syndrome has three phases. In the *approach* phase, when most of the challenges of a current job have been met, sufferers tend to push harder in a vain attempt to recapture the adrenaline rush of the climb. Then, in the *plateauing* phase, when virtually all the challenges have been conquered, these individuals, who are incapable of coasting, bear down to try to produce ever more stellar results, but to less effect and greater dissatisfaction. This leads to the terminal *descending* phase, when performance slips noticeably. As their superstar status fades, they jump ship, accept demotions, or take lateral transfers.

It's a terrible waste, for if the syndrome is recognized, steps can be taken before performance slips to dispel the confusion and set the stage for productive growth to the next assignment. There are four parts to this process: First, understand your "winning formula" – the characteristic way you approach a situation – and the vital part it plays in feeling stale or losing your edge. Second, reconnect with your core purpose in life. Third, recast your current, or future, job to better align your inner aspirations with the external requirements of your work. And fourth, create a developmental path by honing a handful of core leadership competencies.

None of this is easy, but for talented individuals – and the organizations that rely on them – the vaccine of preventive awareness is far better than gambling on an after-the-fact cure once the crisis is full-blown.

Reprint R0703E

STRATEGY & COMPETITION

94 | Competitive Advantage on a Warming Planet

Jonathan Lash and Fred Wellington

Whether you're in a traditional smoke-stack industry or a "clean" business like investment banking, your company will increasingly feel the effects of climate change. Even people skeptical about global warming's dangers are recognizing that, simply because so many others are concerned, the phenomenon has wide-ranging implications.

Investors already are discounting share prices of companies poorly positioned to compete in a warming world. Many businesses face higher raw material and energy costs as more and more governments enact policies placing a cost on emissions. Consumers are taking into account a company's environmental record when making purchasing decisions. There's also a burgeoning market in greenhouse gas emission allowances (the carbon market), with annual trading in these assets valued at tens of billions of dollars. Companies that manage and mitigate their exposure to the risks associated with climate change while seeking new opportunities for profit will generate a competitive advantage over rivals in a carbon-constrained future.

This article offers a systematic approach to mapping and responding to climate change risks. According to Jonathan Lash and Fred Wellington of the World Resources Institute, an environmental think tank, the risks can be divided into six categories: *regulatory* (policies such as new emissions standards), *products and technology* (the development and marketing of climate-friendly products and services), *litigation* (lawsuits alleging environmental harm), *reputational* (how a company's environmental policies affect its brand), *supply chain* (potentially higher raw material and energy costs), and *physical* (such as an increase in the incidence of hurricanes). The authors propose a four-step process for responding to climate change risk: Quantify your company's carbon footprint; identify the risks and opportunities you face; adapt your business in response; and do it better than your competitors.

Reprint R0703F

ORGANIZATION & CULTURE

104 | What It Means to Work Here

Tamara J. Erickson and Lynda Gratton

What distinguishes a company that has deeply engaged and committed employees from another one that doesn't? It's not a certain compensation scheme or talent-management practice. Instead, it's the ability to express to current and potential employees what makes the organization unique. Companies with highly engaged employees articulate their values and attributes through "signature experiences" – visible, distinctive elements of the work environment that send powerful messages about the organization's aspirations and about the skills, stamina, and commitment employees will need in order to succeed there.

Whole Foods Market, for example, uses a team-based hiring and orientation process to convey to new employees the company's emphasis on collaboration and decentralization. At JetBlue, the reservation system is run by agents from their homes, a signature experience that boosts employees' satisfaction and productivity.

Companies that successfully create and communicate signature experiences understand that not all workers want the same things. Indeed, employee preferences are an important but often overlooked factor in the war for talent. Firms that have engendered productive and engaged workforces address those preferences by following some general principles: They target potential employees as methodically as they target potential customers; they shape their signature experiences to address business needs; they identify and preserve their histories; they share stories – not just slogans – about life in the firm; they create processes consistent with their signature experiences; and they understand that they shouldn't try to be all things to all people.

The best strategy for coming out ahead in the war for talent is not to scoop up everyone in sight but to attract the *right* people – those who are intrigued and excited by the environment the company offers and who will reward it with their loyalty.

Reprint R0703G

PERFORMANCE MEASUREMENT

115 | Maximizing Your Return on People

Laurie Bassi and Daniel McMurrer

Though most traditional HR performance metrics don't predict organizational performance, alternatives simply have not existed – until now. During the past ten years, researchers Laurie Bassi and Daniel McMurrer have worked to develop a system that allows executives to assess human capital management (HCM) and to use those metrics both to predict organizational performance and to guide organizations' investments in people.

The new framework is based on a core set of HCM drivers that fall into five major categories: leadership practices, employee engagement, knowledge accessibility, workforce optimization, and organizational learning capacity. By employing rigorously designed surveys to score a company on the range of HCM practices across the five categories, it's possible to benchmark organizational HCM capabilities, identify HCM strengths and weaknesses, and link improvements or backsliding in specific HCM practices with improvements or shortcomings in organizational performance.

The process requires determining a "maturity" score for each practice, based on a scale of 1 (low) to 5 (high). Over time, evolving maturity scores from multiple surveys can reveal progress in each of the HCM practices and help a company decide where to focus improvement efforts that will have a direct impact on performance. The authors draw from their work with American Standard, South Carolina's Beaufort County School District, and a bevy of financial firms to show how improving HCM scores led to increased sales, safety, academic test scores, and stock returns.

Bassi and McMurrer urge HR departments to move beyond the usual metrics and begin using HCM measurement tools to gauge how well people are managed and developed throughout the organization. In this new role, according to the authors, HR can take on strategic responsibility and ensure that superior human capital management becomes central to the organization's culture.

Reprint R0703H

SELF-MANAGEMENT

125 | Realizing What You're Made Of

Glenn E. Mangurian

A ruptured disk pressed against Glenn Mangurian's spinal cord several years ago, leaving the lower half of his body permanently paralyzed. One minute, Mangurian was healthy and secure in his career as a management consultant; the next, his life was transformed and filled with uncertainty. The injury has taught him volumes about resilience and leadership. In this first-person account, he explains how people can create a new future after a crisis hits – and how, even if they're simply tackling everyday challenges, they can prepare themselves for the worst.

Mangurian identifies resilience as one of the key qualities desired in business leaders today, but he says that many people confuse it with toughness. Toughness certainly can be an advantage in business, because it enables you to separate emotion from the negative consequences of difficult choices. But it can also be a disadvantage, because it can cut you off from many of the resources you'll need to bounce back after a crisis. Resilience, by contrast, is mostly about absorbing challenges – not deflecting them – and rebounding stronger than before.

The author has learned a number of lessons about leadership in the face of adversity. For instance, although crisis distorts reality by reinforcing your fears, it also puts an emphasis on what matters right now; it highlights what's important to you and what you're capable of. Another major lesson is that loss amplifies the value of what remains, pushing you to take stock of what you have and to celebrate your assets. Perhaps most important, you can't know what will happen tomorrow – and it's better that way, because it's far more rewarding to engage with the present than just to prevent bad things from happening.

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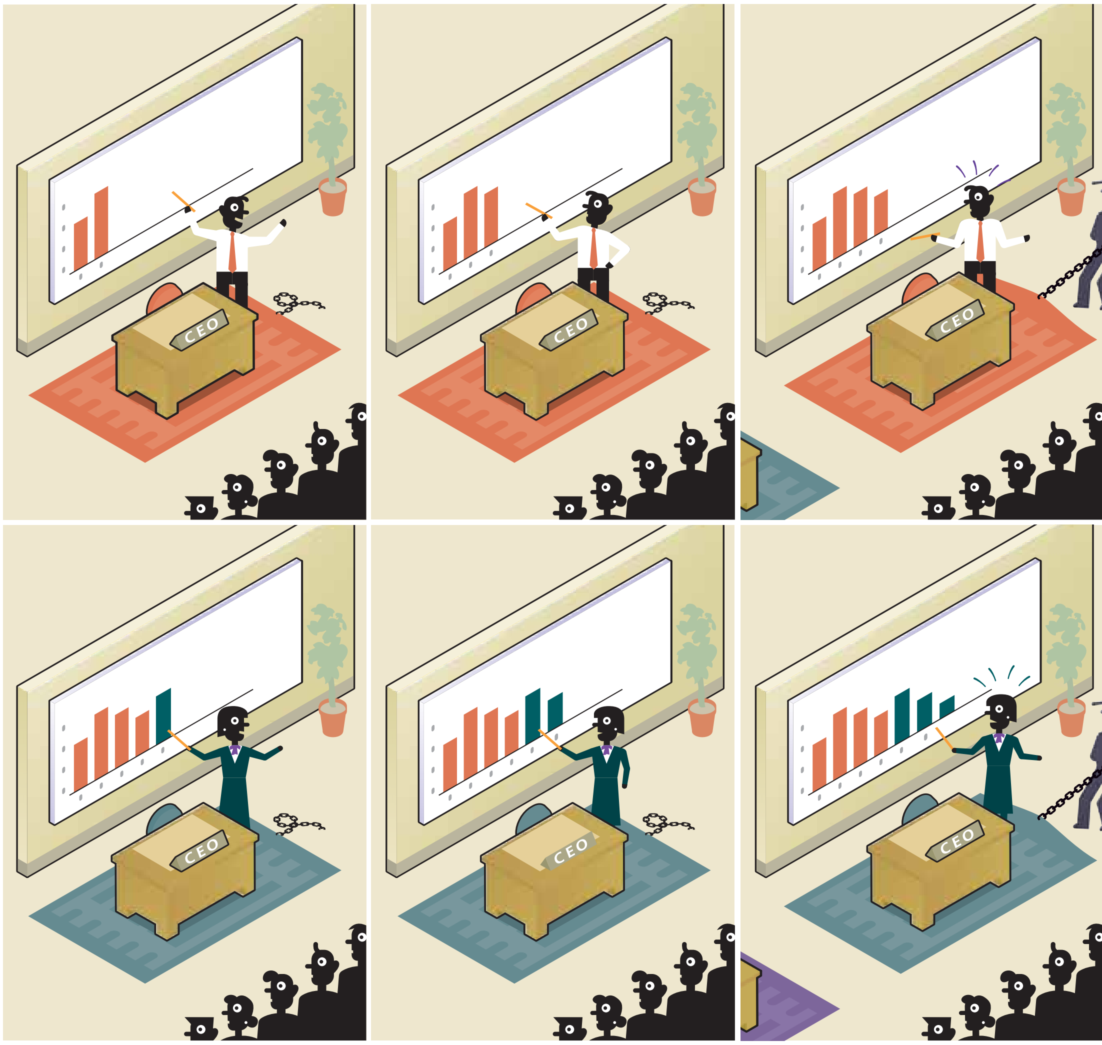

MOYER

Who's Next?

LEARNING TO BE A GREAT CEO takes time. Stakeholders, though, have little patience for leaders who are learning on the job. Dan Ciampa, in "Almost Ready: How Leaders Move Up" (HBR January 2005), cites The Center for Creative Leadership's finding that 40% of new CEOs fail in their first 18 months and writes, "the churn rate is on the rise."

Part of the problem may lie in how leaders are chosen. As Ram Charan says in "Ending the CEO Succession Crisis" (HBR February 2005), "Too often, new leaders are plucked from the well-worn Rolodexes of a small recruiting oligarchy and appointed by directors who have little experience hiring….Hiring a CEO is simply different."

One difference is the importance of taking the long view – not only allowing a newly appointed CEO time to ride out the bumps of a few disappointing quarterly results but also ensuring that lengthy preparation precedes a new CEO's election. As Charan says, "Choosing the CEO's successor is not one decision but the amalgam of thousands of decisions made by many people every day over years and years."

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