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APRIL 2014

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# THE RESILIENT COMPANY



## HOW TO THRIVE IN A WARMER WORLD

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A close-up, artistic photograph of a watch movement. The image is dominated by a large, circular, polished metal gear with fine radial lines, set within a dark red, glossy frame. Other gears and components are visible in the background, creating a sense of depth and mechanical complexity. The lighting highlights the metallic textures and the smooth curves of the frame.

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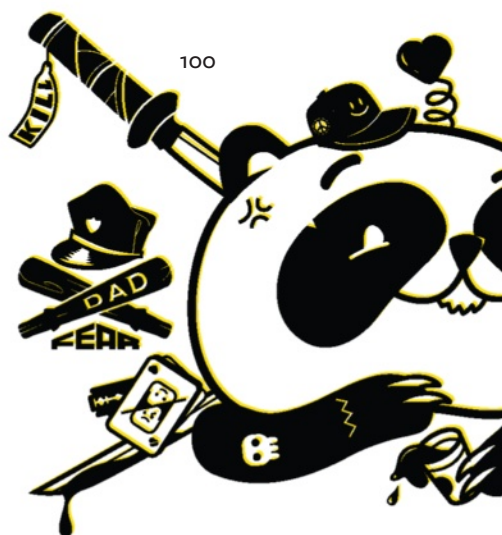
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Amongst the whirlwind of volatility that seems to spin from one crisis to the next, business leaders are looking for new skills and strategies that will help their organizations thrive in the new global economy. At the same time, in this era of unprecedented complexity, the study of resilience has emerged in which scientists, economists, government leaders and psychologists are working to understand how systems, organizations and people can adapt to stay fit within an environment of constant change.

In his new book, *"Resilience, Why Things Bounce Back,"* author Andrew Zolli draws from ecology and sociology to consider resilience "as the capacity of a system, enterprise, or a person to maintain its core purpose and integrity in the face of dramatically changed circumstances." Zolli suggests that "If we cannot control the volatile tides of change, we can learn to build better boats."

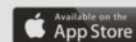
The notion of resilience is generally talked about in terms of economies, markets, ecosystems or people, but rarely in conjunction with organizational real estate. Leading real estate professionals consider how to create greater flexibility in their portfolios, but many overlook how they might better leverage these assets by developing strategies designed for resilience.

At Steelcase we asked ourselves how the concept of resilience could be applied to the creation of the places where people within an organization come together. Could we construct a strategy designed to leverage today's complexities and embrace the speed in which circumstances change? Could real estate become an adaptive system to better support an organization's strategy, brand and culture by shifting fluidly while remaining economically viable? Could we develop that "better boat" through real estate? In each case, we believe the answer is yes.

**Continue reading at [steelcase.com/resilient](http://steelcase.com/resilient)**



To read about this design research, download the e-publication **"Steelcase 360"** via the **Apple® App Store.**



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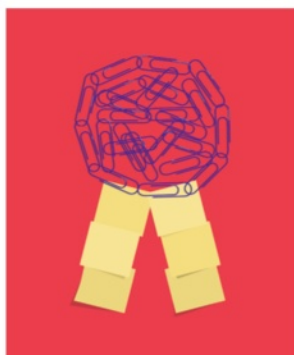
Public corporations *will* be eclipsed.

**RECEIVING FEEDBACK**

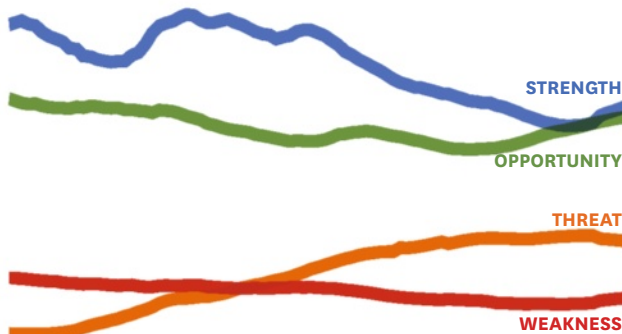
Sheila Heen on three key challenges.  
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# From the Editor

## Honoring Our Own

**O**ur primary goal at HBR is to publish the most important and useful ideas for business. While we hope that everything in our pages serves that mission, we take time each year to celebrate the winners of the HBR McKinsey Awards, given to the most outstanding articles of the previous 12 months.

To determine the 2013 honors, we called on two groups of judges. First, a panel of 11 independent experts read all the feature articles published during the year and rated them for rigor and relevance. It then selected a top piece from among the three ranked highest on its list (actually four, as this year produced a tie for third place). Next, more than 100 members of our Advisory Council of engaged readers reviewed the four short-listed pieces and made their first-place choice.

The two groups agreed on the winning article: **“The Focused Leader,”** by Daniel Goleman, published in December. Goleman, the author of the best-selling book *Emotional Intelligence*, argues that executives must cultivate a higher level of awareness about what truly matters, drawing on recent neuroscience research to demonstrate how they can do so.

Our runners-up, honored as HBR McKinsey Award finalists:

**“Special Forces’ Innovation: How DARPA Attacks Problems,”** by Regina E. Dugan and Kaigham J. Gabriel (October)

**“The Strategy That Will Fix Health Care,”** by Michael E. Porter and Thomas H. Lee (October)

**“Using the Crowd as an Innovation Partner,”** by Kevin J. Boudreau and Karim R. Lakhani (April)

I’d like to thank our expert panel—Beth Comstock, Boris Groysberg, Joan Magretta, Roger Martin, Michael Mauboussin, Christopher Meyer, Vineet Nayar, Alex “Sandy” Pentland, Paul Polman, Eric Ries, and Donald Sull—and our Advisory Council members for their time and commitment.

And I invite all of you to read the HBR McKinsey pieces and share your thoughts about them.



Adi Ignatius, Editor in Chief





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Volume 92, Number 4

April 2014

Printed in the U.S.A.



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## Hiring (and Firing) at Netflix



HBR article by **Patty McCord**, January–February  
Netflix’s former chief talent officer shares the approach she used to build a “culture of excellence”:

Hire only “A” players, and let go of people whose skills are no longer a fit. For Netflix, that meant parting with Laura, a bookkeeper who lacked the necessary accounting credentials, after the company went public. That idea bothered some readers:

The role of a company is not to use people and throw them away when their skill sets are no longer needed. It’s to provide the tools to empower people to build capabilities and acquire new skills. Take Laura, who was fired: Here was a person who understood the culture and had toiled really hard for the company during its

early phases. It would have been a better move to help her acquire a CPA, with Netflix reimbursing her and giving her more responsibility.

**Pramod Dikshith**, manager, Accenture

In a start-up situation it’s not unusual to terminate employees when the company

has outgrown their skills. It’s a gut-wrenching move but a necessary one. The kinds of skills needed in a company with 50 employees are very different from the kinds needed in a company with 500 employees. The same thing is true when you grow from \$1 million to \$50 million in revenues.

Most of the time retraining isn’t enough; the business demands people who have already taken companies from one level to another. Sometimes even the current CEO can’t make the cut. It’s one of the hardest things to do—but it must be done.

**Jacques Vilet**, president, Vilet International

**The author responds:** *The culture we created is not for everybody, and we were honest about that. I wanted Netflix to be a great place to be “from,” no matter how long the journey. Great colleagues, hard problems, tangible deliverables—those experiences create great résumés and careers. I have come to realize that it’s absolutely the responsibility of employees to hone their skills and proactively seek opportunities both within and outside their companies. Sometimes the timing is just wrong for the company or the person, and the next great job is somewhere else. I’ll say that if we don’t provide real life coaching to young workers, then they won’t acquire the skill of constantly learning. I find that technical folks tend to get this more so than other people do,*

### Find the Coaching in Criticism

HBR article by **Sheila Heen** and **Douglas Stone**, January–February

To get better at accepting feedback, you must overcome knee-jerk reactions to criticism, say two communication consultants.

This is a great article! I think it’s important to always be improving yourself, and the best way to do that is through feedback from others. And here’s another method for giving feedback that will allow the recipient to register it: Ask

him or her for permission. Simply asking people if you can offer feedback will usually bring their guard down. Thank you for a great read.

**Nicole Rawski**, director of analytics, Digitaria

All the steps are really useful. But I have a question about the fourth step: “Unpack the feedback.” Do we need to discuss it further with the feedback giver or just try to dig deeper into the feedback ourselves? If it’s by ourselves, how can we do it?

**Xiaofen Zhang**, CFA candidate



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*because for them it's clearer when things change. The pace of change for tech workers tends to be faster since technology is always innovating. The thing is, we are all technology workers now, and we should all think that way.*

It's well worth reading about Netflix on Glassdoor.com, a website that lets employees anonymously review their companies. Note how many times the "culture of fear" is mentioned.

**Frank Kelly**, principal software engineer, Nokia

As an 11-year former employee at Netflix, I can say without a doubt that this HR approach allowed Netflix to scale up without bloated head count. I can't speak to other areas of the company, but in my department there was no culture of fear. I didn't have a job; I got to wake up every day and work on interesting problems with smart people. That's how I felt. The culture also meant that wasting time on internal politics was at an absolute minimum. I'm speaking from my experience, but I know a lot of others who feel the same way.

**Barry W. Enderwick**, partner,  
Kaizen Creative Partnership



**The authors respond:** *Ideally, discuss feedback with the people who gave it, so you find out what they've noticed that led to the feedback or their specific ideas about what to do differently. If those people aren't available to you, do a mental experiment: Imagine different options for what a vague label (like "be more of a team player") might mean. Or you could enlist colleagues to help you. They may have observations or suggestions of their own.*



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## Why We Love Narcissists



HBR post by **Tomas Chamorro-Premuzic**, January

Narcissists all too frequently end up in leadership positions, where they can have a damaging effect on organizations. Chamorro-Premuzic explains why these people rise: They're masters of self-image, take credit but deflect blame, and fit many conventional ideas of how "leaders" behave.

I disagree with your inclusion of Steve Jobs among the narcissists. Jobs was the person, personality, and driving force behind one of the most innovative, disruptive, and successful companies of all time. He was not "excessive" but exactly what Apple needed to succeed in competing against bigger companies like Microsoft and Nokia. Dominant, type A personalities are obsessive and are the creators in this world. To mislabel achievers as "narcissists" does a disservice to our society.

**Michael Cummins**, real estate broker/investor

The author didn't seem to try very hard to dissuade anyone from wanting to become a narcissist. Which raises a question: How do you change a narcissist? Is that at all possible?

**Sachin Ganpat**, consultant, Intersect Services

I believe that this post is a bit too negative in outlook. Narcissists are often what is needed to implement tremendously difficult change initiatives or innovations, which demand their singular focus. Another article I read in HBR, "Narcissistic Leaders: The Incredible Pros, the Inevitable Cons," by Michael Maccoby, classified them into productive and nonproductive narcissists. It gave an interesting perspec-

tive as well as advice on how to deal with them when they're being too self-centered.

**Patricia Pruden**, health care consultant, Children's Cancer Hospital Egypt

For the most part you'll find that people fall in line behind these narcissists because they perceive it as their only way forward. Not to mention the ability of the narcissists to charm or bully their way as necessary. If your job is on the line, you may very well just stay quiet. If a promotion is possible, maybe you'll follow.

**David Hinton**, technician

**The author responds:** *First, my intention was not to sell narcissism to the world but to explain the common but rather irrational fascination with narcissists. So, I'd like to state very clearly that the world would be a much better place if we were less accepting of narcissists. Second, it's not easy to change people, especially when they display personality disorders (which are by definition very rigid patterns of behavior). However, in cases of milder narcissism, it's possible to coach people to behave in a more modest way, focus less on themselves and more on others, and act in a more altruistic manner.*



## Strategy Should Be Uncomfortable

HBR article by **Roger L. Martin**, January–February



Strategic planning attempts to make strategy feel comfortable, when in reality fear, discomfort, and uncertainty are intrinsic to good strategy, says Martin. Strategists mistakenly embrace the predictability of costs when they should be focusing on the less predictable but more important question of new revenue.

This article helps explain why I feel it may make more sense for the strategic planning function to report through marketing than through finance. Marketing is more concerned with the consumer and less prone to falling into some of those traps. That being said, I still think strategic planning should report directly to the CEO.

**Gerald C. Nanninga**, principal consultant, Planninga from Nanninga

I appreciate Rule 3: Make the logic explicit. As a consultant I see so much wishful thinking masquerading as plausible strategy. The logical framework approach is an emerging best practice for strategy design, because it incorporates causal thinking in a simple way that gets everyone on the same page—and exposes flaky thinking.

**Terry Schmidt**, founder, Strategic Planning Academy

Your strategy should be seen not as a straitjacket but rather as a road map clearly pointing out the goal and describing the terrain and the chosen route under the known or assumed conditions.

**Peter Sørensen**, owner, PSB-Management





## Employees Who Feel Love Perform Better

HBR post by **Sigal Barsade** and **Olivia (Mandy) O'Neill**, January

The more “compassionate love”—warmth, affection, and connection—employees feel at work, the better they do their jobs, say two authors who present new research tying caring work environments to higher employee satisfaction and attendance and also client outcomes.

I agree with the article, but I would like to highlight that it is not about going to the office every day with a fake smile and sharing robotic hugs with your coworkers. These feelings have to be authentic. It is not enough to ask your employees about their families; you must ask as if you really care. If you do it in a mechanical way, it's never going to work for anybody.

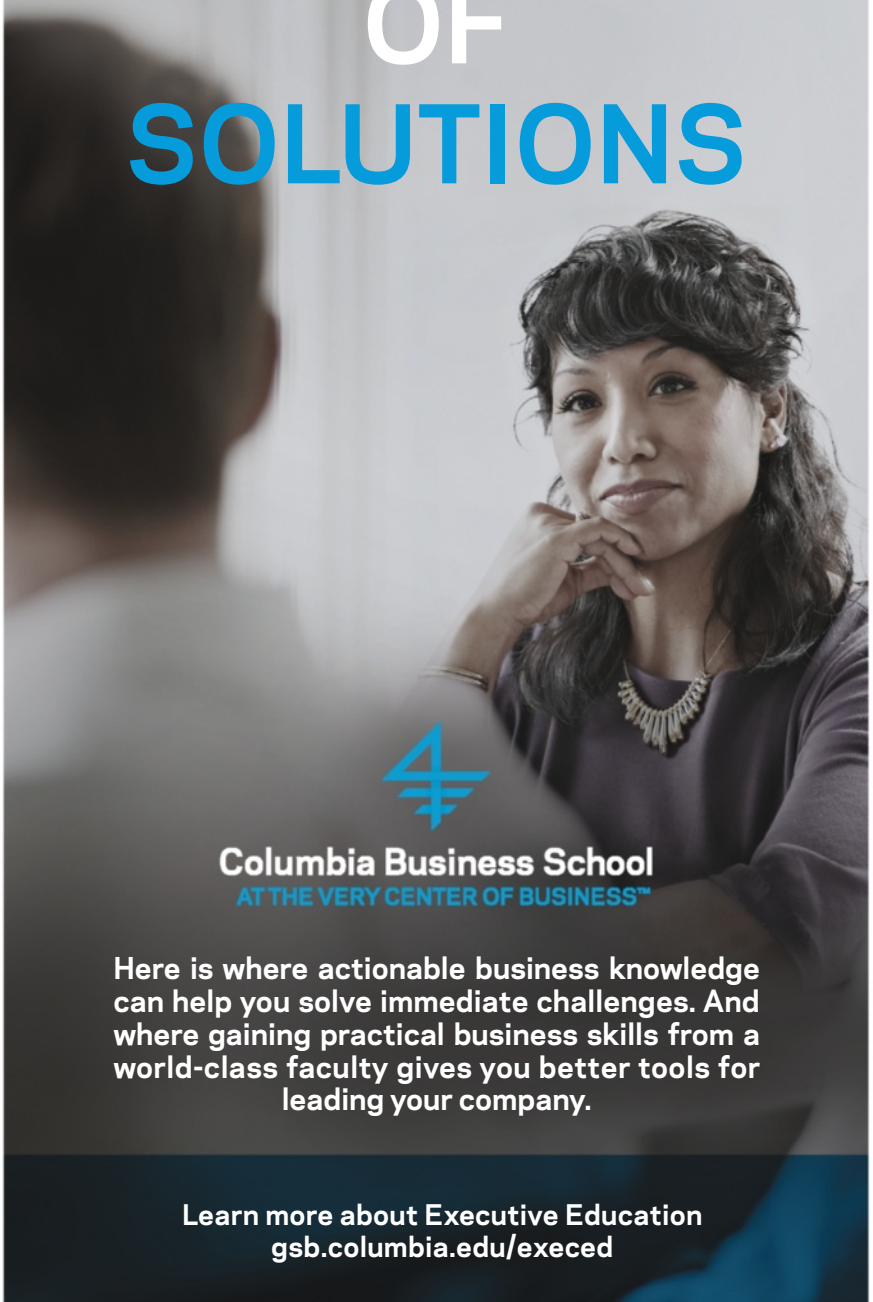
**Fiores Florentino Sierra**, training coordinator, Inproca

Intriguing article. Compassionate love at work surely can create an atmosphere that fosters satisfaction and a sense of joy within individual employees. But it is also important to check these emotions when working in a team. Among a group, the intensity of connections may vary, depending on how similar members' interests, likes and dislikes, lifestyles, and so on are. Since an individual cannot be compassionate at the same level toward each colleague, conflicts may arise. Politicking sets in. Managers have to handle disagreements between “like-minded” silos and groups to harmonize the team. So, as rightly said in the article, an emotional culture needs to be promoted, but it also needs to be reviewed from time to time.

**Chowdhury Fahim Farhad**, manager, Standard Chartered Bank



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# Idea Watch

New Thinking, Research in Progress [hbr.org](http://hbr.org)



In most industries, quality has never mattered more. New technologies have empowered customers to seek out and compare an endless array of products from around the globe. Shoppers can click to find objective data compiled by experts at organizations such as *Consumer Reports* and J.D. Power and go online to read user-generated reviews at sites such as Amazon; together, these sources provide an early warning system that alerts the public to quality problems. And when customers are unhappy with a product or service, they can use social media to broadcast their displeasure. In surveys, 26% of consumers say they have used social media to air grievances about a company and its products. And this issue isn't limited to the consumer space—75% of B2B customers say they rely on word of mouth, including social media, when making purchase decisions.

But just as companies' margin for error has decreased, the likelihood of error has risen. In many industries, cycle times are compressing. During the recovery from the Great Recession, output gains have outpaced employment growth, and employees report straining to keep up with demands.

## ORGANIZATIONS

# Creating a Culture of Quality

Financial incentives don't reduce errors. Employees must be passionate about eliminating mistakes.

by Ashwin Srinivasan and Bryan Kurey

As a result of these pressures, managers must find a new approach to quality—one that moves beyond the traditional “total quality management” tools of the past quarter century. For two years CEB has conducted research exploring how companies can create a culture in which employees “live” quality in all their actions—where they are passionate about quality as a personal value rather than simply obeying an edict from on high. We define a “true culture of quality” as an environment in which employees not only follow quality guidelines but also consistently see others taking quality-focused actions, hear others talking about quality, and feel quality all around them.

We interviewed the quality function leaders at more than 60 multinational corporations, conducted an extensive review of academic and practitioner research, and surveyed more than 850 employees in a range of functions and industries and at all levels of seniority. Some of what we learned surprised us. Most notably, many of the traditional strategies used to increase quality—monetary incentives, training, and sharing of best practices, for instance—have little effect. Instead, we found, companies that take a grassroots, peer-driven approach develop a culture of quality, resulting in employees who make fewer mistakes—and the companies spend far less time and money correcting mistakes.

### Going Beyond Rules

What embeds quality deep in a company’s culture? And how, precisely, does an organization benefit as a result? These questions were at the heart of our “culture of quality” survey.

A minority of the employees we surveyed believe their company has succeeded in making quality a core value: Roughly 60% said they work in an environment without a culture of quality, especially when it comes to having peers who go “above and beyond.” Such companies are missing out on significant benefits. Employees who ranked their company in the top quintile in terms of quality reported addressing 46% fewer mis-

takes in their daily work than employees in bottom-quintile companies. In our surveys, employees report that it takes two hours, on average, to correct a mistake. Assuming an hourly wage of \$42.55 (the median for CEB client companies), a bottom-quintile firm with 26,300 employees (the median head count) spends nearly \$774 million a year to resolve errors, many of them preventable—\$350 million more than a top-quintile firm. Although figures will vary according to industry and company, here’s a broad rule of thumb: For every 5,000 employees, moving from the bottom to the top quintile would save a company \$67 million annually.

We also studied quality-improvement actions in eight different categories and conducted regression analyses to understand the relationship between those actions and employees’ appraisals of how rigorously their company focuses on quality. We found little or no correlation between

the use of standard tools and the achievement of a culture of quality. We are not suggesting that companies abandon those tools; however, they should use them to support rules-based quality measures, not as the underpinnings of a true culture of quality.

We pinpointed four factors that drive quality as a cultural value: leadership emphasis, message credibility, peer involvement, and employee ownership of quality issues. Our research indicates that companies could do much better with all four. Nearly half the employees surveyed reported insufficient leadership emphasis on quality, and only 10% found their company’s quality messages credible. Just 38% reported high levels of peer involvement, while 20% said that their company has created a sense of employee empowerment and ownership for quality outcomes.

We have identified clear actions that can help companies improve in each of the four areas.

**Maintaining a leadership emphasis on quality.** Even when executives have the best intentions, there are often gaps between what they say and what they do. As a result, employees get mixed messages about whether quality is truly important.

Seagate, a \$14 billion provider of media storage solutions, uses a series of leadership engagement mechanisms to help executives identify inconsistencies between their actions or decisions and the company’s ideal culture. Company leaders begin by agreeing on what would constitute an ideal culture and what behaviors would be needed to achieve it. Next, the quality and HR teams compared their definitions of “ideal culture” with employees’ observations, which revealed areas for improvement. The leaders then attended workshops that helped them spot behaviors that might be impeding their stated goal. Simulations made the lessons from the workshop concrete and memorable.

By showing leaders the gaps between the expected and the current state of their culture, Seagate created awareness and buy-in. “Executive participation has been

**A company with a highly developed culture of quality spends, on average,**

**\$350 MILLION**



**less annually fixing mistakes than a company with a poorly developed one.**

## THE FOUR ESSENTIALS OF QUALITY

In our research, we examined tools commonly used to make employees care about quality, including training, best-practices sharing, and monetary incentives. We concluded that only four attributes actually predict a culture of quality:

### Leadership Emphasis

Managers are told that quality is a leadership priority.

Managers “walk the talk” on quality.

When evaluating employees, bosses emphasize the importance of quality.

### Message Credibility

Messages are delivered by respected sources.

Workers find that communications appeal to them personally.

Messages are consistent and easy to understand.

### Peer Involvement

Most employees have a strong network of peers for guidance.

Peers routinely raise quality as a topic for team discussion.

Like members of a sports team, peers hold one another accountable.

### Employee Ownership

Workers clearly understand how quality fits with the job.

Workers are empowered to make quality decisions.

Workers are comfortable raising concerns about quality violations and challenging directives that detract from quality.

the most important factor driving culture change,” a senior development executive told us. “Leadership has shown enthusiasm and commitment that has trickled down through the organization.” Although the company does not share its data, it says that quality metrics have risen since the program began—and it expects the gains to continue.

**Ensuring message credibility.** Most companies energetically promote messages about the importance of quality—but their efforts are wasted if the messages are not believed. One company that has been successful with credible messaging is the beverage firm Diageo, whose brands include Johnnie Walker, Crown Royal, and Tanqueray. Confronted with the challenge of having 21,000 employees in disparate locations, Diageo identified four distinct segments of employees in terms of what drives hard work and created quality messages tailored to each one. It recognized that some workers respond best to messages emphasizing the reduced cost and hassle of producing defect-free goods, for example, while others are inspired by an emphasis on customer satisfaction. Local site managers chose the campaign they thought would most appeal at their site, and this customization helped the company’s messages resonate.


Smart leaders realize that quality messaging, like any campaign, needs to be refreshed over time. Managers should regularly test messages with their employees and use the feedback to ensure sustained relevance.

**Encouraging peer involvement.** Fostering peer engagement is a delicate balancing act. If leaders become overly involved in orchestration, then impact and authenticity suffer—but if they show too little support, they miss important opportunities.

One organization that has created effective peer networks is HGST (formerly Hitachi Global Storage Technologies), a Western Digital company. It uses positive social pressure to encourage employees to generate quality initiatives. The company displays employees’ ideas on posters in a busy hallway, providing a reminder that everyone at the company should work on quality. Managers publicly evaluate employees’ quality-improvement projects, highlighting not only business impact but also softer criteria, such as participant enthusiasm. HGST also organizes friendly “quality competitions” that capitalize on collective pride, not simply financial rewards, to spark ideas. “When I first joined the company, I was skeptical of the whole thing,” a quality and customer support executive told us. “But there’s a real sense of pride in work that people have developed as a result.”

**Increasing employee ownership and empowerment.** One of the defining traits of an organization with a true culture of quality is that employees are free to apply judgment to situations that fall outside the rules. Providing the right level of guidance is key. Too much stifles creativity and discretionary action, while too little leaves employees unclear about their authority to make decisions and carry them out.

Wrigley, best known for manufacturing chewing gum, writes “quality in action” guidelines to help employees understand the company’s expectations. It takes great care to apply the guidelines only to a short but critical list of improvement opportunities—the dozen or so “quality accountabilities” that each function is responsible for on a daily basis—and to strive for clarity while avoiding micromanagement. In addition, Wrigley creates opportunities for employees to observe and recognize quality actions that fall outside the guidelines, and it conducts group brainstorming sessions to determine the root causes of mistakes and identify corrective actions.

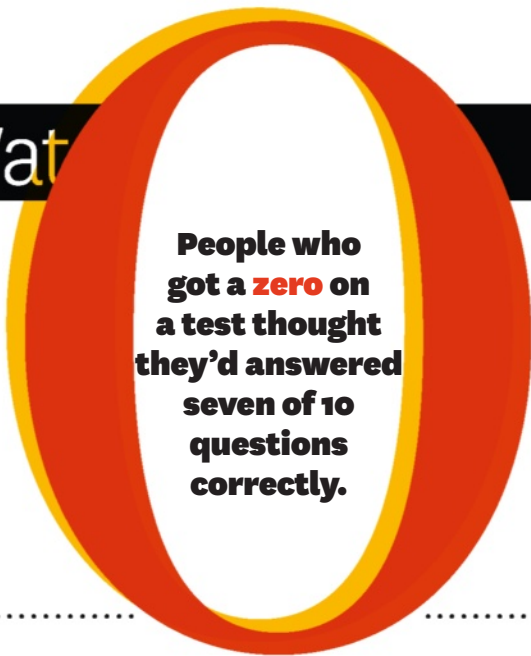
The specific actions needed to help an organization shift from a rules-based quality environment to a true culture of quality will differ from company to company, but the first step in the process will always be the same: Managers must decide that a culture of quality is worth pursuing. Our research unambiguously demonstrates that it is. A culture of quality requires employees to apply skills and make decisions in highly ambiguous but critical areas while leading them toward deeper reflection about the risks and payoffs of their actions. In an environment where customers’ tolerance for quality problems is declining, a workforce that embraces quality as a core value is a significant competitive advantage. 

HBR Reprint F1404A



Ashwin Srinivasan is a managing director, and Bryan Kurey is a senior director, at CEB.

# Stat Wat



**People who got a zero on a test thought they'd answered seven of 10 questions correctly.**

In an online logic test given to volunteers, the lowest scorers vastly overestimated their ability: Respondents who had answered zero of 10 questions correctly believed they had gotten 7 right, on average. According to **Thomas Schläpfer**, of the University of Cologne, and **David Dunning**, of Cornell, people who lack the skills to perform well also tend to lack the ability to judge performance, their own included. But this isn't set in stone: Teaching poor achievers logical reasoning helps them recognize their own errors and assess their skills.

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**GOVERNANCE** by George M. Anderson and David Chun

## How Much Board Turnover Is Best?

Some criticize boards for leaving the evolution of their composition to chance, allowing director retirements to dictate the pace of change. Support for annual director elections and for increased transparency around director nominations suggests that some shareholders would like to see more turnover. Is there evidence that companies and shareholders actually benefit when boards add fresh blood? If so, how much change is desirable?

To explore these questions, we studied board turnover and shareholder returns for the S&P 500 companies from 2003 to 2013. Using data from Equilar, we tracked when independent directors joined and left each board and counted the turnover across rolling three-year periods, grouping the companies into four categories according to the

results. We then examined each company's performance (using total shareholder returns relative to the industry average) in the subsequent three-year period to see how shareholders fared after new directors took seats in the boardroom. Our analysis revealed some intriguing patterns:

- Companies that replaced three or four directors over a three-year period outperformed their peers, suggesting an optimal amount of turnover.
- Most boards miss this optimal zone: In our study, board turnover fell outside it about two-thirds of the time.
- The worst performers tended to be companies with either no director changes at all in three years or five or more changes.

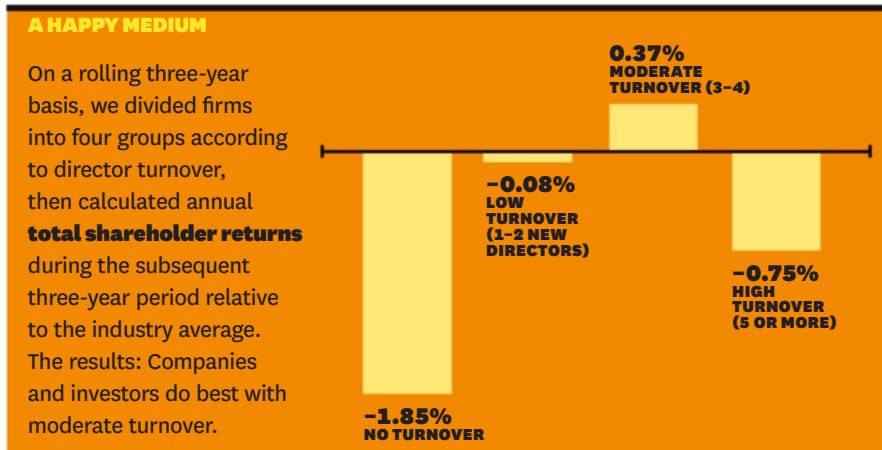
The decisions governing board composition are nuanced and complex. We're not suggesting that boards manage turnover to

achieve a specific target, or that simply replacing directors will somehow produce an increase in shareholder returns. Rather, our analysis indicates that a modest amount of turnover tends to be a characteristic of the leadership and governance behaviors that drive shareholder value over time. That stands to reason: New directors bring fresh perspectives and new skills, and they may be more likely than established members to challenge orthodoxy and raise previously unasked questions.

Understanding the correlation between board turnover and company performance can help inform certain decisions. For example, a company's chairman, CEO, and directors should be aware of the board's turnover rate and how it compares with the optimum we found. They should discuss turnover periodically and, when the rate falls outside the optimal zone, reflect on why—and be prepared to explain the reasons to investors. Boards should also keep the zone in mind when considering actions such as extending the mandatory retirement age and changing the board's size.

Over the years boards have grown more engaged, more independent, and more effective. Attending to turnover—and how it may affect performance—is another step in that direction. ♥

HBR Reprint F1404B



**George M. Anderson** is a member of Spencer Stuart's North American board and CEO practice. **David Chun** is the founder and CEO of Equilar.



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TO MOVE THE  
COMPANY FORWARD.”**

– Otonye Efebo  
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CHALLENGE  
EXCEEDED MY  
EXPECTATIONS.  
AND SO DID  
THE DIVERSITY.”**

– Gabrielle Reijnen  
Advanced Management Program 2012



# Research Watch

For employees with high levels of education, life satisfaction is consistent during the workweek but drops on weekends, falling from about 7.2 to 7.0 (out of 10). Why? During the weekend, they anticipate the stresses of the coming week, according to a survey of German workers that was headed by **Wolfgang Maennig**, of the University of Hamburg. People with less education are not as prone to weekend worrying, the researchers say.



# TGIM

*Thank God It's Monday!*

**MARKETING** by Jonah Berger and Zoey Chen

## When Controversy Sparks Buzz—and When It Doesn't

It's no secret that provocative ads are risky. United Colors of Benetton, for example, has faced numerous boycotts and lawsuits over its “shock advertising”; Kraft's use of a nearly nude male model to promote its Zesty Italian Salad Dressing drew strong protests last year (though the company ultimately elected to continue the ad campaign). But there's another reason marketers should exercise caution: Topics that are *too* hot often generate no buzz at all—and the threshold for “too hot” is surprisingly low. If an issue is more than mildly contentious, our research shows, the discomfort it inspires usually trumps the interest, and the likelihood that people will talk about it falls.

We began by studying 208 articles on the news website Topix. Defining controversy as “the extent to which a topic allows for dispute, debate, and differing opinions,” we asked independent raters to score each article from 1 (not at all controversial) to 7 (very). We then tallied the comments posted in the first 15 days after publication. Slightly controversial articles got more comments than completely neutral ones, but comments generally fell off once scores reached 4.6—barely past the scale's midpoint, suggesting that even moderate levels of controversy can stifle discussion.

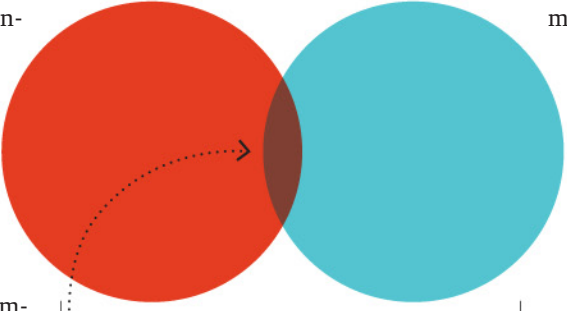
Subsequent laboratory experiments confirmed this overall pattern and showed that contextual factors can temper it. We asked participants to imagine that they were chatting online under a variety of conditions—in one experiment, with their identities either revealed or hidden; in another, in dialogues with either strangers or friends. Anonymity tamped down personal discomfort to some extent, making participants more willing to talk about

moderately controversial topics. When the discussion partner was a friend, discomfort all but disappeared—even with highly controversial topics.

Our findings have important implications for brand managers and marketers contemplating controversy as a vehicle to drive sales. Companies should look for the “sweet spot,” where an image or issue generates enough heat to elicit interest but stops short of raising qualms. They can home in on that spot by considering the channel and the audience they want to reach. To fuel online discussion, for instance, marketers might aim for moderate controversy, knowing that the internet's anonymity extends most people's comfort zones. When hoping to prompt sharing among family members and friends, they might push the envelope a little further.

But above all companies should realize that a little provocativeness goes a long way. There's virtually no scenario in which they stand to gain by stirring up highly charged emotions—and there's a big downside to crossing the line. ♥

HBR Reprint F1404C



Companies should look for the “sweet spot,” where an image or issue generates enough heat to elicit interest but stops short of making people uncomfortable.

**Jonah Berger** is a marketing professor at the University of Pennsylvania's Wharton School and the author of *Contagious: Why Things Catch On* (Simon & Schuster, 2013). **Zoey Chen** is a marketing professor at the University of Miami's School of Business Administration.

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# Defend Your Research



**Anouk Festjens**  
is a PhD student  
at KU Leuven,  
in Belgium.

HBR puts some surprising findings to the test

## Women Too Respond to Sexual Cues by Taking More Risks

**The study:** Anouk Festjens and her colleagues invited female students to perform “customer research” for an apparel company by examining men’s boxers or T-shirts, and then rating the items on factors such as fabric quality. When study participants later answered questions involving financial choices, the researchers found that subjects who had handled the boxers—a “sexual cue”—were more willing to take risks and more impatient for rewards than those assigned to evaluate the T-shirts or to only look at the boxers.

**The challenge:** Does touching men’s underwear really make women more likely to indulge in risky, reward-seeking behavior? **Ms. Festjens, defend your research.**

**Festjens:** There’s a long history of research showing that men’s economic decisions change after they’re exposed to sexual cues, such as pictures of models or lingerie. But because women didn’t respond to visual cues in early studies on this phenomenon, they were left out of subsequent ones. The experiments I did with Sabrina Bruyneel and Siegfried Dewitte at KU Leuven show that if the sexual cue is tactile, women react much like men. Touch seems to be a more effective way to trigger the reward circuitry in their brains. And, like men, when they’re primed to think about sex, they’ll crave other kinds of rewards—money, chocolate, wine, and so on. We also found that women who handled boxers required bigger incentives to delay a €15 payment and were willing to gamble larger amounts in a hypothetical dice game than women assigned to rate the T-shirts.

**HBR: Why would touch be a more powerful trigger?**

Because it brings you closer to the stimulus, and the closer you are, the more you want to have it. Benjamin Bushong and his colleagues at the California Institute of Technology described a similar effect in a paper in the *American Economic Review*. They’d found that people’s willingness to pay for snacks like a Snickers bar increased in tandem with their proximity to the food: Those who merely read the word “Snickers” bid the smallest amounts of money; those who saw a picture of the candy or viewed it behind Plexiglas offered a bit more; and those presented with it on a tray, the most. It’s a Pavlovian response.

**And touching the object is the next step?**

Yes. Another study we cite, from Joann Peck at the University of Wisconsin-

Madison and Jennifer Wiggins Johnson at Kent State University, showed that people were more likely to donate time and money to a charity supporting the homeless when its pamphlets included a fabric sample from the blankets its volunteers hand out. Of course, our research considered the strength of touch only when it comes to sexual cues and financial behavior in women versus men. We’d need further investigation to determine whether it has the same effect in other scenarios.

**Why would visual sexual cues activate risk taking in men but not in women?**

Evolutionary psychologists would argue that men, who have an unlimited ability to reproduce, are trained to pick their partners based on visual information—such as health, youth, and beauty—and to link their ability to attract those partners to their wealth, since that’s how women, with their limited ability to reproduce and higher parental investment, identify the best providers. For women, it’s the reverse: They instinctively look for signals of status in potential mates and link their ability to attract those mates to their looks.

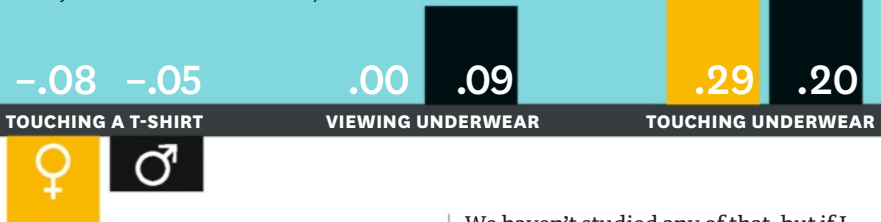
In fact, Kristina Durante at the University of Texas and Sarah E. Hill at Texas Christian University have shown that visual sexual cues cause women to change their beauty-related decisions. They are more likely to buy diet pills or coupons for the tanning salon, for example. But it takes a stronger trigger to change their financial decisions.

## Hey, Big Spender

Both visual and tactile sexual cues prompted male study subjects to spend more on products that are seen as rewards, like wine and chocolate. By contrast, among female subjects, only those exposed to the tactile sexual cue showed an increased willingness to splurge on indulgences.

### Scores for willingness to pay after...

(compared against the mean for all respondents, and adjusted for a standard deviation)



### Are boxers really that sexy? They make me think about laundry.

We've heard that comment from a few other people, too. But our subjects were female college students, so they may not have been as accustomed to washing men's clothes as older women are. And using boxers—which were made of gray or black cotton, the same as the T-shirts—allowed us to keep the study as parallel as possible to a previous one that had asked male subjects to evaluate bras, which we replicated as part of this research.

No one ever questioned whether men would get aroused by bras, of course. Indeed, we found that men's willingness to pay for a variety of products was significantly higher after any kind of exposure to a sexual cue—visual or tactile—versus a neutral cue. For women, the correlations were more complex. Those who handled boxers were more likely to increase their spending on indulgences like wine and chocolate than women who viewed boxers through Plexiglas or handled T-shirts. Neither type of sexual cue seemed to affect willingness to pay for neutral items like computer keyboards or chairs. But, interestingly, touching T-shirts did.

**What are the implications here for retailers? Brick-and-mortar stores beat online ones because women can touch things? Underwear sections should be at the front to get people, particularly men, to spend more?**

We haven't studied any of that, but if I had to make a prediction, I would say yes on both counts. Putting sexually laden cues at the entrance to a store, within touching range, might cause people to be more impulsive in their purchases. And brick-and-mortar retailers might have an advantage because of the touch element—though it could easily be outweighed by other factors, such as price and convenience.

Actually, studies have shown that online retailers might be able to benefit from tactile cues, too. There has been a series of experiments showing that people who shop for goods on a touchscreen versus a desktop perceive those goods to have more rewarding qualities.

### And if I'm a manager keen to avoid impulsive, risky decisions, what should I take away from your research?

Psychologists talk about the hot, emotional state versus the cold, analytical one. Sexual cues—and those related to other rewards—put us in a hot state; they increase dopamine levels and lead us to be more impatient, impulsive, and accepting of risk. So to make good, rational decisions, you should be in a cold state. I have no data on how to induce this in people, but my instinct would be to satiate your desires: Eat, drink, have sex (in your off-hours, of course). Satisfy any craving that might encourage impulsive risk taking. If you're a manager making a big decision, you don't want to be tempted by anything. ♡

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Interview by Alison Beard



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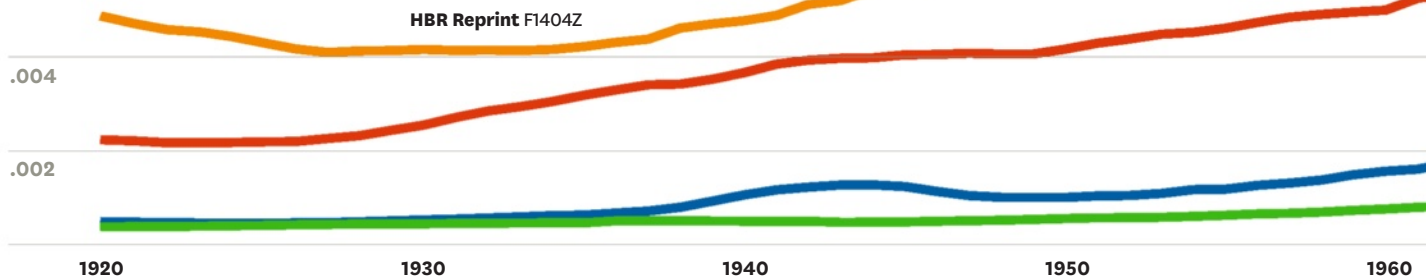
## The Words We Use

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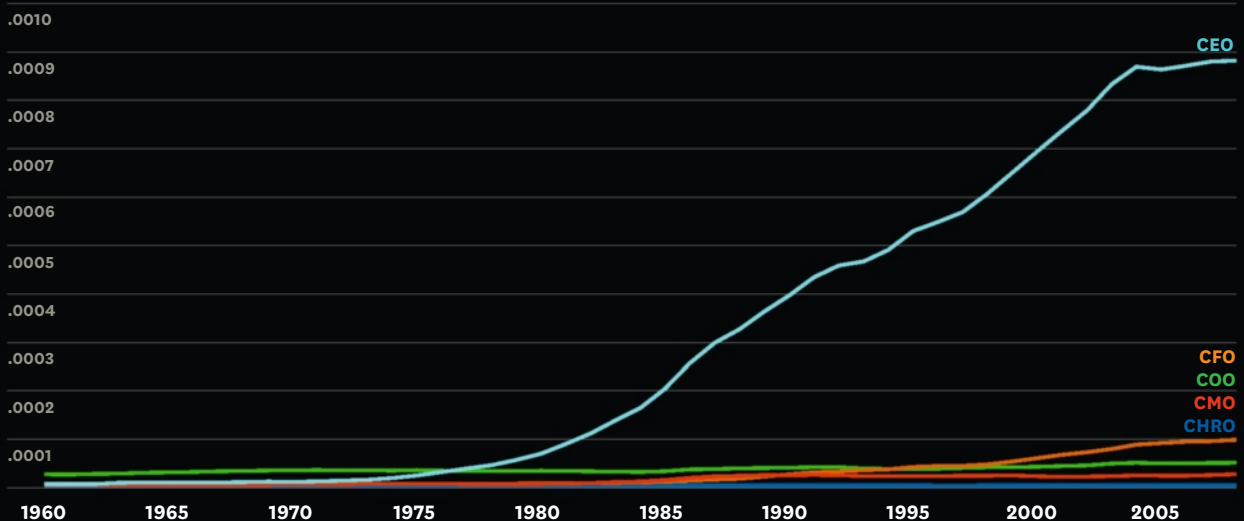
Language is a reflection of culture, so the terms we use most tell us a lot about our shifting priorities. To get a sense of how the world of management has evolved, we turned to Google's Ngram Viewer. This tool charts the frequency of words and phrases in more than 5 million books published from 1500 to 2008. We narrowed our focus to the period beginning in the 20th century.

In the graphs here, the y-axis shows the percentage of times a word appeared among all the words in Google's sample of books for the year shown on the x-axis.

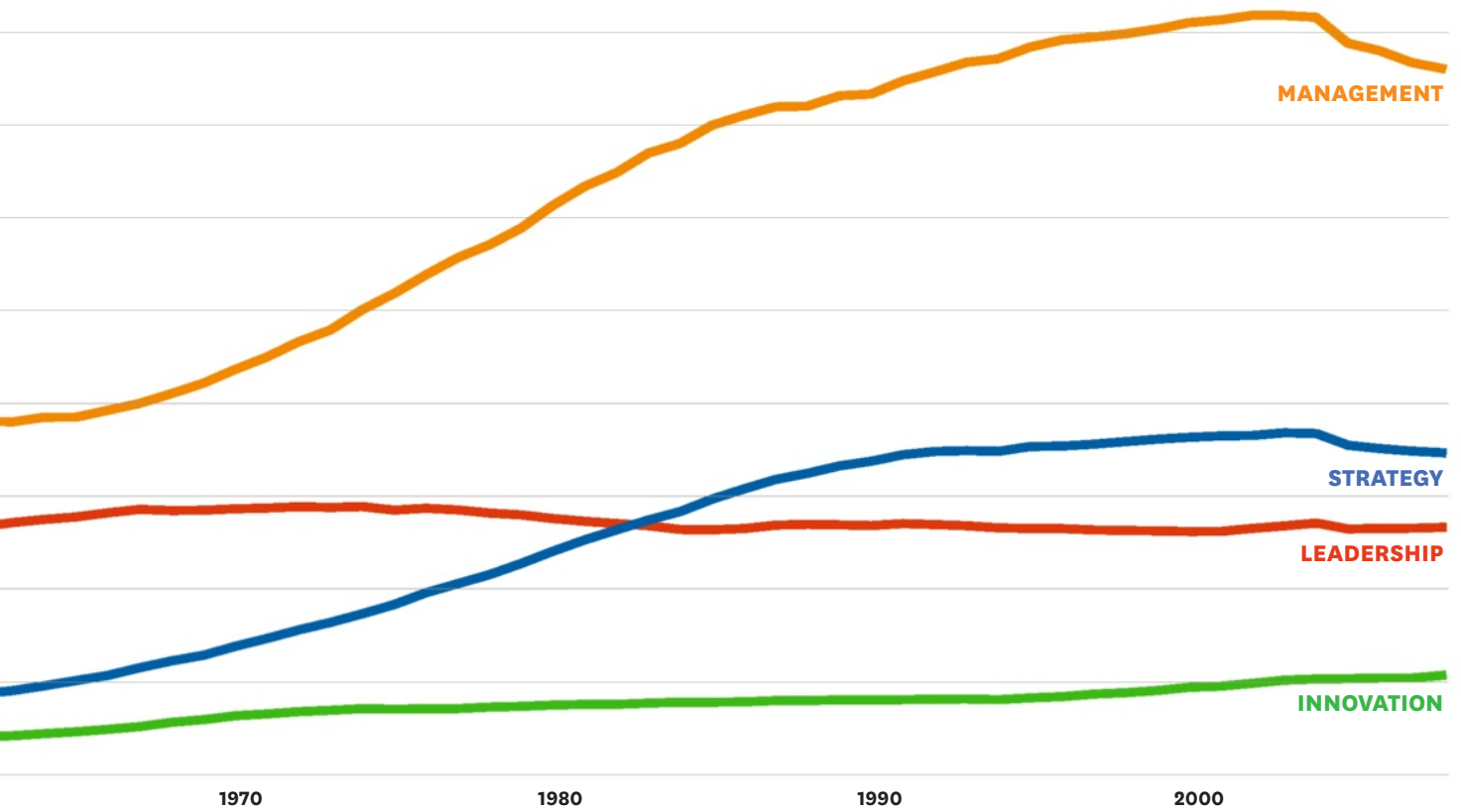
These ngram data demonstrate how familiar terms have risen in popularity and sometimes faded—a testament to our own changing concerns and agendas.



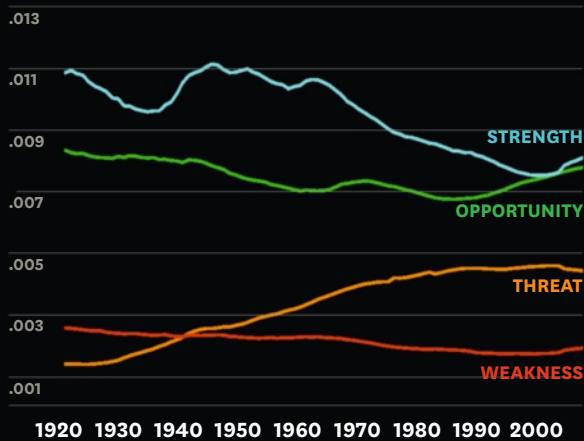
**The Rise of the CEO:** The cult of the celebrity chief executive took off in the 1980s, but its growth has tapered off in recent years.



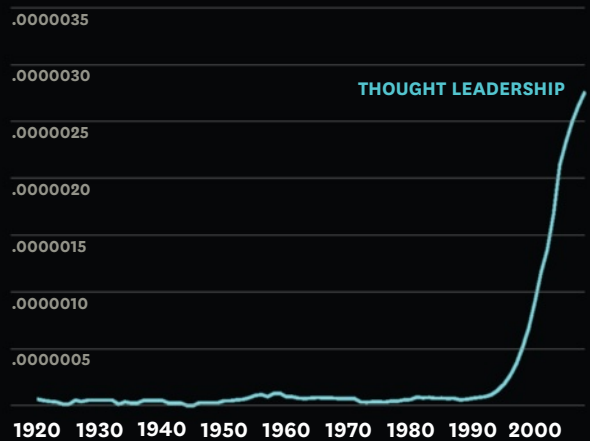
**Management's Supremacy:** While interest in strategy has grown, management appears to have remained a more widespread concern.



**A Different SWOT Analysis:** We seem to focus more on strength than weakness and on opportunity than threat. Optimism rules.



**We'll Reserve Comment on This One**





**William L. McComb** served as the CEO of Fifth & Pacific Companies (formerly Liz Claiborne) from 2006 through 2013.

## Transformation Is an Era, Not an Event

**W**hen I arrived at Liz Claiborne, in 2006, I wasn't expecting to lead a major transformation. The board had hired me to make sense of a swollen portfolio of mainly wholesale brands—more than 45 in all—and everything suggested a “realignment” opportunity. But in my sixth month on the job, the business teams came back with news so bad that we had to issue earnings guidance below consensus by 65%. Mere tweaks wouldn't save us; transformation was the only course.

Focused on that work for seven years, my team and I came to realize that we weren't alone. The reinvent-or-die challenges that used to be rare catastrophes in business have practically become the new normal—but without much direction about how to meet them. So we started compiling what we found to be the *truths of transformation*.

We've outlined at least 10 so far, but a number of them relate to one big lesson: Don't think of transformation as a shocking but short-lived moment in a company's history. It's not an event—it's a whole era. People view Steve Jobs's second tour at Apple as a quick turnaround, and actually it was. But it played out from 1997 through 2006, and no single step was decisive.

When you expect transformation to define an era, you manage it differently. First, you figure out how to sustain a vision, knowing that month-to-month realities will have you tacking this way and that. For us, the transformation consisted of off-loading 20 brands and concentrating on Kate Spade, Lucky Brand, and Juicy Couture—the three with the greatest potential to hit it really big. That entailed moving to a direct-to-consumer strategy for each of the three, building out stores, and developing a solid in-house e-commerce capability—all complex undertakings. Keeping our eyes on the prize meant reminding ourselves con-



**Prepare people to see things get worse before they get better. And take a fresh look at the people you're relying on.**

stantly that we were engaged in building a blockbuster.

At the same time, you resist being an ideologue. The biggest transformation flops the business world has seen were the result of believing in fairy tales. Take JCPenney. In 2012 its managers embraced an ideology: Consumers prefer consistent pricing over constant promotions, and by deemphasizing house brands, JCPenney would attract higher-end consumers. A compelling philosophical argument can win people over in the short term, but in a long-haul initiative it eventually confronts reality. And reality always wins.

Two other truths we discovered about embarking on an era of transformation: You should prepare people to see things get worse before they get better (especially because early moves—which will be assessed according to the metrics of the legacy model—will appear more mistaken than they are). And you must take a fresh look at the people you're relying on. Accept that not everyone is cut out to thrive in conditions of ambiguity and adversity. Recast your team to be transformation-tough.

Now, if only you could do the same with your board! Directors, more than anyone else, tend to view a transformation as an event with tight boundaries that has been precipitated by a crisis (even if the trouble developed over years). The directors usually just want the pain to end. In this I was lucky. Our board held true even as the name of the company changed (it no longer owns the brand that started it all), and as a result we succeeded in building a true blockbuster in Kate Spade. Your board may need more instruction in the truths of transformation. But if you can all settle in to what is bound to be a long learning process, you'll survive to ring in a new era. ♡

HBR Reprint F1404E

# Strategic Humor



CARTOONS: P.C. VEY, CROWDEN SATZ, SUSAN CAMILLERI KONAR



## CAPTION CONTEST



“Thanks for the dramatic reenactment of our quarterly growth chart, but you could have used PowerPoint.”

This month’s winning caption was submitted by **John Gregor** of Edmonton, Alberta.

## Martin



**Roger L. Martin** is the Premier's Research Chair in Productivity and Competitiveness at the Rotman School of Management and the author, with A.G. Lafley, of *Playing to Win* (Harvard Business Review Press, 2013).



## The Public Corporation Is Finally in Eclipse

In his classic 1989 HBR article “Eclipse of the Public Corporation,” Michael Jensen analyzed early leveraged buyouts and identified a new form of corporate organization, the LBO association. He believed it would outperform the traditional public company thanks to “pay-for-performance compensation systems, substantial equity ownership by managers and directors, and contracts with owners and creditors that limit both cross-subsidization among business units and the waste of free cash flow.” To Jensen, the inherent advantages of this structure were so great that it was bound to become the standard. Yet here we are, 25 years later, and public corporations still dominate the business landscape. In a world supposedly changing at unprecedented speed, how can this be?

It's certainly true that big changes can take a long time. It was in 1959 that Peter Drucker announced to the world that “knowledge workers” would eclipse manual workers to become the key human asset in

**Institutional investors are adopting private ownership of giant corporations as a strategy.**

modern business and that companies had better start learning the entirely different way they needed to be managed. He turned out to be right, but it took almost half a century for the eclipse to occur.

I believe that Jensen's critique was valid. The weaknesses he saw in the public corporation in 1989 have only become more pronounced, what with the rise of predatory hedge funds, the growing power of equity analysts, and rapid turnover in the C-suite. More and more executives sacrifice the long-term prospects of their companies in order to meet the short-term expectations of the financial markets.

I think the delay in seeing Jensen's future come to pass stems from a structural paradox embedded in the LBO model that he thought might replace the public corporation. LBO firms have traditionally obtained capital from limited partners on the promise of a return within five to seven years—and to provide that, they need to take their privatized acquisitions public again. They can hardly eclipse public corporations as long as they need a robust public market to make their own model work.

But LBO associations are not the only way to take a company private. Institutional investors are increasingly adopting private ownership of giant corporations as a strategy. An early case in point was the attempt by a group led by the Ontario Teachers' Pension Plan to take Canada's leading telecom provider, Bell Canada, private for \$51.7 billion in 2007–2008. The fund wanted not to take the company public again but, rather, to own the asset privately for the long term.

Although Bell's bondholders blocked that deal, it set the stage for Berkshire Hathaway to take Burlington Northern private in 2009. This was not the first purchase by Warren Buffett of an entire company, but at \$44 billion the total value of the deal was double that of his largest previous acquisition (General Re). And Buffett has no intention of returning Burlington to the public market for a profit. He wants to run it for its cash flow. In 2013 Buffett struck again, with a \$28 billion privatization of H.J. Heinz, and soon afterward Michael Dell took Dell Inc. private in a \$25 billion deal. Although these latter deals involved private equity partners, a return to the public realm was not the logic behind them.

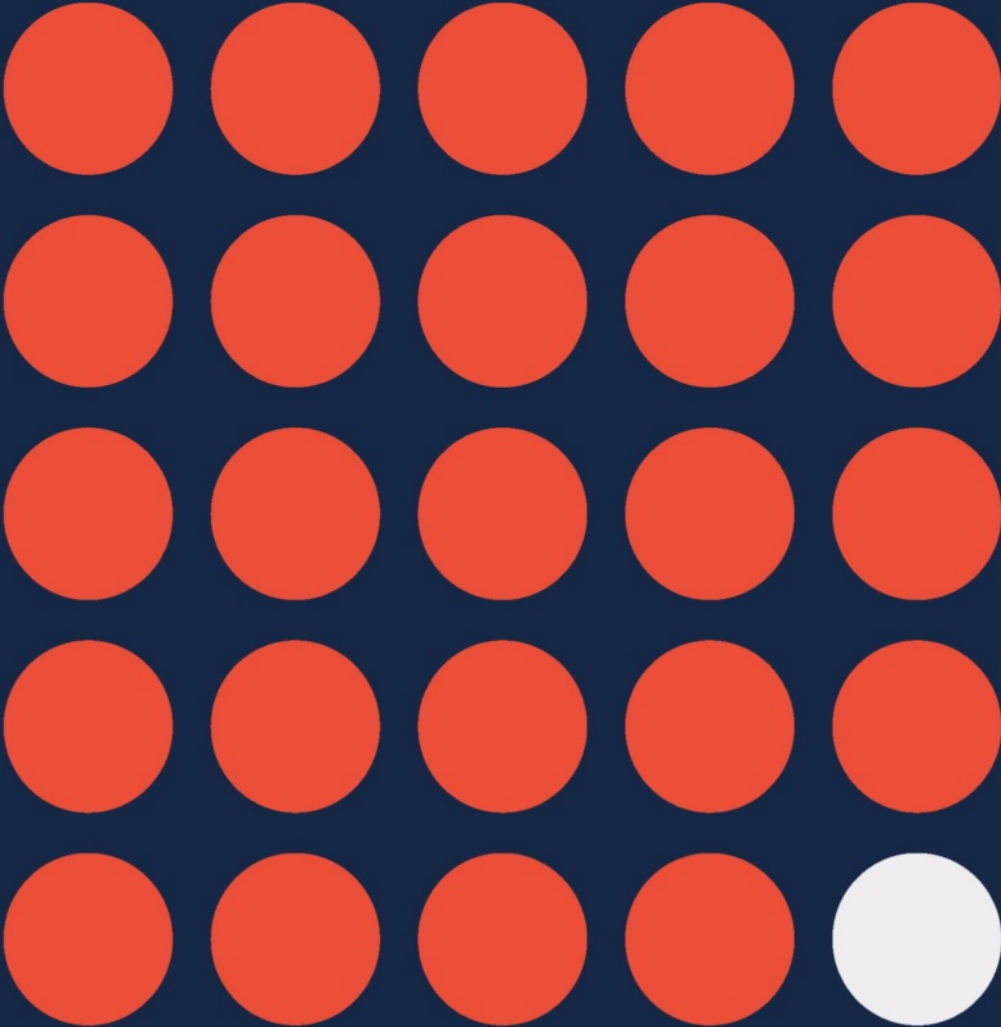
So I believe that Jensen will indeed prove right, but on Drucker timing—50 years. Smart institutional investors will continue the trend, set by Buffett and Dell, of steering their investments away from public corporations, and by 2039 we will be wondering why we ever thought they were a superior form of business organization. ▀

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**Matt Mullenweg** is the founder and CEO of Automattic, the company behind WordPress.com.

# The CEO of Automattic on Holding “Auditions” to Build a Strong Team

by Matt Mullenweg



PHOTOGRAPHY: LIZ CARLUANA

**A**utomattic employs 230 people. We’re located in 170 cities all over the world. Although we maintain an office in San Francisco that functions like a coworking space, most of our employees work somewhere other than our home base. Some are even nomads, traveling from place to place and couch to couch.

This might seem like a recipe for disaster—low productivity, poor management, and abuse. But Automattic is profitable and fast-growing. With an applicant-screening process that gives candidates genuine job responsibilities and relationships, we can hire smarter, retain strong employees longer, and reduce terminations and turnover. The key? Tryouts.

## THE IDEA

**In its early years, Automattic relied on traditional résumé screening and interviews to do its hiring. But over time Mullenweg came to focus on tryouts, in which final candidates are paid to spend several weeks working on a project.**

## Where 9 to 5 Fails

It all starts with the way we think about work. In my experience, people in lots of companies are just going through the motions. If someone shows up in the morning dressed appropriately and isn't drunk or asleep at his desk, we assume he's working. If he's making spreadsheets and to-do lists, we assume he's working really hard. Unfortunately, none of this gets at what an employee actually creates during the day. It's possible (and, sadly, not uncommon) for someone to sit at a desk for eight hours, moving papers and sending e-mail, without producing any results.

At Automattic we focus on what you create, not whether you live up to some ideal of the "good employee." We measure work according to outputs. I don't care what hours you work. I don't care if you sleep late or if you pick up a child at school in the afternoon. I don't care if you spend the afternoon on the golf course and then work from 2 to 5 AM. What do you actually produce? Many people create great things without sitting at a desk in an office all day, including all the people at Automattic. (One employee recently wrote a book about his time with us. Its title—*The Year Without Pants*—should tell you something about our lack of emphasis on professional dress.) We work in open-source software, which is a decentralized product, so uncoupling our workforce from the 9-to-5 workday makes sense. We can do it well because we have the right team.

We used to hire people the way most other companies do. We'd screen résumés and conduct interviews. Sometimes we asked candidates brainteaser-style questions, as Microsoft and Google famously did. We focused on their past experiences and paid special attention to what other start-ups they'd worked for. A candidate might interview with five employees, and we'd all take him or her out to lunch. We invested a lot of energy in the process, and we believed we were being as rigorous as we could.

Inevitably, some of those hires didn't work out, which was a big disappointment.



When you hire someone, you see all the potential in the world. If things break down, you have to do some soul-searching. Is it my fault? Is it something I did as a manager? How did we miss the less-than-positive signs? Managers at other companies appeared not to care, assuming that it was normal for a third of new hires to wash out. But it seemed so inefficient.

As we considered the situation, it became clear that we were being influenced by aspects of an interview—such as someone's manner of speaking or behavior in a restaurant—that have no bearing on how a candidate will actually perform. Some people are amazing interviewees and charm everyone they talk to. But if the job isn't going to involve charming others, their interview skills don't predict how well they'll do as employees. Just like work, interviews can be "performed" without real productivity.

## Tryouts Trump Interviews

The more we thought about why some hires succeeded and some didn't, the more we recognized that there is no substitute for working alongside someone in the trenches. So we gradually changed our approach. I still personally review most of the résumés we receive, and we screen out about 85% of candidates immediately, for lack of relevant experience, lack of technical skills, or mistakes on the application. (One thing I don't pay much attention to is education: I'm a University of Houston dropout, so it would be hypocritical of me to obsess over where or whether someone went to college.) Candidates then have initial interviews, usually via online chat.

The most significant shift we've made is requiring every final candidate to work with us for three to eight weeks on a contract basis. Candidates do real tasks alongside the people they would actually be working with if they had the job. They can work at night or on weekends, so they don't have to leave their current jobs; most spend 10 to 20 hours a week working with Automattic, although that's flexible. (Some people take a week's vacation in order to focus on the tryout, which is another vi-

able option.) The goal is not to have them finish a product or do a set amount of work; it's to allow us to quickly and efficiently assess whether this would be a mutually beneficial relationship. They can size up Automattic while we evaluate them.

Paying them for their efforts is important; this isn't about getting work done free. Originally we tried to set hourly pay rates based on what they might earn if they were hired, but that became too complicated. We were almost negotiating what we would pay someone who hadn't yet received an offer, which didn't make any sense. To keep it simple, we decided to pay a standard \$25 an hour, whether the candidate was hoping to be an engineer or the chief financial officer.

If you're applying to work in customer support, you'll be talking directly to customers. If you're an engineer, you'll be writing real code. If you're a designer, you'll design. In some cases the nature of the job means that we have to get creative. If you're looking for a role in business development, we can't send you out to negotiate deals with potential partners, so we come up with something as closely related as possible to the actual work. A business-side hire might prepare presentations, or do an analysis of a business problem, or run numbers on a potential project. Tryouts may not offer 100% overlap with the job in question, but they give us a better window on someone's skills and cultural fit than a lunch meeting would. We're especially interested in how well candidates self-motivate, how well they communicate in writing (because most of us work remotely, we rely heavily on instant messaging), and how they deal with mistakes. We don't expect perfection—we care more about how quickly they identify an error, how they communicate about it, and what they learn from it.

### The Final Interview (via Text)

Only very rarely do people object to a tryout or say that they're too busy to undertake one. The tryout may feel like an extraordinary obligation, but that makes it a filter: We want people who are willing to



## ONE MANAGER'S EXPERIENCE

When Matt Mullenweg asked Scott Berkun, a veteran Microsoft executive and management author, to become a “team leader” at Automattic, he said yes—on one condition: He wanted to write a book about working in its unique corporate culture. Berkun, the author of *The Year Without Pants: WordPress.com and the Future of Work*, talked with HBR about the experience.

### What did you think of the job tryout process?

I'm a huge fan, because it makes sense. Somehow hiring managers have come to believe that having people talk about work in a job interview is a reliable indicator of their ability to do work. It's not. If you want a cake for your wedding, you're going to ask the baker for a sample. You don't ask him to talk about his cake. Tryouts are far better predictors of who can do the job and be a good fit.

### Did the tryouts give you, as a manager, more confidence in making hiring decisions?

To some extent, yes. I like to talk about hiring decisions with my team. At Automattic, instead of talking about how a candidate replied to interview questions, we could give firsthand reports of how he responded to a particular problem. Firsthand data gave us more confidence.

### Should other companies use tryouts?

Many already do, albeit under different names. An internship is very similar—it's limited-term employment that you hope will lead to a long-term job. Apprenticeships have existed in artistic endeavors since the Renaissance.

### What in the culture was difficult to adapt to?

I adjusted well to working remotely. Communicating digitally was easy: Even if you work in the same building, most of your dealings with colleagues are done via computer anyway. In general I really liked working at Automattic. My frustrations had to do with the level of ambition. The culture of the company is to collaborate and to make a lot of incremental changes. People had so much freedom to take risks, and I was disappointed by how few employees took advantage of that to make really big bets.

### What should other companies learn from Automattic?

They could learn from its commitment to innovation. Executives like to talk about being innovative, but most people are really conservative. Matt Mullenweg is willing to try stuff out. He's happy to see stuff not work—he'll say, “Now we know a little more about how this problem can be solved.” If other companies adopted a model in which the CEO was the chief experimenter, they'd be more successful.

do what's necessary to succeed and who are passionate enough about Automattic to make the process a priority. Tryouts aren't like a bake-off; if we audition 10 people and they're all strong, we may hire all of them. Applicants are competing against our standards of quality, not against one another.

During a tryout, we try to provide a lot of feedback. If we conclude that an applicant isn't going to succeed, we call an end to the process as quickly as possible, out of respect for everyone's time. Sometimes a candidate decides to end the trial.

We also prioritize coordinating the system. It's a huge investment of time, and we've found that any single Automattic employee can oversee only two or three auditions at once. We now have four engineers who perform that service for their department. In our culture, overseeing a tryout takes higher priority than doing your regular job; it's perfectly acceptable for people to temporarily step back from their usual work for that reason.

When the process is over, all the people involved have a great sense of whether they want to work together going forward. At that point the final step is an interview with me. (Even as our company has grown, I continue to spend at least a third of my time on hiring.) I've changed my interview style dramatically over the years, to stay in the spirit of the tryout process. I conduct interviews via text-only Skype chats or instant messaging. I don't know the gender or ethnicity of anyone I interview; I see only the words on the screen. It's as close to a double-blind process as you can get. I'm looking mainly for passion and cultural fit. Of the people who make it to the final interview, 95% get a job offer—a testament to the effectiveness of our approach.

Even when we don't ultimately offer someone a position, he has obtained valuable information about what we viewed as his strengths and weaknesses. If we see potential, we'll encourage him to continue developing his skills and reapply. Repeat applicants tend to be strong, because they've taken the feedback to heart and worked to improve; we've hired many of them.

## **Trials also help potential employees avoid big problems down the road.**

### **We're In It for the Long Haul**

Trials don't just help us better determine who will succeed at Automattic; they help potential employees avoid big problems down the road. If a working relationship sours after a few months, the company can just let the person go. It's not the best outcome for anyone—we still have to deal with turnover costs—but for the employee, it's terrible. She may have quit another job to accept the one she's now losing. Maybe she has moved across the country. She's left with a short-term job on her résumé, which can be a red flag for future employers.

When we hire someone at Automattic, we want the relationship to last for decades. That's not the way most Silicon Valley companies operate. (See, for instance, "Tours of Duty: The New Employer-Employee Compact," HBR June 2013.) But we feel strongly that the most productive relationships are formed over years, not months. If you're making a movie, it might be reasonable to bring people together for the time required to film it and then move on. But if you're trying to build products that will change the world, it's going to take much longer, and there's value in retaining people for a large chunk of their careers.

Some people say that younger workers have a different notion of job tenure and want to move around more frequently. That may be, but I think companies, too, have changed. If a company treats people as if they'll be around for a while, managers develop a different sensibility when it

comes to investing in and retaining people. Loyalty is a two-way street.

Overall, we end up hiring about 40% of the people who try out with us. In 2013 we hired 101 people, and only two of them didn't work out. In the entire history of the company we've hired 270 people, and only 40 of them are no longer here.

Our flexible-work philosophy is one reason we use this unique hiring process: We have to go to great lengths to identify people who will thrive in our culture. Outsiders have always questioned whether our system of limited supervision would be effective as we grew. "It's fine when you're at 10 or 15 people, but when you get to 30, it falls apart," they'd say. After we passed 30 people, we started hearing that the magic number was 100—and then 150. Now that we're approaching 250 employees, we still have no significant issues.

There are some quirks in the way we work that tryouts help us address. For instance, we tend not to hire people with little professional experience, because our lack of structure may be too unfamiliar to them. But that doesn't mean we never hire young people—we've acquired more than one talented teenager. (And I was 19 when I cofounded WordPress.) Many of our workers were self-employed or freelance at some point in their careers, which helps them understand how to be self-directed.

Auditions may not be the right process for your workplace, but you probably could augment a traditional interview process in order to move beyond appearance to real potential. A candidate assessment that mimics the actual work the candidate must do to succeed will give you the best hiring ROI. Maybe it's a trial; maybe it's a presentation; maybe it's a short-term assignment that can be done in an afternoon.

Nothing you do for your company has as much impact as putting the right people around the table. The aphorism is true: You can't manage your way out of a bad team. An approach to hiring that genuinely identifies real skill and fit will give you the best shot at assembling the right team. ▣

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## FIRST PLACE

### The Focused Leader

December 2013

Renowned psychologist **DANIEL GOLEMAN** looks at how leaders husband their most valuable resource: their own attention. Goleman is codirector of the Consortium for Research on Emotional Intelligence in Organizations at Rutgers University and the author of *Focus: The Hidden Driver of Excellence*.

## THE FINALISTS



### “Special Forces” Innovation: How DARPA Attacks Problems

October 2013

The Pentagon’s Defense Advanced Research Projects Agency has arguably achieved the longest-running record of radical invention in history. **REGINA E. DUGAN** and **KAIGHAM J. GABRIEL**, DARPA’s former director and deputy director, explain how. Dugan is now a vice-president of engineering and the director of the Advanced Technology and Projects (ATAP) group at Google, and Gabriel is the deputy director of ATAP.



### The Strategy That Will Fix Health Care

October 2013

**MICHAEL E. PORTER**, one of the world’s leading thinkers on strategy, and **THOMAS H. LEE**, the former network president of Partners HealthCare, lay out a fundamentally new approach to addressing health care’s rising costs and uneven quality. Porter is the Bishop Lawrence University Professor at Harvard University, and Lee is the chief medical officer at Press Ganey.



### Using the Crowd as an Innovation Partner

April 2013

Excluding crowdsourcing from the corporate innovation tool kit means losing an opportunity. **KEVIN J. BOUDREAU** and **KARIM R. LAKHANI** describe how best to tap the power of the crowd. Boudreau is an assistant professor of strategy and entrepreneurship at London Business School and a research fellow at Harvard’s Institute for Quantitative Social Science (IQSS). Lakhani is the Lumry Family Associate Professor at Harvard Business School and the principal investigator of the Harvard-NASA Tournament Lab at IQSS.

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The Big Idea



# *Making Business Personal*

Companies that turn employees' struggles into growth opportunities are discovering a new kind of competitive advantage.

*by Robert Kegan, Lisa Lahey, Andy Fleming, and Matthew Miller*

To an extent that we ourselves are only beginning to appreciate, most people at work, even in high-performing organizations, divert considerable energy every day to a second job that no one has hired them to do: preserving their reputations, putting their best selves forward, and hiding their inadequacies from others and themselves. We believe this is the single biggest cause of wasted resources in nearly every company today.

What would happen if people felt no need to do this second job? What if, instead of hiding their weaknesses, they were comfortable acknowledging and learning from them? What if companies made this possible by creating a culture in which people could see their mistakes not as vulnerabilities but as prime opportunities for personal growth?

For three years now, we've been searching for such companies—what we think of as *deliberately developmental organizations*. We asked our extended network of colleagues in academia, consulting, HR, and C-suites if they knew of any organizations that are committed to developing *every one* of their people by weaving personal growth into daily work. We were looking for companies anywhere in the world, public or private, with at least 100 employees and a track record of at least five years.

All that scanning turned up only about 20 companies. In this small pond, two of them stood out: Bridgewater Associates, an East Coast investment firm, and the Decurion Corporation, a California company that owns and manages real estate, movie theaters, and a senior living center. Both had been meeting our definition of a deliberately developmental organization for more than 10 years. Happily, they were in very different businesses and were willing to be studied in depth.

These companies operate on the foundational assumptions that adults can grow; that not only is attention to the bottom line *and* the personal growth of all employees desirable, but the two are interdependent; that both profitability and individual development rely on structures that are built into every aspect of how the company operates; and that people grow through the proper combination of challenge and support, which includes recognizing and transcending their blind spots, limitations, and internal resistance to change. For this approach to succeed, employees (Decurion prefers to call them members) must be willing to reveal their inadequacies at work—not just their business-as-usual, got-it-all-together selves—and the organization must create a trustworthy and reliable community to make such exposure safe.

As you might guess, that isn't easy or comfortable. But by continually working to meet these linked obligations, deliberately developmental organizations may have found a way to steadily improve performance without simply improving what they're currently doing. That's because progress for their employees means becoming not only more ca-

pable and conventionally successful but also more flexible, creative, and resilient in the face of the challenges—for both personal and organizational growth—that these companies deliberately set before them.

## THE COMPANIES

Bridgewater Associates, based in Westport, Connecticut, manages approximately \$150 billion in global investments in two hedge funds—Pure Alpha Strategy and All Weather Strategy—for institutional clients such as foreign governments, central banks, corporate and public pension funds, university endowments, and charitable foundations. The company began in a two-bedroom apartment in 1975 and is still privately held, currently employing about 1,400 people.

Throughout its nearly four decades, Bridgewater has been recognized as a top-performing money manager; it has won more than 40 industry awards in the past five years alone. At the time of this writing, the Pure Alpha fund had had only one losing year and had gained an average of 14% a year since its founding, in 1991. The All Weather fund, which is designed to make money during good times and bad, has been up 9.5% a year since its launch, in 1996, and delivered an astonishing 34% return from 2009 through 2011, even as the hedge fund industry as a whole underperformed the S&P 500. (The fund apparently did lose money in 2013, according to the *New York Times*.) In both 2010 and 2011 Bridgewater was ranked by *Institutional Investor's Alpha* as the largest and best-performing hedge fund manager in the world. In 2012 the *Economist* credited the firm with having made more money for its investors than any other hedge fund in history. (The previous record holder was George Soros's Quantum Endowment Fund.)

Across the country, in Los Angeles, Decurion employs approximately 1,100 people to manage a portfolio of companies including Robertson Properties Group, with retail and commercial projects in California, Hawaii, and the Pacific Northwest; Pacific Theatres and ArcLight Cinemas; and its newest venture, Hollybrook Senior Living. In May 2011 *Retail Traffic* magazine recognized Robertson Properties as one of the 100 largest shopping center owners and managers in the United States. Pacific and ArcLight combined have the highest gross per screen in North America. ArcLight's revenues have grown by 72% in four years—from \$47 million in 2009 to \$81 million in 2013. In 2012 *Forbes* named ArcLight's flag-

## Idea in Brief

### THE PROBLEM

Most people at work are doing a second job that no one's paying them to do—preserving their reputations, putting their best selves forward, hiding their inadequacies.

### THE PROPOSITION

What if a company was set up in such a way that instead of hiding their weaknesses, employees used them as opportunities for both personal and business growth?

### THE RESULT

The examples of two very different companies—a hedge fund and a movie theater operator—suggest that it's possible to meld business growth with personal growth in every employee's day-to-day work.

ship cinema, ArcLight Hollywood, one of the 10 best movie theaters in the United States.

We have spent more than 100 hours each with Bridgewater and Decurion, observing their practices and interviewing their people, from the most senior leaders to the newest recruits. Virtually no aspect of either company was declared off-limits to us. From the extensive data we collected, we extracted the common traits that, we believe, set these companies apart. We shared our observations and generalizations with both of them and seriously considered their suggestions and impressions. Neither one asked us to alter any of our conclusions.

We acknowledge that a deliberately developmental organization is not for everyone—just as the Jesuits are not the only good choice for every man with a fervent religious calling, or the Navy Seals for every committed commander. But we offer our observations of these two companies as evidence that quests for business excellence and individual fulfillment need not be at odds—and that they can be combined in such a way that each causes the other to flourish.

### THE PRACTICES

Ordinarily, people acknowledge their vulnerability and imperfections only in rare moments behind closed doors with trusted advisers who swear to protect their privacy. But what we saw at Decurion and Bridgewater was a pervasive effort to enable employees to feel valuable even when they're screwing up—to see limitations not as failures but as their “growing edge,” the path to the next level of performance.

**Getting to the other side.** Transcending your limits—which Bridgewater calls *getting to the other side*—involves overcoming the fight-or-flight response occasioned by confronting what you are working on about yourself. In a traditional company, root-cause analysis of a problem will stop shy of crossing into an employee's interior world. At Bridge-

water, examining a failed investment decision certainly includes a root-cause analysis of the specific data, decision criteria, and steps taken to make the investments. But it goes further, asking, “What is it about how you—the responsible party and shaper of this process—were thinking that might have led to an inadequate decision?”

Consider, for instance, how one Bridgewater employee, John Woody, confronted what CEO Ray Dalio called his “reliability problems,” as recorded in a 2013 Harvard Business School case prepared by Jeffrey Polzer and Heidi Gardner. Pulling no punches, Dalio told Woody that the perception across the organization was that he could not be counted on. Woody's immediate reaction was to angrily reject the feedback. But he did not go off to nurse his grievances or even to uncritically accept what he'd heard. As he began to consider the exchange, he first saw the irony of his reaction. “Here we pride ourselves on being logical and facing the truth, but my initial response was ‘You're wrong!’ which is me already being illogical,” he says. “Even if what he was saying was not true, I was giving him no chance to show me it might be.”

After continued reflection and conversations with many people in the organization over many weeks, Woody began to recognize in himself a behavior pattern “that goes all the way back to when I was a kid”: He resisted others' control and oversight and was quick to anger when challenged. Looking at the gap between how he wanted to be seen and how he was seen, he realized that he wanted to be “the guy you could give the ball to on the two-yard line”—but that others did not perceive him that way. “People were saying they are unsure I'll even be there to catch it, let alone be able to run it in. And that hurt.”

Early on, nearly everyone finds this level of vulnerability disorienting, no matter how enthusiastic he or she may have been about the culture during the hiring process. Dalio acknowledged this fact in

## LEADING a Deliberately Developmental Organization

If you are a leader who wants to build a DDO, you should understand that you can't want it just for the company. You must want it for yourself. You must be prepared to participate fully and even to "go first" in making your own limitations public. You must also not want it just to generate extraordinary business results—you must put equal value on leading a company that contributes to the flourishing of its people as an end in itself. You will need patience: It takes time to develop an environment in which people feel safe doing the personal work they'll be asked to do on a regular basis. And you must continually support, defend, and champion this new form of community.

Building an effective DDO also requires that new people be chosen very carefully, with an eye to their appetite for personal reflection and

their comfort with examining their own limitations. Even so, it may take 12 to 18 months to be sure that a new hire will do well in this culture, so you should be prepared for a higher rate of turnover than you might otherwise expect. But the people who make it through this induction will most likely display dramatic levels of commitment and engagement.

A sustainable DDO culture depends on a critical mass of people who are together long enough to build strong relationships and gain experience with the practices that facilitate development over time. Thus we question the value of this approach for companies that work on a contractor model and maintain flexibility by depending heavily on free agents, because turnover for them might be too high, and commitment to the organization too low.

a companywide e-mail with the subject line "I fail every day," in which he challenged employees with this question: "Do you worry more about how good you are or about how fast you are learning?" Shifting focus from the former to the latter can lead simultaneously to important personal changes and increased business effectiveness.

When Inna Markus, a member of our research team, asked Woody what progress he was making on his reliability problem, he insisted that he still had a long way to go. Yet it is clear that he has come quite a distance already: "I prioritize more ruthlessly," he says, "pause longer and more thoughtfully before promising things to others, visualize more granularly how I will actually get something done, check in with those who ask things of me more frequently and with more questions, and lean on those around me much more explicitly now than I ever did."

Bridgewater uses a variety of tools and practices to help people learn to treat errors as growth opportunities. For instance, all employees record problems and failures in a companywide "issues log," detailing their own contributions to mistakes. Logging in errors and problems is applauded and rewarded. Not recording a mistake is viewed as a serious breach of duty. Another reflective practice involves a "pain button" app, which is installed on everyone's company-issued iPad and allows employees to share experi-

ences of negative emotions at work—especially those that raise their defenses.

Openly acknowledging those experiences prompts follow-up conversations among the parties involved as they seek to explore the "truth of the situation" and identify ways to address the underlying causes. In one such conversation, a senior manager led members of a work group through a collective diagnosis of why a previous meeting had meandered and failed to reach a productive conclusion. Everyone offered thoughts. The employee who'd led that meeting agreed that he'd gotten wrapped up in defending his own and his colleagues' shoddy work. More than that, he allowed, this was an instance of a bigger, previously unacknowledged tendency he had to worry more about looking good than about achieving the business goal. At most companies a conversation like this would rarely turn toward examining an employee's habitual way of thinking—and if it did, it would be in a closed-door performance review. At Bridgewater such analysis happens in routine meetings with colleagues.

**Closing the gaps.** Ordinarily, in an effort to protect ourselves, we allow gaps to form—between plans and actions, between ourselves and others, between who we are at work and our "real selves," between what we say at the coffee machine and what we say in the meeting room. These gaps are most often created by the conversations we are *not* having, the synchronicities with others we're *not* achieving, and the work that, out of self-protection, we're avoiding.

To help close these gaps, and to gain more immediate access to the business issues at stake, Bridgewater and Decurion have created discussion formats that allow employees to speak authentically about the personal dimensions of those issues. Bridgewater uses a group probing of an individual's reasoning, as described above. Decurion conducts what it calls a fishbowl conversation, in which several people sit in the middle of a circle of their colleagues. In one such conversation we watched three employees from the IT, marketing, and operations arms of the theater business talk about why a new customer-loyalty program seemed to be stalling. The COO of the theater division suspected that these three key players were not communicating effectively. So she asked them to describe how they were experiencing the situation. The fishbowl format enabled the wider theater managers' group to listen to, learn from, and participate in the conversation. With careful facilitation by another senior manager, the three

## JOINING a Deliberately Developmental Organization

were able to express the ways in which they each felt shut out or shut down by the other two when decisions were made and information should have been shared. Each also identified some personal trigger or blind spot that had led him or her to shut down one of the others. They could then reach agreement in the presence of colleagues about how to proceed in a different way. Because dialogues like these are routine, people view them as a healthy exercise in sharing vulnerability, rather than a rare and threatening experience.

Over time, exposing one's own vulnerability feels less risky and more worthwhile as people repeatedly witness and participate in conversations about conflict, revelations of their colleagues' weaknesses, and discussions of the undiscussable. In fact, these organizations' most surprising and hopeful accomplishment may be converting their employees' default view of the "unimaginably bad" (*If I risk showing my weaknesses, it will be just horrible!*) into a sense of developmental progress (*If I risk showing my weaknesses, nothing bad will happen to me, I'll probably learn something, and I'll be better for it in the end*). The gap between who they really are and who they think they need to be at work diminishes or even disappears.

**Constructive destabilization.** Deliberately developmental organizations don't just accept their employees' inadequacies; they cultivate them. Both Bridgewater and Decurion give a lot of attention to finding a good fit between the person and the role. But here "good fit" means being regularly, though manageably, in over your head—what we call *constructive destabilization*. Constantly finding yourself a bit at sea is destabilizing. Working through that is constructive. At both companies, if it's clear that you can perform all your responsibilities at a high level, you are no longer in the right job. If you want to stay in that job, having finally mastered it, you'll be seen as someone who prefers to coast—and should be working for a different kind of company.

Many organizations offer people stretch assignments. Some commonly rotate high potentials through a series of stretch jobs. At Bridgewater and Decurion all jobs are stretch jobs. As Dalio puts it, "Every job should be like a towrope, so that as you grab hold of the job, the very process of doing the work pulls you up the mountain."

Decurion's ArcLight Cinemas has an elaborate set of practices that allow managers at all levels to facilitate constructive destabilization by matching individuals and groups to appropriate development

Ray Dalio and one of us (Bob Kegan) were present for the initial presentation of a Harvard Business School case on Bridgewater. Heidi Gardner, a case coauthor, asked the students toward the end of the discussion, "So how many of you would like to work at Bridgewater?" Just three or four hands went up in a class of 80. "Why not?" she asked. One young woman who'd been an active and impressive contributor to the case conversation replied, "I want people at work to think I'm *better* than I am; I don't want them to see how I *really* am!"

Clearly, people who consider joining a DDO must be willing to show themselves at their worst. And those who join with a distinguished record must be willing to consider big changes in the way they operate. Senior hires at both Decurion and Bridgewater told us: "I heard the words about how it

was going to be different, but I didn't understand what that would mean for me."

A DDO makes work deeply engaging; it becomes a way of life. If you want to be able to go home and leave work completely behind, this may not be the right place for you.

The brand of happiness a DDO offers—which arises from becoming a better version of yourself—involves labor pains. Some people might think they would appreciate that but really would not. Others simply cannot imagine that pain at work could lead to something expansive and life changing.

Finally, a DDO is continually evolving. If you expect a workplace to never fall short of its most inspiring principles and guiding ideas, you will quickly be disappointed. A DDO makes space for its people to grow; they must make space for it to develop in return.

opportunities. The general manager at each location uses data about individual growth to identify ideal job assignments for every employee every week—assignments meant to serve both the crew member's development and the company's business needs. The management team at each location meets weekly to discuss the goals and performance of each hourly employee and to decide whether someone is ready for more responsibility—say, a reassignment from ticket taker to auditorium scout. (Scouts move from one screen to another looking for ways to assist customers; the job requires a fair amount of initiative, creativity, problem solving, and diplomacy.)

As employees demonstrate new capabilities, their progress is recorded on "competency boards," which are set up in a central back-of-house location in each theater. Colored pins on these boards indicate the capability level of each employee in 15 identified job competencies. This information is used to schedule shift rotations, facilitate peer mentoring, and set expectations for learning as part of a development pipeline. The process meshes individuals' skills with organizational requirements; everyone can see how important individual growth is to the business and how everyone else's job knowledge is expanding. At weekly meetings about a dozen home-office executives and movie house general managers review a dashboard showing theater-level and circuit-level



**Over time, exposing one's own vulnerability feels less risky and more worthwhile as people repeatedly witness and participate in conversations about conflict, revelations of their colleagues' weaknesses, and discussions of the undiscussable.**

business metrics, which include not only traditional industry data on attendance and sales but also the number of crew members ready for promotion to the first tier of management.

Matching a person to an appropriate stretch job is only half the equation. The other half is aligning the job with the person. Decurion creates numerous opportunities for employees to connect their

day-to-day work with what is meaningful to them. At most team meetings, for instance, structured check-ins at the beginning and checkouts at the end allow people to identify ways in which they feel connected to—or disconnected from—the work at hand and their colleagues. A manager might, for instance, describe a communication breakthrough with a colleague and how it has made a shared project even more meaningful. Another manager might report on progress in curbing her tendency to jump in and save the day rather than let the team step up and feel fully accountable.

At one-on-one “touchpoint” meetings with their managers—which happen frequently at all levels of the company—employees can discuss how to realize their personal goals through opportunities tied to Decurion’s business needs. One member of a theater crew, for instance, who aspired to become a set decorator (outside Decurion), told us that such a dialogue prompted her general manager to involve her in decor for special events at the cinema—an activity far beyond the scope of her job—in order to align her personal interests with an organizational goal.

For a company to match people with jobs on a continual and granular basis requires that no particular job be dependent on or identified with a single person. That means relinquishing the security of being able to count on someone with long tenure and expertise in a certain role. One senior executive told us, “The purpose of your expertise is to give it away [to the next person coming up]. That sounds wonderful, but in practice—and I have experienced this personally—it is not always easy.” Still, all those people constantly growing into ever-changing roles create an organization that becomes more resilient even as it improves the execution of its current strategy.

**Everyone is a designer.** If something isn’t working optimally at Bridgewater or Decurion, it’s everyone’s responsibility to scrutinize and address the design of the underlying process. For example, frequent “pulse-check huddles” at Decurion allow theater crew members to analyze how a previous set of shows went. In these huddles we saw 17-year-old employees give and receive feedback with their peers and managers about problems in floor operations and ways to improve service for the next set of shows. These young people had learned early on to read the details of the theater’s profit-and-loss statement so that they could understand how every aspect of operations (and, by extension, their own actions) contributed to its short- and long-term prof-

itability. When offering ideas for improvements—such as changes in food preparation or readying 3-D glasses for distribution—they spoke in terms of their effect on the guest experience and the financial health of the business.

If a new line of business is being launched, a team will spend lavish amounts of time designing the right process for managing the work. Decurion's employees operate on the assumption that structure drives behavior, so they often focus on subtle aspects of organizational design, such as how offices are arranged, how frequently conversations happen, and what tasks will require collaboration among which people. Unlike Lean Six Sigma and other quality improvement approaches, process improvement at Decurion and Bridgewater integrates a traditional analysis of production errors and anomalies with efforts to correct employees' "interior production errors and anomalies"—that is, their faulty thinking and invalid assumptions.

A major initiative at ArcLight, for example, involved creating teams made up of marketing professionals from the home office and general managers of individual theaters. The company reasoned that if the friction and misunderstanding that typically exist between these groups could be overcome by focusing their collective expertise in small, location-specific teams, improved local film and special-event marketing would produce millions in additional revenue. We observed several such teams holding regular meetings in which they shared ways they were learning to work effectively together and things that still needed improvement. From these discussions it became apparent that audiences varied more from cinema to cinema than the home-office marketers had realized. As they integrated general managers' specialized knowledge about their customers into a nimbler social media strategy, the group's financial performance improved. The managers and marketers stretched themselves to pull together in a new way—and hit new revenue targets. ArcLight's people were as likely to tell us that those revenue targets were designed to stretch people's capabilities as the other way around, illustrating the integrated nature of business and personal development at the company.

**Taking the time for growth.** When people first hear stories like these, a common reaction is "I can't believe the time they devote to the people processes," usually in a tone suggesting "This is crazy! How can you do this and get anything done?" But Decurion

and Bridgewater are not just successful incubators of employee development; they are successful by conventional business benchmarks. Clearly they *do* get things done, and very well.

The simple explanation is that these companies look differently at how they spend time. Conventional organizations may pride themselves on how efficiently they agree on solutions to problems. But do they have so many "efficient" meetings because they haven't identified the personal issues and group dynamics that underlie recurring versions of the same problem? A senior investment analyst at Bridgewater puts it this way: "[The company] calls you on your 'bad,' but, much more than that, it basically takes the position that *you* can do something about this, become a better version of yourself, and when you do, we will be a better company because of it."

## THE COMMUNITY

If people must be vulnerable in order to grow, they need a community that will make them feel safe. Deliberately developmental organizations create that community through virtues common to many high-performance organizations—accountability, transparency, and support. But, arguably, they take them to a level that even the most progressive conventional organizations might find uncomfortable.

**Accountability.** Bridgewater and Decurion are not flat organizations. They have hierarchies. People report to other people. Tough decisions are made. Businesses are shuttered. People are let go. But rank doesn't give top executives a free pass on the merit of their ideas, nor does it exempt them from the disagreement or friendly advice of those lower down or from the requirement to keep growing and changing to serve the needs of the business and themselves.

Senior leaders are governed by the same structures and practices that apply to other employees. At Decurion they take part in check-ins, sharing their own concerns and failures. At Bridgewater their performance reviews are public, as are all other employees'. And every one of those reviews mentions areas of needed improvement—if they didn't, that would mean those leaders were in the wrong roles.

Thus Dalio explicitly states that he doesn't want his employees to accept a word he says until they have critically examined it for themselves. And Christopher Forman, Decurion's president, has helped create a voluntary 10-week course, *The Practice of Self-Management*, which many employees have taken several times. The course is taught by

Forman and other Decurion leaders, including the head of the real estate company, who told us, “My colleagues didn’t feel I’d mastered the material, so they asked me to teach it myself next time around. A typical Decurion move, this caused me to understand the ideas and practices at a much deeper level and to see how to apply them to the businesses.”

**Transparency.** When, in 2008, Decurion’s leaders decided to reduce the size of the headquarters staff by 65%, external experts advised them not to tell the employees until the last possible moment, to avoid damaging morale and to prevent the people they wanted to retain from seeking other positions. Instead, they announced their decision immediately.

They enlisted everyone in the transition process, sugarcoated nothing, and shared the financial details behind the decision. Forman explains, “We chose to trust that people could hold this [information].” No resignations followed. Why? “We created a context in which everyone was able to contribute and to grow,” Forman says, “both those who wound up staying with the company and those who left.” Trusting employees in this way enabled them to reciprocate, to believe that the downsizing was a growth experience that would make them more valuable to the organization—or to future employers.

At Bridgewater every meeting is recorded, and unless proprietary client information was discussed, all employees have access to every recording. All offices are equipped with audio or video recording technology. If an employee’s bosses discuss his performance and he wasn’t invited to the meeting, the tape is available to him. And he doesn’t have to scour every tape to find out if he was the subject of some closed-door conversation. In fact, he’s likely to be given a heads-up so that he *will* review the tape.

Initially, Bridgewater’s attorneys strenuously advised against this practice. But no longer. In three lawsuits subsequent to its initiation, all three rulings favored Bridgewater precisely because the company could produce the relevant tapes. “And if the tapes show we *did* do something wrong,” one senior leader told us, “then we *should* receive a negative judgment.”

**Support.** At both companies everyone from entry-level worker to CEO has a “crew”—an ongoing group that can be counted on to support his or her growth, both professionally and personally. Certainly, good teams in conventional companies also offer moral support. People form bonds, trust one another, and talk about personal things that relate to work and

to life beyond work. But these conversations are usually about coping with the potentially destabilizing stresses of the job. In a deliberately developmental organization, the crew is meant to be as much an instrument of that destabilization as a support of one’s growth through vulnerability. Decurion and Bridgewater people, including industry leaders whose prior work at other companies had been marked by extraordinary success, mentioned again and again that they felt “ill-equipped,” “immobilized,” “out on a rope without a net,” “beyond my competencies,” “repeatedly ineffective with no guarantees I would get it.” And yet a team that tried to support someone by reducing destabilization—*restoring* equilibrium—would be seen as doing him no service at all.

**MANY FINE** organizations that are not deliberately developmental and may have no interest in becoming so are nonetheless able to create cultures that foster a sense of family fellowship. They demonstrate that a deep sense of human connectedness at work can be unleashed in many ways. But a deliberately developmental organization may create a special kind of community. Experiencing yourself as incomplete or inadequate but still included, accepted, and valued—and recognizing the very capable people around you as also incomplete but likewise valuable—seems to give rise to qualities of compassion and appreciation that can benefit all relationships.

As psychologists, we have sometimes seen this unusual kind of connection among the members of a personal-learning program or a facilitated support group. From such groups we can glimpse the possibility of a new kind of community, as we take up the interior work of our own growth. But these programs are not meant to be permanent or to address the work of the world. By their existence as vibrant, successful companies, Decurion and Bridgewater offer a form of proof that the quest for business excellence and the search for personal realization need not be mutually exclusive—and can, in fact, be essential to each other. ▣

HBR Reprint R1404B



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**ARTWORK Julie Dodd, Paper Eggs**  
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3" x 2.5" x 2.5"

# Resilience in a Hotter World

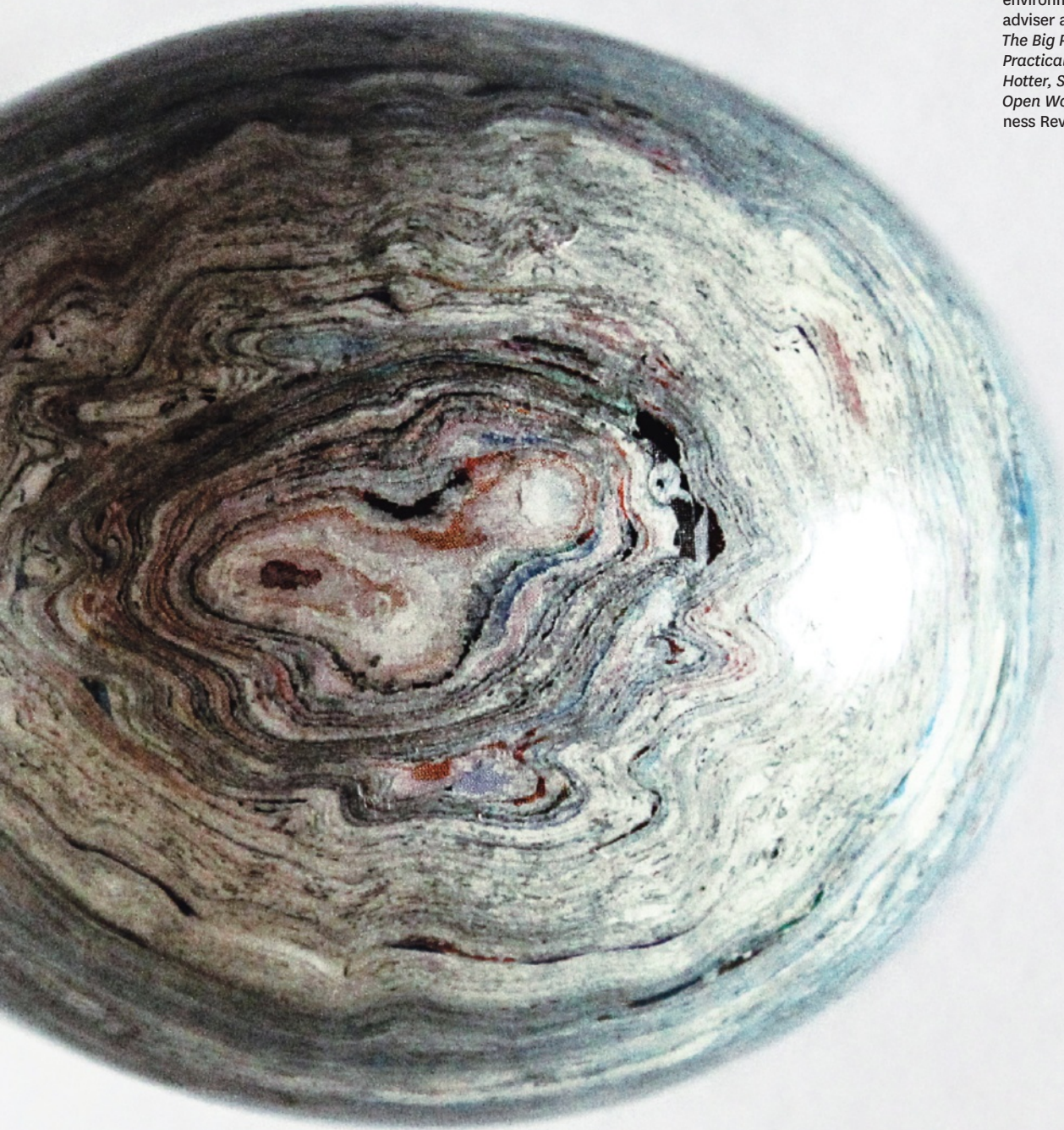
*Extreme weather and rising demand  
for resources call for a fundamentally  
new strategy.*

**by Andrew Winston**





**Andrew Winston** is an environmental strategy adviser and the author of *The Big Pivot: Radically Practical Strategies for a Hotter, Scarcer, and More Open World* (Harvard Business Review Press, 2014).



# Wild weather is taking a toll on people and businesses around the globe.

In late 2011 devastating floods struck Thailand, upending supply chains. With suppliers of critical auto parts knocked out, the production of Toyota, Honda, and other carmakers fell by hundreds of thousands of vehicles (and Toyota took an earnings hit of \$1.5 billion). In October 2012, when Hurricane Sandy flooded New York, a Con Edison electric substation exploded, plunging lower Manhattan into nearly four days of darkness. The record-setting 14-foot storm surge cost the utility more than \$500 million—and New York businesses a total of \$6 billion. A year later, Typhoon Haiyan, reportedly the most powerful storm to ever make landfall, ravaged the Philippines, killing more than 6,000 people and causing an estimated \$14 billion in damage.

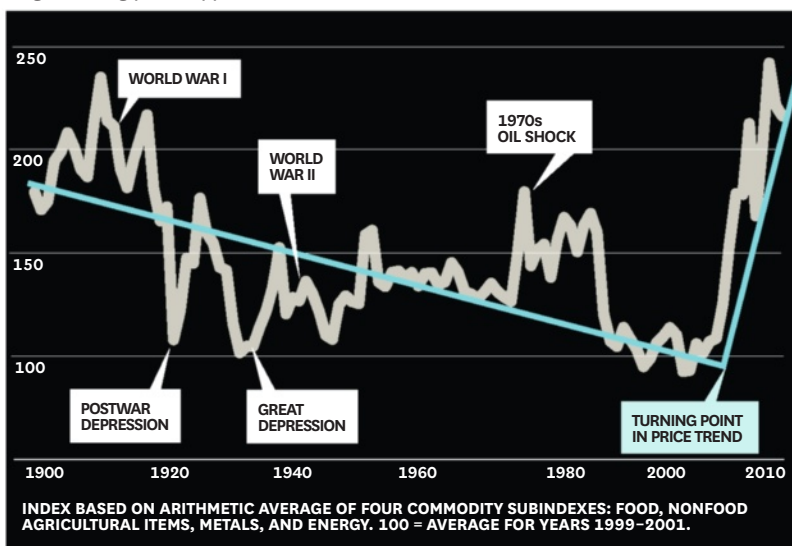
It's impossible to pin any one weather event on climate change, but the scientific consensus is that as the planet gets hotter, the frequency and severity of destructive weather will only increase. Along with—and often because of—these weather patterns, we're seeing increases in the prices of most commodities that business and society rely on. This is a sharp reversal of the trend toward lower prices that occurred during the past century. (See the exhibit "Soaring Commodity Prices.") Major storms, droughts, and floods are cutting the supply of some renewable commodities, such as crops and clean water. Nonrenewable resources, such as oil and some metals, are also becoming scarcer. The world won't run out of them immediately, but easily obtained, cheaper stores of them are dwindling. Meanwhile, growing populations and new wealth, particularly in China, are driving up demand for all commodities. This recently happened with cotton. As a consequence, prices for it rose 300% over one two-year period, forcing apparel makers and retailers to choose between passing along the costs to consumers, which would reduce sales, or keeping prices steady and taking a direct hit to margins.

Though companies today face many global-scale challenges—from destabilizing demographic shifts to the threat of financial system collapse—extreme weather caused by climate change and increasing limits on resources are both having an unprecedented impact, threatening corporate profits and global prosperity. These "megachallenges" will require companies to fundamentally rethink their strategies and tactics.

To manage them, all parts of society—government and public institutions, the private sector, and citizens—must act in concert. But business, with its financial and material resources and unique innovativeness and talent, must lead the way.

## SOARING COMMODITY PRICES

A McKinsey Global Institute analysis shows that over the past decade, commodity price increases have erased a century of price declines. Resource prices will always be highly volatile, with significant short-term dips, but in the long run rising prices appear to be the new norm.



## Idea in Brief

### THE CHALLENGE

Global climate change and increasing constraints on resources will require companies to fundamentally rethink their strategies, operations, and business philosophy in order to create new value and thrive.

### THE STRATEGY

Firms must embrace a new vision by fighting short-termism, basing goals on science, and pursuing radical innovation; they must place a value on natural capital (such as clean air and water) and redefine how they measure ROI; and they must engage in new forms of collaboration with governments, NGOs, peers and competitors, and customers.

### THE RESULT

These strategies will create more resilient companies that can manage, and profit from, extreme volatility. They will also help companies address society's largest challenges and create a more prosperous world for all.

### PIVOT STRATEGY

#### A New Framework

I've spent more than a decade studying and advising many of the world's largest companies, exploring how they deal with environmental and social pressures. So far, I've seen companies pursue mostly incremental improvements in environmental performance with easily justified projects that deliver quick paybacks, such as energy-efficiency initiatives. It's time to move beyond such table stakes, however. An extreme world calls for extreme change.

Companies in the vanguard are beginning to make what I call "the big pivot." This represents a profound change in strategy, operations, and business philosophy that will make organizations more resilient and help them create new value in a hotter, resource-scarce world. As I'll discuss in detail, pivoting requires companies to take radically different approaches to how they craft their vision, define value, and form partnerships. (See the chart "The Big Pivot Strategies.")

Companies that embrace pivot strategies will be better able to thrive in the face of extreme, unpredictable "black swan" events, such as rapid shifts in input availability or record storms like Hurricane Sandy and Typhoon Haiyan. The one thing we know for sure is that such events will happen. And as the uncertainty expert Nassim Taleb argues in his book *Antifragile*, the best systems help organizations not only survive the unpredictable but get stronger.

By making dramatic improvements in operational efficiency and cuts in material and energy use, waste, and carbon emissions, companies become much more flexible and, possibly, antifragile. This discipline increases a firm's *cost and risk resilience*: Companies that rely on fewer resources will be more competitive in a world of declining availability and higher prices. Organizations that minimize energy use and generate their own power from renewable

sources can operate more reliably if the electrical grid falters. An executive at Walmart, for instance, has pointed out that the retailer's commitment to increase its already sizable use of onsite renewable energy 600% by 2020 will help keep its "stores up and running no matter how bad the weather is or who else might be shut down."

Pivoting also increases what I call *revenue resilience*, providing protection against volatility in demand. As all customers begin to deal with climate change and resource scarcity, their expectations will change. By adapting and innovating to fulfill customers' new needs, companies can ensure that sales remain steady or increase. Businesses that create products and services for a cleaner, more "circular" economy—one that virtually eliminates waste and keeps precious resources in productive use indefinitely—will tap into a massive, growing market. As customers strengthen their own resilience by lowering their costs, risks, and resource dependency, multi-trillion-dollar markets in construction, energy, consumer products, transportation, and other sectors will all be in play.

Companies that understand how climate change and resource scarcity affect their full value chain—from raw materials to product recycling—will be better positioned to maintain or grow market share. They also will be able to address society's largest challenges and build a more prosperous world for all.

That said, the big pivot is not about philanthropy or citizenship. There's deep self-interest in recognizing that, as many have said, business cannot succeed on a planet that fails. And it's simply good business to fill market needs by addressing the risks humanity faces.

The following framework can help companies improve performance, increase resilience, and advance the common good—which they benefit from as well. In total, these strategies help companies



#### About the Spotlight Artist

Each month we illustrate our Spotlight package with a series of works from an accomplished artist. The lively and cerebral creations of these photographers, painters, and installation artists are meant to infuse our pages with additional energy and intelligence to amplify what are often complex and abstract concepts.

This month we feature the work of [Julie Dodd](#), a British sculptor and installation artist. She says she uses her work "as a platform to reflect my concerns of our consumption and environmental responsibility." Dodd, who works primarily with paper, much of it recycled, also says her pieces are "inspired by the patterns and shapes found in nature." More of her work can be seen at [juliekdodd.moonfruit.com](#).

pivot from maximizing short-term earnings first (while treating environmental and social challenges as niche issues), to operating in a way that makes tackling the world’s biggest problems the first priority and then leverages the tools of capitalism—like markets and competition—to do so profitably.

Most of these approaches aren’t easy, but they also aren’t impossible or naive. Many companies are undertaking them today.

**VISION**

**Asking Heretical Questions**

Companies need to have a clear vision of how climate change and resource scarcity will affect their prospects and their ability to reach long-term goals. This vision should take into account the best environmental data available. (See the sidebar “Use Science to Set Aggressive Goals.”) Pegging goals to hard science will force companies to take a longer view.

Climate change and resource constraints do affect companies in the short term, of course, but proactively tackling them in earnest (rather than just responding to their impact) is not a quarterly exercise. Innovation and adaptation are long-term activities, and maintaining a three-month horizon inhibits the creativity and investment needed to build resilience. Company leaders need to challenge Wall Street orthodoxy, as Unilever CEO Paul Polman has, resisting pressure to provide quarterly guidance, so they can focus on building real value over years, not months.

To confront short-termism—or develop any sound long-term strategy, for that matter—you must ask what I call “heretical questions.” These challenge the way things are normally done within any function and at any scale, from the firm’s business model down to specific operations. Consider a now famous example involving logistics. Some years ago at delivery giant UPS, a manager asked an unorthodox question: “Can we cut fuel costs by avoiding left turns?” Today, like many of its peers with large fleets, UPS uses routing technologies and strategies, including skipping those left turns, to reduce miles driven and wasteful idling, saving 8.4 million gallons of fuel a year.

Heretical questions have also helped companies reimagine how they make products to reduce reliance

**THE BIG PIVOT STRATEGIES**

To be resilient, companies must transform their strategies in three ways: They must rethink their vision, embracing radical innovation and a long-term mind-set; redefine their valuation methods to account for unpriced costs and benefits; and pursue new kinds of partnerships to achieve goals beyond the reach of individual firms.

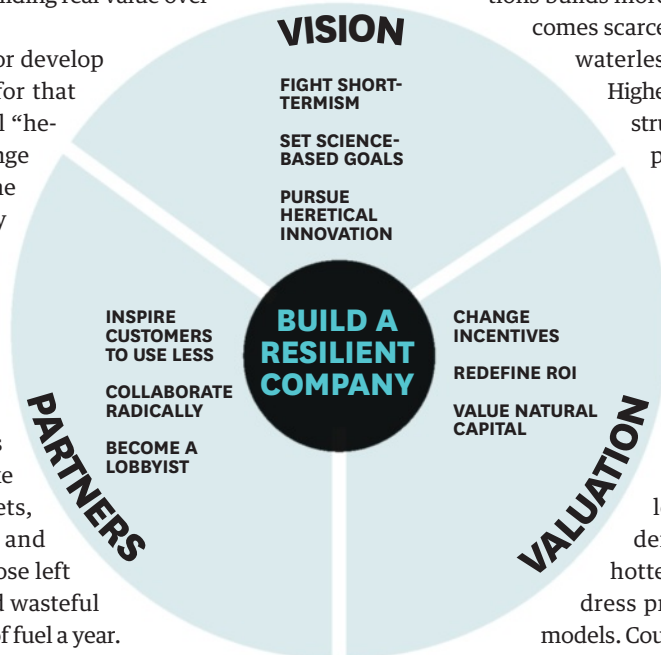
on key resources. At Adidas and Nike, innovators asked whether it would be possible to dye clothes—a very water-intensive process—without using any water. Both companies have identified technologies that accomplish that goal. At Kimberly-Clark, the heretical question was “Do paper towel and toilet paper rolls really need cardboard tubes?” As part of its \$100 million Scott Naturals brand, the company has since developed tubeless rolls.

Larger heresies can create greater value. Some companies, for example, are pursuing “reverse innovation,” which turns conventional product development on its head. To meet the needs of emerging markets, these firms create low-cost products that require less material or use less energy than Western-economy versions do—and then introduce them to developed markets. GE came out with one such innovation, a portable electrocardiograph for the Indian and Chinese markets, and then sold it in the United States for 80% less than similar products.

Organizations need to encourage heretical questions at operational and product levels and beyond, going so far as to challenge business models and basic assumptions about economic growth. Patagonia, for example, has famously asked, “Can we help our customers learn to buy only what they really need?” (See the sidebar “Growth in a World of Scarcity.”)

The innovation that results from heretical questions builds more-resilient companies. If water becomes scarce, Adidas and Nike factories using waterless technologies can still operate. Higher pulp prices will not affect the cost structure of Kimberly-Clark’s tubeless products as much as rival offerings’. Companies that reverse-innovate more-affordable products that consume fewer resources can compete more effectively in all global markets.

It’s easy to say, “Be heretical,” but the kind of innovation that tackles megachallenges doesn’t follow from asking any question that pushes the envelope. The right questions will underscore the unique pressures of a hotter, resource-scarce world and address processes, strategies, or business models. Could we operate without using water or emitting carbon, or help our customers do the same? How can we turn our product into a service



## Use Science to Set Aggressive Goals

Scientists have solid estimates of how much planet-warming carbon humans can emit into the atmosphere before the average global temperature increase hits a critical threshold of two degrees Celsius, beyond which the repercussions from climate change may be devastating to the economy and humanity.

Using those numbers, accounting giant PwC has calculated that the world must reduce total carbon intensity—the carbon emitted per dollar of GDP—by 6% a year until 2100. At that rate, intensity reductions will outpace growth in energy demand enough to lower total absolute carbon emissions. In a similar study (which was based on work from McKinsey) WWF, the international NGO, recommended a 3% annual reduction in absolute total emissions. Investing in energy efficiency and rooftop solar to meet that goal would produce a net present value of up to \$780 billion in the United States alone, the study said.

Some companies have set goals explicitly based on these science-based calculations. In the mid-2000s, Ford Motor

established targets for its product development portfolio—involving a mix of engine-efficiency improvements, new fuels, and hybrid and electric vehicles—to ensure that the company's vehicles would help prevent the world from going over the global-warming threshold. Toshiba has set goals to improve product energy and material efficiency 10-fold by 2050, a target in line with the most important climate recommendation from the scientific community—cutting global carbon emissions 80% to 90% by midcentury.

These companies have been the most explicit about connecting goals to science, but many others have set aggressive targets, too. My research team has collected the environmental and social goals of the world's largest companies

(and has made them available at [www.pivotgoals.com](http://www.pivotgoals.com)). More than a quarter of the *Fortune* Global 200 companies have carbon emission or energy reduction targets that would meet the recommended pace of change in intensity (PwC's numbers) or absolute emissions (WWF's).

One group of companies—including Apple, BMW, Deutsche Bahn, Honda, Nestlé, P&G, Unilever, and Walmart—ultimately aim to be powered entirely by renewable energy. Two more have set specific target dates: IKEA (2020) and Lego (2016). A second group, including AT&T, GE, Lloyds Bank, Saint-Gobain, and Volkswagen, plan to reduce energy intensity in operations by 25% to 75%, depending on the target year. Diageo North America has already beaten its

target and slashed its operational emissions by 75%. Such efforts help increase companies' resilience to energy and carbon costs.

A third group of companies, mostly in tech, are building revenue resilience by shrinking the energy footprint of their products, which satisfies customers seeking to reduce their own energy use, carbon impact, and costs. Sony plans to cut per-product energy consumption by 30% from 2008 to 2015, and by 2020 Intel plans to make its computer and data center products 25 times more efficient than they were in 2010.

Though these goals are just for carbon and energy, other kinds of environmental metrics and goals matter as well. If you have water-dependent operations in a dry region, for example, the size of the local watershed determines your ability to stay up and running. Water goals for you, your peers, the community, and the region all need to be based on that reality.

and drastically cut its physical footprint? Can we recycle or recapture 100% of our products after their use? Could our business have an entirely positive impact and be regenerative?

### VALUATION

#### Making Better Investment Decisions

Businesses are efficient at allocating resources. Managers regularly decide where to invest human, financial, and capital assets to reap the highest returns, using well-known tools, such as measures of return on investment. Those tools help organizations maximize whatever they value most—usually earnings.

But the tools are only as good as the information that goes into them. The calculations require estimating both inputs and outputs. Many things that can create (or destroy) value either don't have

a price or are not included in the calculations. These items fall into two buckets: (1) what economists call externalities, or benefits or costs incurred outside the company, and (2) everything else that indirectly drives profits and value within the company but cannot be measured easily.

Externalities include pollution and damage to natural resources on the negative side of the ledger, and everything a company does for society but doesn't get paid for, like job and wealth creation, on the positive side. At the same time, nature provides society and business many services that go unpriced in the marketplace, including clean air and water, a relatively stable climate, plants and animals to use for food and medicine, and much more. These assets are called natural capital, and businesses mostly ignore their value.

## Growth in a World of Scarcity

When resources are finite, never-ending growth is impossible. So how can companies pursue growth while acknowledging the need for a reduced footprint overall? Five innovation approaches offer guidance:

Make your current products the lowest-impact options in the market and steal share aggressively from competitors.

Develop more sustainable products or services that reduce customers' footprints in categories you're currently not playing in.

Develop services that replace products or greatly reduce their material impact. For automakers, investing in the car-sharing business is a disrupt-before-being-disrupted strategy, which is why Ford, GM, and others have done it.

"Decouple" the growth of the business from its use of resources and its emissions. Though Nestlé has expanded its production volume by over 50% since 2000, most of its environmental impacts, from water use to greenhouse gas emissions, are down in absolute terms.

Create "regenerative" offerings that improve the health of customers and the planet. Alcoa, for example, makes building panels that clean smog, while Europe's largest home improvement retailer, Kingfisher, has a mission of becoming "net positive" and helping customers build homes that generate more energy than they use.

Basic economics predicts that when the value of a resource is unmeasured, businesses will systematically underinvest in protecting it. Or worse, when a valuable resource costs nothing, it will be consumed aggressively and can abruptly become scarce. Consider the way the global economy is using the atmosphere as a free carbon dump. It's promising, however, that companies like Dow Chemical and Puma are now attempting, along with partners such as the Nature Conservancy, Trucost, and PwC, to assess how natural systems create value for their businesses. Those efforts will help the companies prepare for (or avoid) the day when natural inputs become scarce or are priced in the market, most likely by governments.

But for now it's hard for most firms to justify spending time and money managing externalities. More pertinent to day-to-day operations are the indirect and unpriced value creators (or destroyers), often given the shorthand "intangibles." Woefully underappreciated, these include the ability to attract and retain talent; support from the community and the license to operate from society; reduced risk and enhanced resilience; customer loyalty; and all brand equity. A firm's environmental and social performance can enhance or diminish all these assets. And while they're mainly off the books, they now account for the majority of corporate market capitalizations.

Because ROI tools calculate only the returns that companies can easily put a number on (typically, cash payoffs), they discourage investments in things that create harder-to-measure, indirect benefits. Take capital outlays for onsite renewable energy projects that may not deliver a payback fast enough to meet internal hurdle rates. These initiatives won't get funded, and companies will forfeit all the cost-resiliency benefits of reducing dependence on expensive fuels or on the grid. Traditional

tools also overlook indirect costs. Consider a natural capital example: Dredging and developing coastal wetlands makes sense as a real estate investment, but only because the flood protection that the lands provide is priced at zero. Their loss undermines resiliency by making all coastal assets, from refineries to homes, more vulnerable to extreme weather. If that cost were valued, it would greatly reduce the ROI of developing the land.

Companies need methods to gauge the value of the longer-term and indirect benefits of investment decisions. Such tools are now being adapted from industries that place bets further out, like pharmaceuticals and utilities, and applied to environmental and social initiatives. While those methods are evolving, managers can still modify how ROI is currently calculated to better reflect value that is unmeasured but that they know is not zero.

Some companies, such as 3M, IKEA, and Intel, simply lower the hurdle rate for investments in areas like pollution prevention, renewable energy, and green buildings. Others dedicate a portion of the capital expense budget to green investments: Johnson & Johnson allocates \$40 million annually solely to energy and greenhouse-gas-reduction projects.

Another method, which GE and Diversey (the cleaning products division of Sealed Air) have used, is to create a portfolio of efficiency projects. Some initiatives, such as energy-related projects, are quick wins and easily meet the internal hurdle rate, while others take longer to pay off. But in aggregate, the projects meet the hurdle rate. It's similar to a basket of equities in your 401(k)—your account may beat the market, but not every stock you own will.

Finally, some companies are getting ahead of the regulators and putting prices on the unvalued themselves. According to the *New York Times*, the Carbon

Disclosure Project recently reported that 29 of the world's biggest companies are incorporating prices on carbon emissions into their long-term financial plans. Most use so-called "shadow prices," which exist only in spreadsheets, to estimate investment returns over time in a world where carbon will cost real money. Anticipating that carbon will be priced at some point, these companies are helping managers see the risks inherent in long-term investments—like coal plants—that may suddenly become much less valuable or turn into liabilities. A small subset of the 29 companies, including Microsoft and Disney, even charge their divisions real fees for every ton of carbon emitted by their operations. They then invest the collected funds in energy-efficiency or carefully selected carbon offset projects, like reforestation.

None of these methods for valuing hard-to-measure benefits is surprising. Companies have long made significant investments without an exact ROI calculation in areas such as R&D and marketing and when entering new regions. What's new is that this mind-set is being applied to initiatives that address environmental and social challenges—projects that have always faced harsh internal scrutiny.

#### PARTNERS

### Collaborating in Radical New Ways

Vast problems that reside firmly in the commons—such as global climate change and regional water shortages—demand large-scale solutions beyond the capabilities of any single company. They call for partnerships among three major kinds of stakeholders: governments, peers and competitors, and customers.

To spur governments into action, companies need to get off the sidelines (or even the opposing team) and lobby for policies like carbon pricing, higher energy-efficiency standards, and massive public-private investments in green infrastructure. Such lobbying is about both the common good and competitive advantage—if you make the most-efficient products and services, for example, higher standards or a price on carbon can be good for you. And promoting clean-economy investment helps the many sectors that build and finance energy, transportation, water, and other types of infrastructure.

Because governments are often frozen, companies must lead the change. One relatively new approach is to create standards for suppliers that go beyond government requirements, a kind of "de facto" regulation. Walmart, for example, will require suppliers to report publicly on the use of 10 toxic

chemicals in their products in 2015 and phase them out soon after. HP recently challenged its suppliers to reduce their manufacturing and transportation-related carbon emissions by 20%.

Companies must tackle problems together—and even work with their fiercest competitors. Take the companies collaborating to change how food and beverages are kept cold. Current refrigerants are mainly chemicals in the hydrofluorocarbon family—which happen to be dangerous greenhouse gases, thousands of times more potent than carbon dioxide. Coca-Cola has teamed up with its suppliers

## At Adidas and Nike, innovators asked whether it would be possible to dye clothes without using water.

to find substitutes, is investing in new technologies, and has helped lead a coalition including the Consumer Goods Forum, Greenpeace, Unilever, and even archrival PepsiCo.

The powerful idea taking hold here is "precompetitive" cooperation—that is, working together on issues of common concern while competing elsewhere. To succeed at this, companies must ask, "What are we really competing on? What truly differentiates our product from competitors?" Coke and Pepsi battle over taste, distribution networks, and marketing; no customer picks one over the other on the basis of how the vending machines work.

Because a new technology can be expensive until it gets up to scale, companies often mutually benefit from building the market together. Some large retailers, for example, share methods for reducing store energy use, in part to help drive demand for—and lower the costs of—new offerings like efficient lighting and building management systems. This same logic could apply to other environmental quests. I'm currently in the early stages of building an alliance of big energy buyers—what I call the Energy Pivot Coalition—that will purchase sizable quantities of renewable energy and clean technologies for their operations, including onsite solar power, localized "microgrids," and energy storage.

By committing to build the market for these technologies and take on some investments with longer payback periods, the members of the coalition could reap all the hard-to-measure benefits of a public, well-marketed move to renewables: very low and predictable variable energy costs, resilience to weather and grid outages, employee engagement

Experimentation lets the business harvest big upside gains from heretical innovations that disrupt markets, while risk avoidance keeps most of the business stable. In *Antifragile*, Taleb suggests putting 90% of an investment portfolio in low-risk cash and 10% in extremely risky bets that can pay off 10-fold or much more in volatile circumstances. Companies can do

## An energy firm could protect itself against a rapid drop in demand by building capabilities for energy-efficiency services.

and inspiration, and customer loyalty and increased sales, among others. The coalition may also help utility partners make the biggest pivot of all—away from fossil fuels—by replacing lost revenue and profits from older, declining technologies.

Companies need to work with partners up and down their value chains, from suppliers to customers, to solve systemic problems. For most firms, the majority of their environmental footprint and social impact is not within their direct control but lies upstream with suppliers or downstream with customers using the product, as it does with cars burning fuel or with detergent (most of the life-cycle energy is used heating water to wash clothes). Some leading companies are starting to have tough conversations—directly in the B2B world or through marketing campaigns to inspire behavioral change among consumers—about how to work together to reduce consumption and lessen environmental impact.

### Resilience, Trust, and Prosperity

In a volatile world, developing real resiliency—an ability not just to recover from hits but to avoid problems altogether—requires a concerted, focused effort. Companies that embrace building longer-lasting, more-sustainable enterprises will find themselves in some unusual, seemingly paradoxical, territory. The principles of resilient systems include diversity and redundancy (which go against lean, cost-cutting philosophies); speed and fast failure with careful calculation; and a near-religious avoidance of risk for the vast majority of the business, coupled with extreme risk taking with pilot programs or small parts of the enterprise. This last aspect is challenging but logical.

the same with product lines and businesses, launching new services that compete with the core product but profit them mightily if customer needs shift dramatically. An energy company, for example, could protect itself against rapid reductions in demand by building the capabilities to offer energy-efficiency services. That's antifragility.

The vision, valuation, and partner strategies I've described invoke many of these principles. In addition to cost and revenue resiliency, they will lead to what I call *brand resiliency*—deepening customer loyalty, improving your organization's position in the talent market, and engendering a greater trust among consumers, partners, and governments.

Such trust increases when you open up and demonstrate commitment and show how your organization walks the talk. But openness is no longer optional. New technologies and connectedness now put all of a company's activities under a magnifying glass. Customers increasingly expect ready access to information about the things they buy: How, where, and by whom are your products made? What's in them? What is their environmental and social impact? How the parts of your value chain operate—either with disregard for sustainability issues or with best practice leadership—is now linked tightly to your brand and business prospects.

Pivot strategies are not just a sound defense but a smart offense as well. And beyond the business advantages they enable, they're critical to our collective well-being. In a world with tighter resources and a volatile climate, a big pivot is an essential investment in the future of your company and the global commons. 

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# Sustainability a CFO Can Love

by Kurt Kuehn with Lynnette McIntire

**AS A CFO** who advocates sustainability, I've noticed that many of my peers take a lukewarm view of the idea, perhaps because they simply don't see how sustainability can produce returns for a business. I can relate: I, too, am always looking for ways to allocate resources effectively and create value. Yet most companies do have sustainability programs, and the finance folks obviously approved the expenditures. My question is, What was the process by which those investments got green-lighted? In particular, how were certain projects chosen over all the other possibilities?

As a founding member of UPS's sustainability steering committee, I have wrestled with that challenge, and I've developed a point of view—one that emphasizes the power of organizational momentum and embraces “enlightened self-interest.” My approach is rooted in two beliefs: that companies have a responsibility to contribute to society and the environment, and that every investment a company makes should return value to the business.

These beliefs don't have to be at odds—although they often mean that sustainability programs must be subjected to alternative financial evaluation models (see the sidebar “Why ROI Analysis Falls Short”). In fact, the programs with the greatest impact not only align with companies' strategies but move in tandem with their activities.

The benefits of looking for momentum and finding a way to add to it are undeniable. If you push something in the direction it is already going, you will accomplish much more with each unit of





energy. That is the guiding philosophy behind the process described below, which may not be unique to us. The sustainability activities of some of the companies we admire most seem to reflect similar thinking. These companies have found ways to apply their direction, strengths, and acumen to accelerate positive change.

### Going with the Flow

When Haiti was struck by a devastating earthquake in 2009, UPS responded as it usually does—delivering food and other necessities to the site. But one of our managers, Craig Arnold, soon spotted another way to make a difference. While volunteering at a Salvation Army center in Port-au-Prince, he heard reports of fraud. With more than 10,000 victims lining up every day for food, medicine, and hygiene supplies, aid workers had set up a system whereby each family could get its share—but the system consisted simply of paper index cards on which were handwritten the names of eligible families. Some people would arrive at the front of the line after a long wait only to discover that their cards had already been marked. Apparently, others claiming to be them had taken their supplies, perhaps to sell on the black market.

At a time when aid was still just trickling in and supplies were short, the problem really bothered Arnold. So he and some UPS colleagues went to work on a low-tech solution. Over a weekend, they cobbled together an automated system using a laptop computer, bar-coded identity cards, and a proprietary tool called UPS Trackpad, originally designed to track packages inside office buildings. The following week each family had an identity card. With the possibility of theft virtually eliminated, emotions calmed in the waiting lines. A big source of stress was removed for Salvation Army workers, too. That Trackpad system is still in place in Haiti and has been adopted at other disaster sites.

This is a striking example of what you might wish would happen with every socially minded project you undertake. Arnold's solution cost UPS a few thousand dollars but probably had as great an impact as the \$1 million contribution we made to relief organizations in Haiti. The key was that momentum already existed on both sides: The Salvation Army's solid infrastructure, personnel, and humanitarian mission were on the ground, and UPS had useful existing strengths—technology, specialized knowledge, business acumen, and a habit of speedy problem resolution. The right combination of our organizations' capabilities gave the relief effort a healthy push forward.

Some fans of martial arts might recognize in this focus on momentum the fundamental principle of judo. The father of that discipline, Jigorō Kanō, emphasized the power of *seiryoku zen'yō*, or “maximum efficiency, minimum effort.” The way to achieve that in a match is to follow the movement of your opponent and strike in a way that takes advantage of his momentum rather than resisting his force. Others have applied the judo analogy to business to suggest using a larger competitor's very heft to hasten its fall. But here we're talking about taking advantage of momentum in order to achieve positive change. The idea is to guarantee an initiative's success.

Perhaps a better analogy, then, is rowing on a river. If you had a choice, would you choose to fight the current? You'd get a lot farther faster by going with the flow. How does one do that in a sustainability program? Let me describe the five steps we follow at UPS.

**1. Assess your strengths.** What does your company have to offer that could make a big difference? Find out by assessing your core competencies, infrastructure, and relationships as part of your sustainability strategizing. You will probably discover strengths that charitable partners often lack, such as:

If you push something in the direction it is already going, you will accomplish much more with each unit of energy.

## Idea in Brief

### THE PROBLEM

Many business leaders struggle to justify investments in sustainability—if not in general, at least in particular. Given the infinite possibilities to do good in the world, where should they focus?

### THE PRINCIPLE

At UPS the answers are clearer today thanks to a principle of building on momentum. When one of its existing strengths aligns with a social need relevant to its strategy, and a good NGO partner can be found, the company achieves the maximum impact for its commitment of resources.

### THE PAYOFF

Other companies can benefit from the process UPS has developed: (1) Assess your strengths, (2) choose your spots, (3) find momentum, (4) build productive partnerships, and (5) convene other sources of strength.

- *Capital.* You may have lower-cost access to cash, materials, or supplies on a sustainable basis.

- *Specialized knowledge and experience.* Your technical experts may include R&D scientists and product designers as well as accountants, IT gurus, and logisticians.

- *Relationships.* Your network is valuable for your connections with other companies, civic organizations, regulators, elected officials, suppliers, customers, and marketplaces.

- *Processes.* Businesses that have lived through decades of quality management and reengineering tend to have highly streamlined operations, metrics, and processes they can transfer.

- *Physical assets, personnel, and infrastructure.* Even if you are not a manufacturer, you've made substantial investments in means of production—facilities, office equipment, research—that sometimes sit idle or can be easily shared.

- *Business acumen.* As donors become more focused on outcomes, nonprofits can benefit by tapping into your knowledge of balance sheet levers, asset and risk management, marketing, pricing, strategic planning, and more.

One of my favorite examples of a strength-driven sustainability initiative is Campbell Soup's involvement in Just Peachy Salsa. The Food Bank of South Jersey had become aware that local farmers were throwing away 850,000 pounds of peaches each year because bruises and other imperfections made them unacceptable to grocery store produce managers. Those at the food bank saw an opportunity to process the fruit into a salable product and thus raise revenue to fund their work. The farmers agreed to donate the fruit; what was needed was expertise and infrastructure to create the product. That's where Campbell stepped in. Its culinary and product development teams created a delicious peach salsa recipe, and the company donated ad-

ditional ingredients, manufacturing capacity, and the work of hundreds of employees to produce and package the salsa.

For a company that was already going to invest in sustainability and was strongly promoting more-healthy eating, what could make better sense? But note how atypical this is. Whereas most packaged-goods companies simply donate their products to food banks, this approach created a new revenue stream that will continue to generate about \$100,000 a year for the Food Bank of South Jersey. Moreover, it keeps many tons of fruit from going to waste, and provides a new, healthy choice for families to enjoy.

Pfizer is another company that thinks about how its strengths can be leveraged for the public good. Since 2003 it has deployed more than 300 of its professionals as "global health fellows." On the company's website you can find fellows' accounts of how their skills helped to address specific health challenges. For example, in 2011 Andreas Kuznik, then a global health economics researcher at Pfizer, tackled a chronic shortage of health-care professionals in Uganda. He and his team noted that a big source of pressure on the system was the increasing number of AIDS patients, who required regular monitoring and prescription refills. The team introduced the business concept of "task-shifting" at one Ugandan clinic so that the work of providing medicine would migrate from doctors to pharmacists, who were less busy. It also suggested a simple change: writing 45-day rather than 30-day prescriptions. Relieved of tasks that didn't leverage their specialized abilities, the Ugandan doctors had more time to devote to patient care.

Marks & Spencer has strengths in retail footprint and advertising. Wanting to support Oxfam's collection of used clothing (some of which is passed along to people who need it, some of which is recycled into

new garments), it realized that many of its customers had very full closets. The “shwopping” program it introduced combines the ideas of shopping and swapping: Customers are encouraged to bring a piece of clothing they no longer want whenever they come to Marks & Spencer to buy something new, and to drop it in a convenient box at the store. When they do, they get a coupon entitling them to a discount on their purchase. Everyone wins.

**2. Choose your spots.** Finding the right space for your efforts in sustainability has to begin with narrowing down the field somehow. You might take cues from either external stakeholders or internal managers. Stakeholders include customers, shareholders, and suppliers that increasingly prefer to do business with companies they see as responsible—but also activists, who may be a risk. Managers know the company’s capabilities, cost structure, and objectives well, and can see the strategic fit of one proposed initiative versus another.

We think both these perspectives are important, and we combine them in what’s called a materiality matrix. (See the exhibit “How UPS Chose Its Spots.”) One axis indicates how relevant our external stakeholders believe certain issues are to being a good cor-

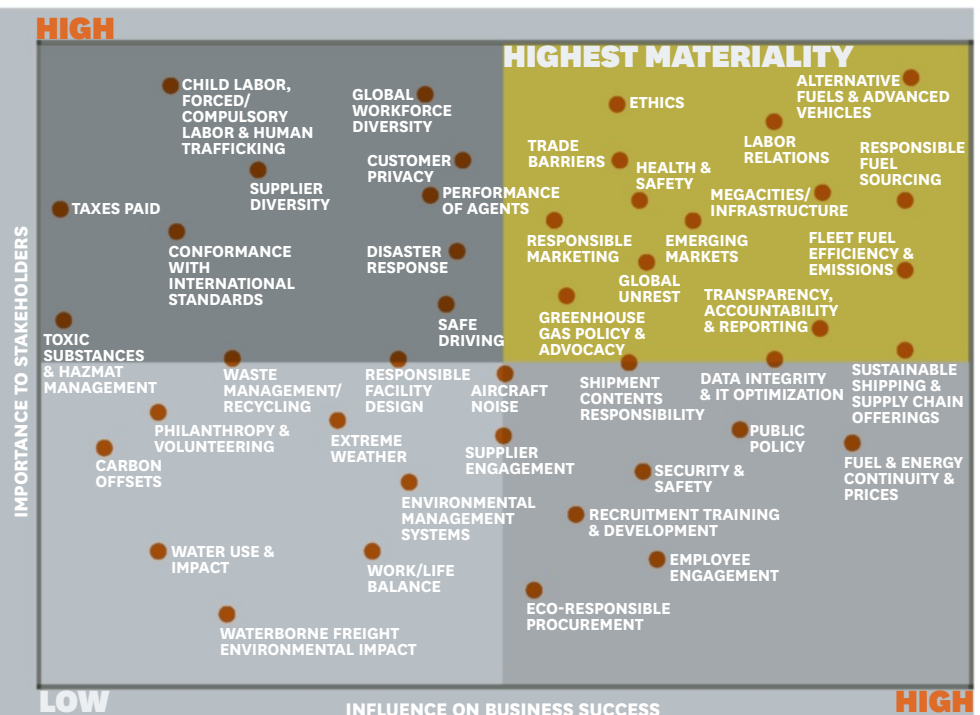
porate citizen; the other indicates which ones senior executives consider strategic and important to the company’s future success. Maximum momentum is found in the upper right quadrant, where issues draw energy from both sides. (This might be viewed as a practical method of arriving at what Michael Porter and Mark Kramer have called “shared value” opportunities.)

One priority that UPS was able to identify through this method is safety training for drivers in certain emerging economies. Stakeholders were concerned that the rapid expansion of the middle class in Vietnam, Cambodia, South Africa, and elsewhere has created new traffic nightmares—not only more commercial vehicles on the road but also a huge influx of first-time drivers. They perceived UPS as an expert in road and workplace safety because of its systems and performance. Meanwhile, company managers recognized that these countries are strategically important to UPS as new growth markets. Thus a program that involved working with nonprofits and humanitarian relief agencies to deliver our proven safety training programs wouldn’t encounter resistance from either inside or outside stakeholders. Even public officials have endorsed it.

## HOW UPS CHOSE ITS SPOTS

Companies get the most out of sustainability investments when they fund initiatives that both respond to stakeholders’ greatest concerns and tap into existing operational momentum. Combining these two dimensions yields a simple decision-making tool known as a materiality matrix.

Plotted on the matrix here are issues that UPS collected from its internal and external stakeholders. Your company’s issues and assessment will be different, but you, too, can use the matrix to provide a framework for management debate and a guide to smart investment.



SOURCE UPS

Environmental projects, too, are a strategic fit. We know that our vehicles and planes produce emissions and that we have an obligation to invest in a cleaner planet.

**3. Find momentum.** A materiality matrix narrows the field of possibilities, but it rarely points to a specific initiative. For example, it might indicate that a given company would do well to join the fight against AIDS or help preserve pristine forests or improve air quality, but within any of those areas numerous organizations are working in various places on different parts of the solution.

Having a bias toward adding to momentum makes the next step easier. It leads you to focus on where energy is already in motion and where your company's additional efforts could make a big difference. Ideally, your existing operations and initiatives will dovetail with societal or environmental needs for which others are already driving change.

Take the 2001 decision at Starbucks to source coffee beans according to "fair trade" principles that had been in existence for some 40 years. That move aligned with the coffee retailer's rapid global expansion. In its first annual "global responsibility" report, Starbucks noted that it wanted to ensure a high-quality, consistent, and stable source of coffee. The company was in a position to advance the fair trade movement in terms of both public visibility and business requirements.

Sometimes the momentum a company needs to recognize comes from governmental priorities. Indeed, failing to respond to them may imperil its license to operate. Pharmaceutical companies in some emerging economies, for example, are strongly encouraged to provide products free (or at deep discounts) to disadvantaged portions of the population or to government health-care agencies in return for permission to sell their products at a premium price in the commercial marketplace. If a government is focused on environmental goals, a company's conservation or air quality projects can tap into existing momentum. If job creation is a priority, apprenticeship programs or skills training through community colleges might achieve maximum impact with a given level of investment.

**4. Build productive partnerships.** Some companies, including UPS, have developed decades-long partnerships with NGOs and nonprofits. By now the parties have mutual respect and truly collaborate on initiatives that will produce impressive and demonstrable results. But most companies just sign up for

**Focus on where energy is already in motion and where your company's efforts could make a big difference.**

existing projects on the assumption that they and the NGO will figure out some way to shoehorn in the company's strengths.

This may be an area in which my background in corporate finance leads me to see things differently. In business, proposed combinations always involve a lot of due diligence. No one wants to be surprised after an agreement is inked, so we tend to be closely attuned to risks and red flags, even as we remain enthusiastic about potential synergies. The same should be true of joint projects between NGOs and businesses.

To ensure a productive collaboration from the outset, it helps to clearly articulate that the business's hope is to apply its strengths and add to momentum. Then the partners can proceed to understand each other's strengths, weaknesses, and shared values and to compare perspectives about the impact they want to achieve. Next they should draft a strategic plan; define goals and objectives; establish a timetable, metrics, and milestones; and agree on the resources required and what will define success. Both sides need clear rules of engagement and an open dialogue to adjust to each other—or to know when it's time to part ways.

One thing that might derail a partnership quickly is discovering that the NGO's people are fundamentally antagonistic toward the corporate world. Two businesses that are contemplating a strategic partnership often have rivalries and cultural differences, but usually both believe in basic business principles and objectives. That's not necessarily true of NGOs—and many of them don't share the typical company's desire to avoid taking sides politically. If an NGO's stance is anticorporate, trying to ignore that inconvenient fact is useless. The business partner must either acknowledge and accept it or shop around for another partner.

**5. Convene other sources of strength.** Large businesses all participate in networks of organizations, in their extended supply chains and across their industries. They have the power to convene other players and combine their strengths. If they do so for a good sustainability cause, they can add even more to its momentum.

UPS has enjoyed success with multicompany projects, particularly those relating to humanitarian logistics and disaster relief. Most notably, we've joined with our competitors TNT and Agility to support the UN's World Food Programme during disasters. One would think that competitors would be

reluctant to share their operational knowledge for fear of poaching. But in this case each company identified its local relationships and infrastructure and devised a plan that leveraged its strengths for greater impact.

UPS has also joined forces with some customers on disaster relief projects, ensuring that their donated products are received on time around the world. The effort is particularly productive when we can combine multiple customer-donation shipments, reducing transportation costs for all by sharing trucks and planes or using employee volunteers to pack emergency supplies. Such projects have an

added benefit: Our employees and those of our customers bond in a way that is simply not possible in a regular work situation. That personal relationship, we've seen, often translates into new business.

We have even helped create entities to address sustainability challenges. I'm thinking of our founding investment in Aidmatrix, a nonprofit that tracks donated supplies and serves as a matchmaker for donors and charities. Such matchups are particularly critical in the first days after a disaster, as well-meaning citizens offer teddy bears and old clothes when relief workers really need water and blankets. One of the biggest challenges agencies face is transporting needed goods the last mile to a relief site. Aidmatrix not only helps them locate the needed goods; it helps them solicit transportation donations, keep track of inventory in their supply chains, and learn when more supplies must be shipped.

UPS supported this project because it teaches us how we can more effectively contribute charitable shipping (on the basis of need rather than the order of incoming requests) and it helps relief agencies deliver more efficiently too. It gives us a place to which we can refer donors that need in-kind transportation services we can't provide. In recent years we have contributed logistics expertise to software develop-



## Why ROI Analysis Falls Short

Most executives who champion sustainability programs are reluctant even to talk about their commercial benefits, much less to formally document cost/benefit analyses. To ask forthrightly about the return on investment, they think, is crass and calls into question the sincerity of the effort. Even in purely internal discussions, funding for initiatives is extended “because it’s the right thing to do” or “because it’s part of our corporate culture.”

As an inveterate number cruncher, I wish all sustainability investments could be shown to yield attractive financial returns. Sadly, though, an ROI analysis isn’t always possible, for several reasons.

**You can’t get all the data.** ROI analysis depends on having verifiable data. But sustainability programs find their success beyond company boundaries, so internal systems and process metrics can’t capture all the relevant numbers. Meanwhile, the NGOs, community groups, and activists collaborating with the company often

don’t use standard accounting practices or the budgetary rigor that is institutionalized in businesses. Even when business systems and processes are built into sustainability initiatives, the metrics tracked, the definitions of successful outcomes, and the quality of the reporting can vary wildly among participants.

**Much of the return is intangible.** Traditional financial models are built around trackable, monetized results. Yet most benefits of sustainability programs involve fuzzy intangibles: They provide a bank

ers at Aidmatrix, and we are partnering with it as it goes international.

### What We're Choosing Not to Do

Following the principle of adding to momentum, UPS has moved its philanthropic giving over the past decade toward expertise and in-kind donations and has aligned it with the corporate mission to enable global commerce through logistics. Our more strategic approach to sustainability has led to many of the projects we've taken on recently. But the test of a good strategy is not just whether it has you doing good things; it must also allow you to decide what *not* to do. Aiming for "maximum efficiency, minimum effort," we've been able to see more clearly that some projects and ideas aren't for us.

We tend to avoid projects that have no logistics component. We encourage our employees to use their business, logistics, and transportation skills when volunteering. Far too many times, I've seen unskilled volunteers create more trouble than value. Truth be told, NGO staffers spend a lot of time correcting the work of their generous corporate helpers.

Today, corporate giving is less likely to be guided by individual executives' personal choices. Such gifts may be heartfelt and happily received by the

NGOs that get them, but they don't deliver strategic value to either side and so are often not sustained. When the executive goes, so does the support.

More generally, UPS makes fewer one-off contributions. When all the components of a sustainability program are guided by a materiality matrix analysis and a plan to find and increase momentum, connections tend to form among them, creating a cumulative effect.

### Momentum's Extra Benefits

When you approach sustainability from a position of your strengths, the line between the two realms of value creation—helping to make the business profitable and helping to keep the planet well—begins to blur. As I've noted, business competencies can reveal social possibilities. At the same time, sustainability work can inspire business improvements.

This can happen in very small ways—and small ways add up. An employee at our corporate headquarters, for example, read a series of internal articles on environmental grants given by the UPS Foundation. Not long after that, the employee stopped by the office on a weekend and discovered that the lights illuminating vending machines had been left on. It was a small matter to ask our maintenance crews to

of goodwill that protects a company's reputation and enhances its brand equity; they inspire employees, develop leaders, and invigorate our lives. So these projects need to be evaluated using different criteria, which shouldn't be impossible. Early-stage R&D is often justified not on the basis of commercial return (because it's hard to know where it will lead) but as the cost of identifying and managing risks and opportunities. Likewise, sustainability programs are undoubtedly investments in the future. But to prove that

numerically would mean adding attributes such as risk mitigation, opportunity, community enhancement, environmental benefit, and social engagement to the "value" elements in a company's financial models.

**Payback is on a different time frame.** Even when their future benefits can be forecast, sustainability projects often require longer-term payback windows. At UPS we extended the ROI terms for many of our alternative fuel and energy projects in order to support their viability and innovation.

It is not unreasonable for business leaders to want a positive return on their sustainability expenditures, but they may need to adjust their assumptions and traditional financial models. They may have to connect the dots on how sustainability projects link to existing commercial programs, ambitions, and missions. But ideally, the company's sustainability projects were chosen with those links in mind.

For me, the convenient analogy is advertising. I cite that old line from the retailer John Wanamaker: "Half my advertis-

ing is wasted. I just don't know which half." His admission didn't prevent him—or other marketers across the decades—from investing in advertising. No one denied it was essential. But it did keep people looking for better ways to make the benefits measurable. And they have found them.

We're at the same point with sustainability. ROI is impossible now yet not wrong to hope for. For the moment, let's accept that as a challenge but not an excuse, and rely on the metrics we have.

routinely turn them off. The result: a \$10,000 drop in monthly electricity bills in one state alone.

Companies can achieve success in bigger ways, too, by choosing the right projects. In a competitive environment that demands constant innovation, work on sustainability challenges can reveal new possibilities. Often companies view their own strengths through a certain lens. Outside stakeholders bring other agendas and opinions about what knowledge and skills a company has to offer, and

erations, customer deliverables, and employee interactions, frontline managers face less of a trade-off between hitting their business objectives and participating in community projects. The latter doesn't always mean yanking employees out of their productive routines and creating entirely new and separate work flows. When sustainability activity is integrated into their work, employees often spot opportunities for new projects—and find creative ways to fold them into their lives, both on the job and off. That makes it far more feasible for small and midsize companies to participate in sustainability initiatives. The projects are tied more closely to the company's mission and operations—and are less likely to be driven by an NGO seeking one big checkbook.

## Managers often focus on constraints, while external stakeholders imagine possibilities.

they are unencumbered by assumptions about its business model. Managers often focus on constraints, while external stakeholders imagine possibilities.

What I particularly liked about Craig Arnold's low-tech innovation in Haiti is that to everyone's surprise, the tool remains in use. The NGOs that adopted it love that the system is so simple and inexpensive—in sharp contrast to the frustration that can result when companies proudly donate sophisticated technology solutions that simply aren't appropriate in constrained environments. The learning curves those solutions entail and their finicky response to rustic conditions make it hard to deploy them effectively. It's a good lesson to keep in mind as we invest in customer-facing innovations.


At least as important is the employee engagement that results when people apply the same capabilities they use at work to make the world a better place. It's a wonderful thing when a UPS employee realizes that logistics and managerial skills are a valuable societal asset worth talking about and sharing. Employees not only do sustainability projects well; they derive enormous personal satisfaction from them, which strengthens their bond with the company.

Best of all, when companies add momentum to sustainability work, more of that work gets done. As these projects are streamed into the flow of op-

### An Idea in Motion

Determining how to use limited internal resources to generate the greatest possible impact in a hard-to-measure realm like sustainability is a tough challenge. I've shared my viewpoint because I know it's a challenge that many companies face. Activists, employees, and communities expect corporations to contribute more to society than ever before. Workers want their employers to take the lead in promoting sustainable practices and are frustrated if they can't find a career path that satisfies their social and environmental aspirations. Managers know it's no longer enough to provide good jobs and obey the law.

In the midst of these shifting sentiments, it's a problem for CFOs that so many of us still haven't figured out how to get behind our companies' sustainability efforts. Many are hesitant to embrace those initiatives on the assumption that they will divert resources from more business-minded pursuits.

I encourage other executives to act, despite such reservations, on their belief that companies have an obligation to use their resources for societal good. The relationships, systems, and operational disciplines that many businesses have developed for financial gain can make all the difference to sustainability efforts. There is momentum toward a better approach to sustainability—one that combines corporate and NGO strengths. Will you add to it? 

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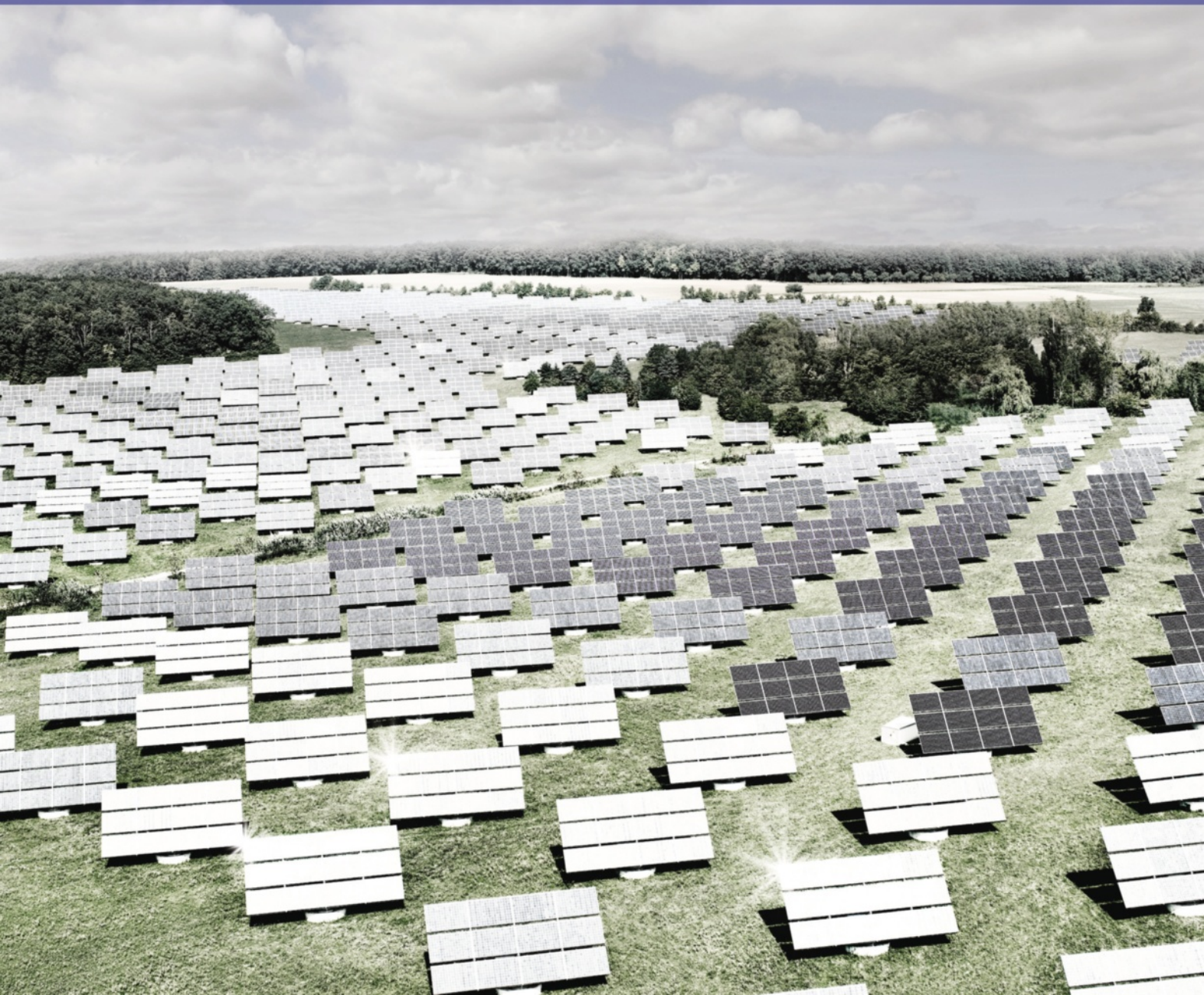
 **Kurt Kuehn** is the chief financial officer at UPS and a 2013 winner of the C.K. Prahalad Award for Global Sustainability Leadership. **Lynnette McIntire**, who formerly managed sustainability communications at UPS, is a social innovation fellow at Babson College's Lewis Institute and the founder of Silver Birch Communications in St. Paul.

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# Spotlight

**ARTWORK** Julie Dodd, *Blood Cells*  
2012, print and wire, 5" x 7"





**Ram Nidumolu** is the CEO of Innovastrat and the author of *Two Birds in a Tree* (Berrett-Koehler, 2013).

**Jib Ellison** is the founder and CEO of Blu Sky. **John Whalen** and **Erin Billman** are principals at Blu Sky.

# The Collaboration Imperative

***New partnership models can protect the environment and create value for everyone.***

*by Ram Nidumolu, Jib Ellison, John Whalen, and Erin Billman*

**“BUSINESS COLLABORATION”** IS the great oxymoron of corporate sustainability. Countless efforts by companies to work together to tackle the most complex challenges facing our world today—including climate change, resource depletion, and ecosystem loss—have failed because of competitive self-interest, a lack of a fully shared purpose, and a shortage of trust. To be sure, smart companies have embraced sustainability as a business imperative, and many have successful ongoing initiatives in areas they can address on their own—streamlining their manufacturing processes or reducing their fleet emissions, for instance. But when it comes to developing collaborative solutions to systemic problems, very little progress has been made.

The good news is that in our sustainability consulting to governments, NGOs, and global companies, we are seeing both a growing awareness of the critical need for improved collaboration and the emergence of innovative models that create value for companies and drive systemic change. Optimal collaborations focus on both business processes and outcomes. They start with a small group of key organizations, link self-interest to shared interest, encourage productive competition, and, above all, build and maintain trust.

In this article, we'll examine the most effective models for systemic sustainability collaboration, using case studies in dairy, apparel, waste reclamation, and municipal water management. But first, let's look more closely at why collaboration is critical in addressing global sustainability challenges.

### Systemic Solutions

The earth's natural commons—the atmosphere, natural resources, and biological ecosystems—provide enormous value to both business and society. However, much of that value is being destroyed through the suboptimal ways in which companies and other

stakeholders use these complex and fragile systems. The next frontier of value creation for business, we believe, is to find ways to preserve and protect the natural commons while unleashing their vast untapped potential.

Consider the world's tropical forests. Spread over 1.9 billion hectares, they are among the most complex environmental systems in the world. They provide vital ecosystem services such as climate regulation, water filtration and supply, and nutrient cycling. They also provide natural resources, including food, fiber, freshwater, medicines, minerals, and other raw materials. The economic value of the forests (typically assessed by estimating the cost of replicating them through man-made means) is an estimated \$4 trillion annually. Tropical forests also support 50% of the earth's terrestrial biodiversity. And, along with oceans, they are the world's most important global carbon sinks: natural reservoirs that capture and store more atmospheric carbon than they release.

Poor management has led to the disappearance of half of these forests in the past century, chiefly through their conversion to agricultural and com-

## FOUR MODELS FOR SUSTAINABLE COLLABORATION

Each square in this matrix represents a different model for collaboration, based on the breadth of organizations involved and the desired goals. Most collaborations will and should evolve over time, leveraging aspects of various models as needs and circumstances change.

FOCUS  
 OUTCOMES  
 OPERATIONAL PROCESSES

<p><b>KEY STRATEGY</b> Develop <i>industry benchmarks and standardized systems</i> for measuring environmental performance across the value chain</p> <p><b>EXAMPLE</b> The Sustainable Apparel Coalition's Higg Index</p>	<p><b>KEY STRATEGY</b> Institute "<i>payment for ecosystem services</i>" models in which firms invest in funds that compensate local communities for improving conservation and protection outcomes</p> <p><b>EXAMPLE</b> The Latin American Water Funds Partnership between Coca-Cola's largest bottler and upstream farmers and landowners</p>
<p><b>KEY STRATEGY</b> Identify and share <i>industrywide operational processes</i> that reduce emissions, natural resource consumption, and waste and protect the environment</p> <p><b>EXAMPLE</b> Dairy Management Inc.'s efforts to reduce milk's carbon footprint while producing renewable energy</p>	<p><b>KEY STRATEGY</b> Initiate <i>extended collaborations</i> that engage the business community and noncorporate stakeholders in the pursuit of operational innovations and best practices that create shared value</p> <p><b>EXAMPLE</b> Action to Accelerate Recycling's collaboration to change consumer behavior</p>

COMPANIES ACROSS THE VALUE CHAIN

COMPANIES AND NONBUSINESS STAKEHOLDERS

PLAYERS

## Idea in Brief

### THE PROBLEM

Addressing global sustainability challenges—including climate change, resource depletion, and ecosystem loss—is beyond the capabilities of even the largest company.

### THE ANALYSIS

To tackle these threats, and unleash new value, companies and other stakeholders must collaborate in new ways that focus on both processes and environmental impact.

### THE SOLUTION

Optimal collaborations start with a small group, bring in project management expertise, link self-interest to shared interest, encourage productive competition, create quick wins, and, above all, build and maintain trust.

mercial land. This is a classic case of sacrificing system value in favor of profits reaped by a few individual companies. Although business and society would ultimately benefit more in economic terms by preserving forests, shorter-term incentives for individual companies or sectors have led to their rapid destruction. Other vital natural commons—the atmosphere, oceans, watersheds, wetlands, coral reefs, and rivers—are experiencing similarly significant adverse impacts.

Preserving natural commons and tapping their full, long-term value require new collaboration models that consider ecosystems as a whole.

### New Collaboration Models

In our work with global companies such as Walmart, Microsoft, Nike, Alcoa, and Waste Management, as well as with many NGOs and governmental organizations, we've identified four collaboration models that address systemic challenges and create systemwide value. These models have two defining characteristics: (1) They engage carefully selected stakeholders and (2) they focus collaborative effort on innovation in either operating processes or business outcomes. (See the exhibit "Four Models for Sustainable Collaboration.")

**Stakeholder inclusion.** While sustainability collaborations typically engage a variety of players, including NGOs, academia, and governments, successful systemwide change requires participation by the right players. These are the key stakeholders that will be affected by sustainability initiatives and that, by changing their practices and other behaviors, can protect and capture system value. There are two such types of collaborations:

- *Corporate collaborations* include manufacturers, suppliers, distributors, retailers, and other players across the business value chain. Noncorporate players such as NGOs, academics, and government

may offer input, but they are not integral operational partners. It is the corporate players whose behavior must change to drive the requisite innovations.

- *Extended collaborations* are those in which both businesses and noncorporate partners—local governments and other stakeholder communities—are integral to the process.

**Processes and outcomes.** The second dimension characterizing effective collaboration models is an explicit focus on improving either business processes or environmental impact outcomes.

- *Coordinated processes.* Stakeholders identify and share new operational processes that reduce resource consumption and waste and protect natural resources.

- *Coordinated outcomes.* Stakeholders work together to define desired outcomes, create standardized metrics for measuring environmental impacts, and benchmark performance.

Most sustainability collaborations will and should evolve over time, moving from one model to another or taking on features of multiple models. Let's look at each model in turn.



### Corporate Collaborations Focused on Processes

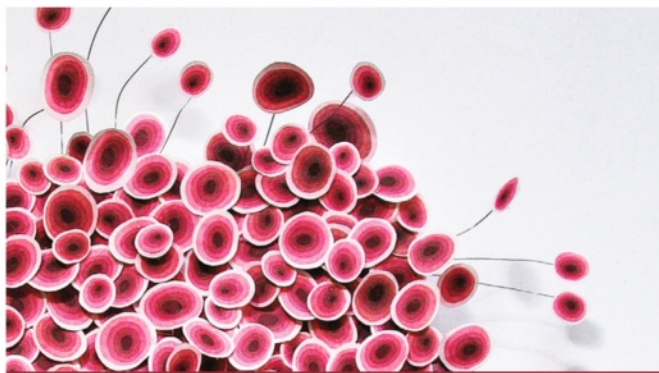
#### CASE STUDY: DAIRY MANAGEMENT INC.

Among the most effective ways companies can unlock the value in natural ecosystems is to collaborate on improving operations. Collaboration can focus on a particular node in the supply chain or address processes that span the value chain.

Consider the U.S. dairy industry. In 2007, key business leaders realized that the increasing pressure from NGOs, retailers, and consumers to reduce the industry's carbon footprint—especially from dairy operations and methane emissions—threatened the whole industry. In response, they began collaborating to identify inefficiencies and foster

operational innovations across the value chain. For instance, they realized that manure, one of the biggest sources of carbon emissions, represented an untapped resource that could generate new revenue for farmers while reducing emissions.

However, the collaboration faced enormous barriers. Dairy farmers saw sustainability as a code word for government regulation and increased costs. The industry had no experience or skills in measuring or addressing its carbon footprint. In addition, there was no history of voluntary collaborative action among the farmers, processors, and retailers. To the contrary, the key players saw themselves as rivals in a zero-sum competition for profits.



Despite these challenges, Dairy Management Inc. (DMI), an industry group funded by dairy farmers, launched an initiative to reduce carbon emissions across the value chain by 25% by 2020. To govern this effort, DMI created the Innovation Center for U.S. Dairy, engaging CEOs of companies representing 75% of milk sales in the United States.

To overcome the skepticism of many industry leaders, DMI reframed the challenge by helping dairy farmers see that sustainability had long been a core value of the industry: In maintaining their family farms on the same land for generations, farmers had developed important capabilities that were directly relevant to the challenges ahead. DMI also pointed out that the farmers' biggest corporate customers were increasingly concerned about carbon emissions—a compelling reason to work together to reduce them. Finally, DMI promised the participants that only actions that were good for business would be considered.

With the farmers' support, DMI worked with the University of Arkansas's Applied Sustainability Center to develop a life-cycle analysis of milk's carbon footprint, which included primary research with hundreds of dairy farmers. This gave the industry a single shared knowledge base about carbon in the

## Building and Maintaining Trust

**Without trust, most collaboration efforts are unlikely to survive, however noble the cause and worthy the participants. Two practices can help organizations lay the groundwork of trust among stakeholders.**

### **Practice appreciative inquiry.**

Pioneered by Blu Skye's academic partner David Cooperrider, from Case Western Reserve University, the appreciative inquiry method is based on research in the field of positive psychology. Appreciative inquiry helps focus attention in a specific direction. If we focus on problems, we often find more problems. If we focus on strengths and possibilities, we become more inspired and innovative. The approach is designed to create in a short time a true spirit of collaborative innovation among participants.

We have adapted this model to address systemic sustainability challenges. Several projects described in this article employ the methodology in overall project management and in the ongoing facilitation of member communications and meetings. For example, the U.S. dairy industry's sustainability summit was focused on an inquiry that crystallized the promise of win-win solutions: "How might we work together to reduce the carbon footprint of the dairy value chain and create business value for our companies?"

value chain. DMI also created a sustainability council, which convened 270 industry leaders and stakeholders in a three-day summit to identify opportunities for collaboration. An array of operational innovation projects were proposed, including initiatives to improve methods for growing feed crops, increase the use of methane digesters to turn manure into renewable energy, and boost energy efficiency for farms and dairy processing plants. DMI estimated the potential business value of these projects at more than \$250 million.

The corporate collaboration has strengthened trust and commitment among retailers, milk producers, and dairy farmers, and seven years later, it is going strong. A number of innovation projects have been fully implemented, and the industry continues to develop more-sophisticated tools for measurement and continuous improvement in farming, transport, and processing. The U.S. dairy industry has received millions of dollars in government grants from the USDA to support implementation of these projects. DMI was also recognized at the 2010 UN climate change summit in Copenhagen as a model for how the agriculture sector can unlock system value by simultaneously addressing climate change and creating business value.

**Create deep meaning.** To foster a strong sense of identity and belonging among members from different organizations, we suggest that individuals participate as a group in extended experiences that connect the head and the heart. Executive field trips such as white-water rafting, mountain climbing, and other wilderness trips, combined with storytelling and other shared experiences, strengthen bonds among collaborators and intensify their commitment to the group's goals.

The beauty of such deep engagement is that its effects persist even after the initial goals of the project are met. As Jason Kibbey, executive director of the Sustainable Apparel Coalition, put it, "What is unique about the SAC is the sense of personal mission and fulfillment among the individual members....This culture created the possibility for SAC's success and is continuing even after we've fulfilled our initial mission."

## Corporate Collaborations Focused on Outcomes

### CASE STUDY: THE SUSTAINABLE APPAREL COALITION

One of the best ways to improve corporate sustainability is to set clear targets for desired outcomes and then measure progress. Likewise, one of the most effective ways to drive systemic collaboration is through the development of industrywide performance standards. In the highly competitive apparel industry, early innovator Nike invested years and many millions of dollars in developing internal tools for measuring the environmental impacts of apparel sourcing and manufacturing. However, Nike came to realize that as big as the company was, its measurement tools would have little systemic impact unless a critical mass of apparel brands and retailers adopted them as well.

In 2010 the unlikely pairing of behemoth Walmart and niche player Patagonia convened a group of 10 apparel companies in the belief that the adoption of a single, standardized index would drive efficiency and innovation across the apparel value chain and reduce environmental impact and supply chain risks.

The Sustainable Apparel Coalition, as the collaboration is known, developed a measurement tool called the Higg Index, which allows companies to compare environmental performance outcomes in areas such as energy efficiency, material waste, water use, and sustainable raw materials. It provides benchmarks at the company, product, and factory level. Drawing on work already done by Nike and the Outdoor Industry Association, the coalition quickly built a prototype and began testing it, in the fall of 2011, across more than 50 brands, retailers, and suppliers. The SAC's benchmarks have mobilized a "race to the top," in which companies that score lower than competitors on the index are motivated to improve their ratings.

The Higg Index is not just driving better outcomes; it is influencing capital investment decisions and changing operational behavior. Target and other major retailers have integrated the index into their supplier scorecard, using the measures to select suppliers. Apparel brands have used the index to help reduce fabric waste through improved product design. And manufacturers have used it to justify investments in new capabilities like wastewater recycling and improved energy efficiency. The index even improves performance within companies, as departments compare their scores and engage in productive competition.

More important, the Higg Index is enabling systemic collaboration on innovative practices that achieve desired outcomes, such as used-apparel recycling, are adopted across the industry. The SAC now includes well over 100 organizations, representing a combined 30% share of the global apparel market. The coalition has fostered a strong culture of trust, openness, and collaborative spirit among fierce competitors. As one member explained, the SAC is like a training camp for Olympic athletes. “Together we challenge each other to stretch and improve our performance. Then we go out and compete.”

### **Extended Collaborations Focused on Processes**

#### **CASE STUDY: ACTION TO ACCELERATE RECYCLING**

In extended collaboration models, noncorporate stakeholders—such as local communities (and the NGOs that represent them)—are integral partners in developing and implementing sustainability initiatives.

One such extended collaboration is the Action to Accelerate Recycling (AAR). AAR was formed, in 2012, to capture untapped value from recycling that no single company could on its own. Alcoa and other leading companies had been working for years to increase aluminum recycling rates but had achieved only incremental improvements. Every year in the United States, 54.3% of aluminum cans are recycled; the rest, worth \$900 million, end up in landfills. The recycling rates for glass and PET plastic bottles are even lower (33% and 29%, respectively).

Boosting recycling clearly requires a systemwide collaboration. Recycling rates for aluminum depend heavily on the recycling of packaging and printed materials of all types, so the AAR initiative encompassed a spectrum of business stakeholders: Alcoa business leaders, consumer beverage brands, consumer packaged goods companies, materials manufacturers and packaging companies, retailers, and recycled content haulers and users. And because the success of recycling ultimately depends on consumer behavior, local municipalities, governments, and NGOs had to play a key role in developing AAR programs.

Six projects have been identified by this extended collaboration, including expanded curbside recycling programs; pilots for vending machines that accept consumers’ returned cans; on-premise recycling at bars, restaurants, and workplaces; integrated awareness campaigns; and work with trade associa-

tions to collect key recycling data. The deliberately ambitious goal is to increase such “PPM” recycling—aluminum cans, glass and plastic bottles, paper and paper board, and steel—by 20% in three years. This stretch target was set to drive participants to seek significant system solutions, rather than solutions aimed at only one segment of the value chain. The increases called for in each of the PPM categories would produce an estimated \$2.7 billion in recovered material value, reduce CO<sub>2</sub>-equivalent emissions by 3.7 million metric tons, and create hundreds of thousands of green jobs.

The extended collaboration has reinvigorated efforts at the company level. For instance, Alcoa supplemented its AAR efforts with a \$2 million commitment to expand education programs and improve recycling processes.

### **Extended Collaborations Focused on Outcomes**

#### **CASE STUDY: LATIN AMERICAN WATER FUNDS PARTNERSHIP**

Companies have always competed in their use of forests, watersheds, rivers, oceans, and other ecosystems. But an emerging class of collaboration models coordinates investment in and use of shared ecosystem services by focusing stakeholders’ efforts on improving beneficial outcomes. The goal is to enable a steady supply of critical natural resources to corporations by working with local communities that affect, or are affected by, these businesses.

One of the most useful extended collaboration models is called payments for ecosystem services. PES models, as they’re commonly known, maintain a steady flow of specific services (such as freshwater and timber from watersheds, forests, and other biodiversity habitats) in exchange for payments by corporations that use the services. Payments are made by corporations to local communities not simply as compensation for the use of the ecosystem services but as investments in their preservation and protection.

Consider the Latin American Water Funds Partnership (LAWFP), a PES initiative launched in June 2011. The partnership comprises corporations including Coca-Cola FEMSA (the world’s largest bottler of Coca-Cola products), water utilities, NGOs such as the Nature Conservancy and the Global Environment Facility (the largest public funder of environmental projects), and the Inter-American Development Bank.

Together, the participants invest in a fund to pay upstream farmers and landowners, as well as local governments, to take actions that conserve the watersheds. Efforts include forest restoration, improvements in livestock grazing practices, sustainable agriculture to reduce soil erosion, and the shoring up of watershed boundaries to reduce sediments and improve water quality.

The LAWFP currently comprises 32 local funds totaling \$27 million, based in Brazil, Colombia, Mexico, and other Latin American countries. The funds seek investments that will produce the highest returns (or eliminate the most cost) by increasing the quality and quantity of drinking and irrigation water, maximizing the efficiency of hydropower, and mitigating

is clear, these types of collaborations are difficult because of the complex human and organizational issues involved.

In particular, a deficiency of trust can undermine even the best-intentioned sustainability effort: Participants struggle to establish a shared vision and governance model, disagree on how investments and rewards are divvied up, and worry about the “free rider” problem, in which benefits accrue to nonparticipating actors. Making matters worse, many sustainability efforts suffer from a lack of independent, overarching project management capability.

The late C.K. Prahalad pioneered the concept of “next practices” as a way to enable breakthrough innovation in organizations. (See “Why Sustainability

## To prevent logjams, start by convening a small “founding circle” of participants that share a common motivation and have mutual trust.

flood risks. The collaboration is expected to benefit 50 million people and improve 3 million hectares of natural ecosystems.

Funds of this type are typically trusts designed to provide long-term investment in sustainability over several decades. For corporate investors, the payoff takes several forms: The funds ensure both the quality and quantity of ecosystem services and reduce the need for expensive mitigation efforts in the future. A \$1.5 billion New York City water fund, for example, supports farmers, landowners, and other upstream stakeholders in protecting and maintaining the Catskills-Delaware watershed, which supplies the city. Thanks to initiatives supported by the fund, the city has avoided the need to build a water filtration plant at an estimated cost of \$8 billion to \$10 billion—a 600% return on its investment.

### “Next” Practices

By design, many sustainability collaborations embrace a diverse array of stakeholders from the very beginning. Unfortunately, this approach dooms many efforts: By including participants with opposing intentions at the outset, progress is often stalled or killed before productive momentum can build. Even when the economic benefit to all participants

is now the key driver of innovation,” HBR September 2009.) Let’s look at seven next practices that enable successful sustainability collaborations.

**Start with a small, committed group.** To prevent the logjams that can occur when many stakeholders with conflicting goals try to work together, start by convening a small “founding circle” of participants. The members must have a common motivation and have mutual trust at the outset. This group develops the project vision and selectively invites subsequent tiers of participants into the project as it develops. Ultimately, all stakeholders, including NGOs, governments, universities, and local communities, should be represented.

Careful selection of participants at each stage is critical. For example, in the dairy industry case, invitees were selected following a six-month interview process designed to identify participants who could bring the most knowledge, ability, and leadership skills. The nucleus of the Sustainable Apparel Coalition, which we advised, comprised a group of companies that had already demonstrated sustainability leadership in the industry. Walmart hosted the first meeting and invited the group (including several direct competitors) to tour its apparel offices and listen in as Patagonia’s founder and CEO, Yvon Chouinard,

talked about sustainability to the Walmart staff. This openness was so countercultural that some invitees wondered if the offer was genuine. As the initial group made progress in terms of both governance and action, the group reached out to more companies to participate. Then, as the SAC's vision, action orientation, and trust-based culture became more broadly recognized, it began to attract other industry players that wanted to drive change.

**Link self-interest to shared interest.** To be successful, collaboration initiatives must ensure that each participant recognize at the outset the compelling business value that it stands to gain when shared interests are met. Such was the case with Coca-Cola FEMSA and its Latin America Water Funds partners. The bottler understood that the essential input into its operation—water—is best secured by investing in upstream efforts of farmers and other stakeholders at the river's headwaters to maintain a high-quality supply of water downstream.

**Monetize system value.** The key to linking self-interest and shared interest is to quantify how the collaboration reduces costs or generates revenue for each participant. FEMSA, for instance, reaps substantial financial benefits from its water-funds investment in the form of avoided costs; it won't need to build expensive water treatment plants to ensure the quality of its water supply.

Data analytics and business process analysis are also useful tools in monetizing system value at the group and individual level. In the case of the Latin American Water Funds Partnership, advanced analytics software helped identify which of the proposed protection and restoration activities would benefit the watershed and stakeholders the most. Projects were prioritized accordingly.

**Create a clear path with quick wins.** Successful collaborations convert a shared vision and individual passions into an action plan. However, many collaborative sustainability initiatives develop ambitious long-term goals that are only marginally relevant in the short term. To generate momentum and commitment, the action plan must also emphasize quick wins. Business thrives on visible and immediate results, and sustainability collaborations are no exception. Even if these wins are small initially, the cost savings or incremental revenues provide proof to other executives inside participants' organizations that the investment is worthwhile.

The dairy industry summit led to a mix of projects that included longer-term initiatives, such as ef-

**Large-scale sustainability collaborations must be structured to drive healthy competition among players.**

orts to reduce cattle methane emissions, as well as ventures with immediate financial benefit, such as energy audits and energy-efficiency improvements that could lower operating costs for both farmers and processors in less than a year.

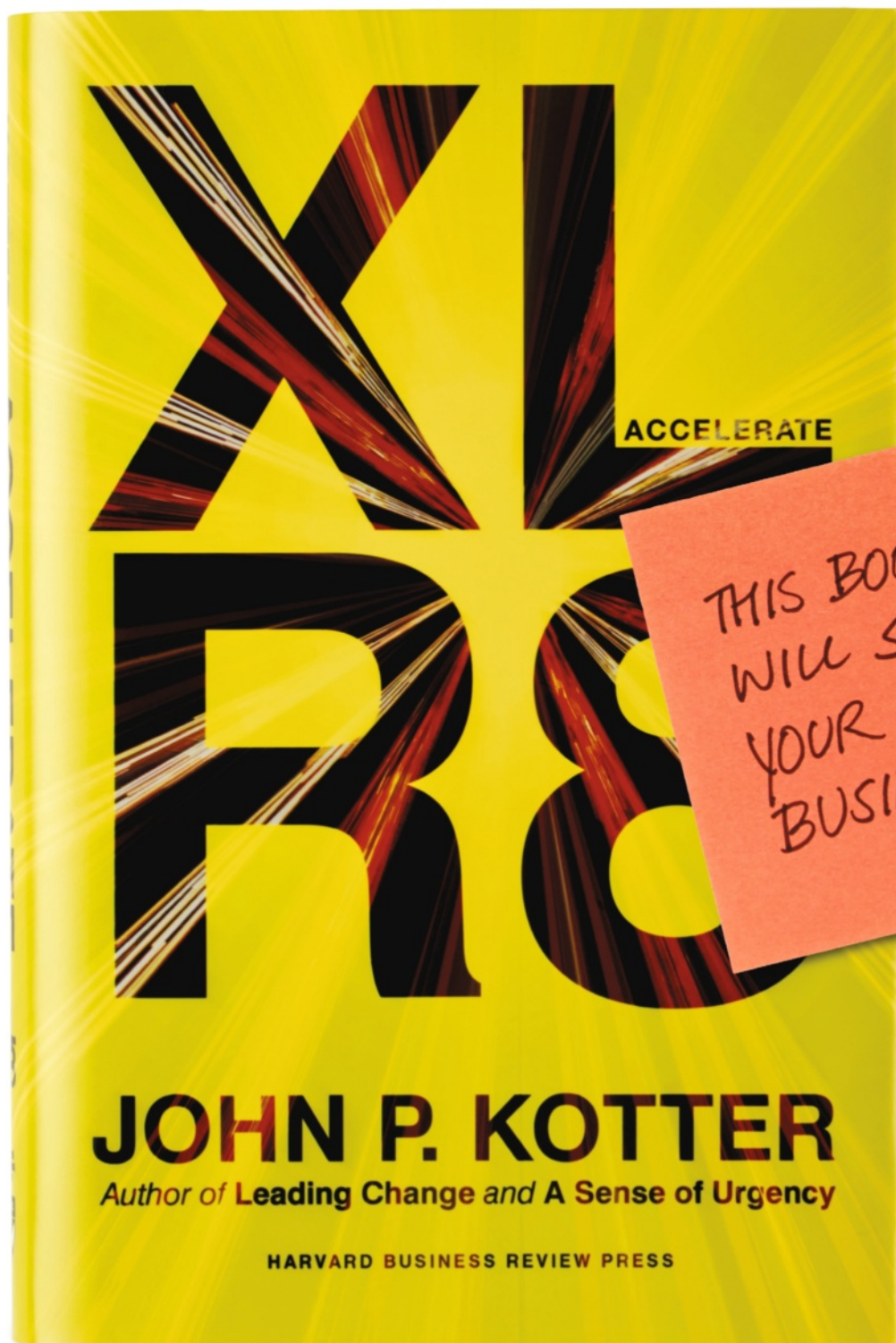
**Acquire independent project management expertise.** Sustainability collaborations can be complicated by participants' conflicting priorities of the various participants. Therefore, these partnerships should be designed and overseen by independent project-management specialists with demonstrated competence in trust building among diverse stakeholders. Additionally, the project management function must be seen by all participants as neutral and committed to the success of the project, rather than to any individual stakeholder. NGOs can often be quite effective in this role, but they must be committed to creating solutions that work for all participants, and the project managers must have the requisite skills.

**Build in structured competition.** The founding circle must find a way to sustain the focus on ambitious outcomes established at the outset. Healthy competition is often effective in generating long-term momentum. Unlike the self-interested competition that sinks many collaborative efforts, competition within large-scale sustainability collaborations must be explicitly structured to support shared goals. The Sustainable Apparel Coalition's Higg Index drove such structured competition, as players with low scores sought to improve while those at the top strove to remain there. The index also enabled transparency, which is central to most collaborations' success.

**Nurture a culture of trust.** Given the central importance of trust in successful collaborations, building and maintaining trust is an ongoing practice foundational to every other practice during the collaboration project. (See the sidebar "Building and Maintaining Trust" for two approaches to nurturing trust.)

**ULTIMATELY, THE BEST WAY** to scale collaboration is through markets that have the right incentives in place. We expect these markets to take off once the collaboration practices described here become widely adopted. When the full power of markets is brought to bear in unlocking environmental systems value, the good of the commons will truly become the common good of business. ▣

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# Spotlight

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# How to Survive Climate Change and Still Run a Thriving Business

**Checklists for smart leaders**

by Eric Lowitt

**T**HE WORLD IS GETTING HOTTER, unleashing environmental effects that threaten companies and society, from record-setting storms, floods, and droughts to melting arctic ice and rising seas. Some firms are shoring up their supply chains, processes, and infrastructure, but most are unwisely proceeding with business as usual. Consider this: According to a recent global survey of nearly 2,000 executives by *Sloan Management Review* and the Boston Consulting Group, two-thirds of leaders agree that climate change is real—but only one-third believe that their companies are prepared for its disruptions.

Although the threats to business are clear and pressing, there are opportunities as well. The checklists on the following pages offer guidance on reducing operational, regulatory, and reputational risk. But they also point up ways to cut costs, improve performance, enhance or build new customer relationships, and otherwise increase

competitiveness and resilience. Not all the recommended actions will be relevant to every company, and they need not be taken in any particular order.

In developing the checklists, I have studied nearly 600 companies and interviewed more than 200 senior executives about their strategic and operational responses to climate change. The recommendations in the lists have been tested and refined through my research into and advisory work with leading firms, including Unilever, Coca-Cola, Nestlé Waters North America, GE, and Owens Corning, along with smaller paper-and-pulp and consumer packaged goods companies.

Like any such tool, the checklists don't provide a one-size-fits-all plan. Rather, they equip executives to customize their strategies according to their goods and services, risk tolerance, reliance on third parties throughout the value chain, customer needs, and other factors.

# Sourcing Checklist



Climate change events make the availability of raw materials increasingly unpredictable, resulting in price volatility, product shortages, and lost sales. The steps below will help you insulate yourself from such disruptions. Remember to consider not just your direct suppliers but your suppliers' suppliers as well.

## General

- ❑ Determine whether essential materials come from areas particularly threatened by climate change.
- ❑ Analyze whether materials are at risk of being regulated, banned by industry associations, or boycotted by consumers because of their climate impacts.
- ❑ Educate procurement employees to use climate change-conscious behavior.
- ❑ Add incentives to meet specific sustainability objectives to your performance criteria and compensation plan. Award bonuses to employees who identify climate-related weak spots or suggest remedial measures.

## Raw Materials

- ❑ Establish backup sources for materials from highly vulnerable areas.
- ❑ Seek suppliers in less vulnerable areas.
- ❑ Explore the use of alternative and recycled materials to substitute for those from highly vulnerable areas.
- ❑ Ensure compliance with all materials regulations.
- ❑ Seek alternative materials in case of regulatory or industry bans or consumer boycotts.
- ❑ Monitor regulatory, industry, and consumer landscapes and establish early warning systems to spot changes in them.

## Resource Use

- ❑ Measure and manage the hydrocarbon energy, agricultural products, metals, and water used in the sourcing of your materials.
- ❑ Set and invest in specific goals to reduce the use of natural and nonrenewable resources.
- ❑ Calculate the cost of greenhouse gas (GHG) emissions from your sourcing activities and include it in your business planning.
- ❑ Monitor upcoming changes in regulations and emissions taxes and adjust business planning accordingly.

## Supplier Conduct

- ❑ Establish and enforce a supplier code of conduct governing such things as waste and wastewater generation, treatment, and disposal.
- ❑ Consider severing ties with suppliers who remain out of compliance.
- ❑ Assign a fixed percentage of work to suppliers with robust climate-change plans.
- ❑ Regularly assess and seek to raise this percentage.

### EXXONMOBIL

The fuel company is among a growing number of firms that now include a carbon emissions price in their pro forma financial calculations.

### NATIONAL GRID

The utility company bases its executives' compensation in part on their performance against carbon emissions-reduction targets.

### WALMART

The retailer's Standards for Suppliers, posted on its website, require supply partners to certify that all sourcing of materials is legal and environmentally sound.

# Manufacturing Checklist



Wasted energy and materials drive up costs and heighten the risks of regulatory action and consumer backlash. And without reliable backups for every aspect of production, you stand to incur product shortages and lost sales in the event of climate-related disruptions. Apply the measures below equally to company-owned and contract facilities.

General	Facilities	Resources & Emissions	Waste	Contract Manufacturer Conduct
<ul style="list-style-type: none"> <li>❑ Determine whether factories are located in areas particularly threatened by climate change.</li> <li>❑ Educate factory employees to use climate change-conscious behavior in both strategic and daily activities.</li> <li>❑ Add incentives to meet specific sustainability objectives to your performance criteria and compensation plan. Award bonuses to employees who identify climate-related weak spots or suggest remedial measures.</li> <li>❑ Encourage factory managers to share climate change preparations and best practices with sister factories, and create performance incentives to do so.</li> </ul>	<ul style="list-style-type: none"> <li>❑ Establish backup plants and employee transportation for factories in highly vulnerable areas.</li> <li>❑ Include the costs of backup plans in your budget.</li> <li>❑ Consider setting up operations in less vulnerable areas.</li> <li>❑ Stress-test your most vital factories with a series of climate change what-if scenarios.</li> </ul>	<ul style="list-style-type: none"> <li>❑ Secure backup energy and water sources.</li> <li>❑ Measure GHG emissions levels and set aggressive reduction goals.</li> <li>❑ Publicly report emissions each year.</li> <li>❑ Measure hydrocarbon energy, water, and other resources used in manufacturing and set aggressive reduction goals.</li> <li>❑ Anticipate future taxes on emissions and factor a projected price per ton into manufacturing cost estimates.</li> <li>❑ Ensure compliance with regulations governing energy and water use and emissions.</li> <li>❑ Monitor emissions regulations closely for changes.</li> </ul>	<ul style="list-style-type: none"> <li>❑ Measure wasted materials, energy, and water and calculate associated costs.</li> <li>❑ Measure reuse of materials, energy, and water and set percentage goals for increases.</li> <li>❑ Explore how reusing manufacturing waste could lower unit costs.</li> </ul>	<ul style="list-style-type: none"> <li>❑ Establish and enforce a code of conduct governing such things as waste and wastewater generation, treatment, and disposal.</li> <li>❑ Establish compliance-assessment procedures to identify weak spots in contract manufacturers' readiness for climate-related disruptions.</li> <li>❑ Conduct on-site audits and create remediation requirements, emphasizing improved risk readiness and the opportunity to deepen your partnership.</li> <li>❑ Consider firing contractors who remain out of compliance with your code.</li> <li>❑ Assign a fixed percentage of work to contractors with robust climate-change plans.</li> <li>❑ Regularly assess and seek to raise this percentage.</li> </ul>

**APPLE**  
The computer company is building a manufacturing plant in Mesa, Arizona, that will run on 100% renewable energy.

**NIKE**  
The sports apparel and equipment company has opened a facility that eliminates the use of water and process chemicals in fabric dyeing.

**BURT'S BEES**  
The personal care products firm recently achieved its goal of contributing zero waste to landfills from its three operating facilities.

# Distribution Checklist



Extreme weather can cripple transportation infrastructure, from roads and bridges to ports and shipping lanes to regional energy grids, and disrupt your distribution and retail destinations. As in the manufacturing checklist, take into account the facilities and activities of your partners as well as your company-owned assets.

## General

- ❑ Educate logistics employees to use climate change-conscious behavior.
- ❑ Add incentives to meet specific sustainability objectives to your performance criteria and compensation plan. Award bonuses to employees who identify climate-related weak spots or suggest remedial measures.
- ❑ Structure your logistics managers' performance objectives and compensation to reward the selection of "lowest environmental impact" carriers.
- ❑ Require your logistics leadership team to regularly assess your transportation methods' exposure to climate risks.
- ❑ Seek ideas for climate change preparation from your carriers and logistics partners and share best practices.

## Ocean Freight

- ❑ Analyze whether your carriers' shipping lanes and ports are in highly vulnerable areas.
- ❑ Determine whether your shippers manage their routes with climate change in mind.
- ❑ Ensure that your shippers have alternative ways to move goods in case of port or lane closures or other climate-related crises.
- ❑ Assess whether your shippers use flex fuels to manage emissions, contain costs, and remain in regulatory compliance.
- ❑ Assign a fixed percentage of your business to shippers with robust climate-change plans.
- ❑ Consider switching carriers and using alternative modes of transportation (such as road or rail) if you are highly reliant on water shipping and your carriers are not actively preparing for climate change.

## Air Freight

- ❑ Determine whether your air freight partners measure hydrocarbon energy use and GHG emissions levels.
- ❑ Assess whether your carriers use flex fuels to manage emissions, contain costs, and remain in regulatory compliance.
- ❑ Determine whether your carriers are pursuing energy-saving plane designs.
- ❑ Incentivize carriers to set and meet aggressive emissions-reduction goals by offering a greater share of your logistics business—provided other characteristics are competitive.
- ❑ Ensure that your carriers seek to "light weight" shipments to reduce fuel consumption—for example, by switching from wood to plastic pallets.
- ❑ Consider shifting product shipments to ocean or land (especially rail) freight.

## Road & Rail

- ❑ Analyze the extent to which strategic infrastructure lies in particularly vulnerable areas.
- ❑ Determine whether local and federal agencies adequately maintain infrastructure.
- ❑ Evaluate investing in infrastructure maintenance if needed.
- ❑ Establish ongoing relationships with local and federal representatives to ensure infrastructure resilience.
- ❑ If government maintenance is inadequate, explore alternative routes and methods (such as switching from road to rail) and consider relocating facilities.

### HP, DELL

Both HP and Dell are among a growing number of companies that have converted product shipments from air to ocean freight because of climate change concerns.

### OCEAN SPRAY, TROPICANA

The rivals formed a collaboration that cuts the logistics costs and carbon emissions of each: Once Tropicana shipments arrive in New Jersey, the boxcars are loaded with Ocean Spray products headed for Florida instead of making an empty return trip.

### BT

The British telecommunications giant is planning its infrastructure spending on the basis of flooding scenarios 50 to 100 years in the future.



**WEB** To download a Powerpoint or Keynote version of the checklists, see HBR's iPad edition or visit [hbr.org](http://hbr.org).

## Wire Services

- ❑ Assess whether your carriers use flex fuels to manage emissions, contain costs, and remain in regulatory compliance.
- ❑ Determine whether your carriers measure and manage GHG emissions.
- ❑ Incentivize carriers to set and meet aggressive emissions-reduction goals by offering a larger share of your logistics business—provided other characteristics are competitive.
- ❑ Include your carriers' GHG emissions in your annual emissions reporting.
- ❑ Assess your carriers' vehicle maintenance programs to ensure that vehicles have the lowest environmental impact possible for their design.
- ❑ Analyze the extent to which you depend on energy and telecom wires to reach your customers.
- ❑ Monitor wires and their surrounding locations for climate change activity.
- ❑ Regularly invest in wires' maintenance and resilience.
- ❑ Alter maintenance routines to monitor and adjust for climate change disruptions.
- ❑ Assess data centers' resilience.
- ❑ Regularly invest in next-generation technologies.

## Final Product Destination

- ❑ Determine whether distribution centers and retail stores are in highly vulnerable areas.
- ❑ Stress-test storage facilities with a series of climate change what-if scenarios.
- ❑ Make and budget for backup storage plans.
- ❑ Ensure that your destination partners have reliable backup energy sources.
- ❑ Incentivize your destination partners to set and meet aggressive energy- and emissions-reduction goals by offering longer-term contracts or financial rewards in return for demonstrated results.

**Award bonuses to employees who identify climate-related weak spots in your distribution networks or suggest remedial measures.**

# Consumption Checklist



Becoming a sustainability leader can differentiate you from your competitors—whereas ignoring the environmental impact of your products can alienate consumers and the public. The steps below will help you adopt and emphasize “green” behaviors around your products’ consumption and recapture value from postconsumer materials use.

General	Product Sales	Product Use	Postconsumer Product Recycling & Reuse
<ul style="list-style-type: none"> <li>Educate the sales force to emphasize your climate change-conscious behaviors, and add incentives to do so to your performance criteria and compensation plan.</li> </ul>	<ul style="list-style-type: none"> <li>Evaluate whether your products use materials that are known to contribute to climate change or are banned by any countries.</li> <li>Assess the extent to which such materials are vital to your success and explore alternative ones.</li> <li>If you have institutional customers, determine whether they give preference to suppliers who are sustainability leaders.</li> <li>If you have individual customers, determine whether they value sustainability when making purchase decisions.</li> <li>Seek ways to differentiate yourself as a sustainability leader—for example, by piloting an energy-saving innovation.</li> <li>Emphasize your sustainability activities in your marketing, publicity, and customer communications. Avoid preaching.</li> </ul>	<ul style="list-style-type: none"> <li>Analyze customers’ climate change-related costs and other impacts from use of your products.</li> <li>Identify ways your products can save customers money by lowering their energy and other natural-resource consumption.</li> <li>Monitor your customers’ commitment to sustainability and work to keep your products aligned with their interests.</li> </ul>	<ul style="list-style-type: none"> <li>Ensure compliance with regulations governing recycling and landfill use.</li> <li>Measure the quantity and quality of postconsumer materials available for your reuse.</li> <li>Analyze the potential cost savings and sustainability benefits from increasing your postconsumer materials use.</li> <li>Set targets for the return of your products’ materials.</li> <li>Analyze the product recycling systems available to your customers.</li> <li>Seek ways to make product recycling easier for and more valuable to your customers.</li> <li>Explore collaborations with private-, public-, and civil-sector entities to create or fortify recycling systems.</li> <li>Conduct scenario planning to prepare for sudden changes to recycling or disposal regulations.</li> </ul>

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## PATAGONIA

The apparel company discourages excess consumption through its “buy less” campaign, which facilitates consumer resale of used Patagonia items.

## EU PARLIAMENT

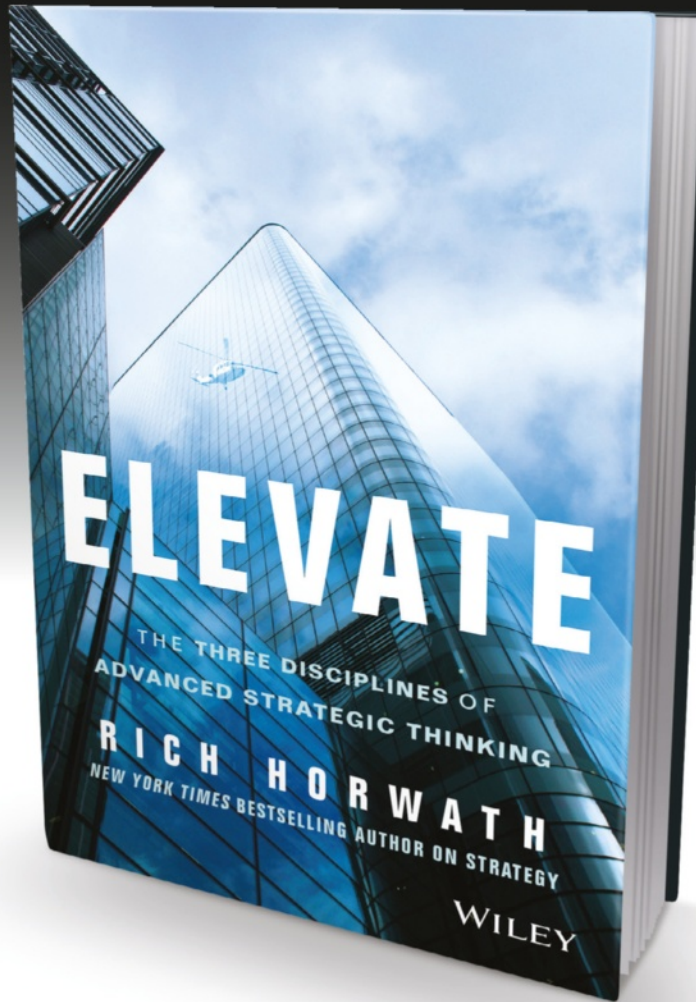
The legislators are considering regulations to encourage a “lease society,” in which consumers buy services rather than products—shifting ownership, upkeep, and reuse to manufacturers and stimulating resource-efficient product design.

## FORD

The auto company has increased the fuel efficiency of its top-selling truck by making the body and other parts from aluminum and thus shaving about 700 pounds off the vehicle’s weight.

 **Eric Lowitt** is the founder of Nexus Global Advisors and the author of *The Collaboration Economy* (Wiley, 2013).

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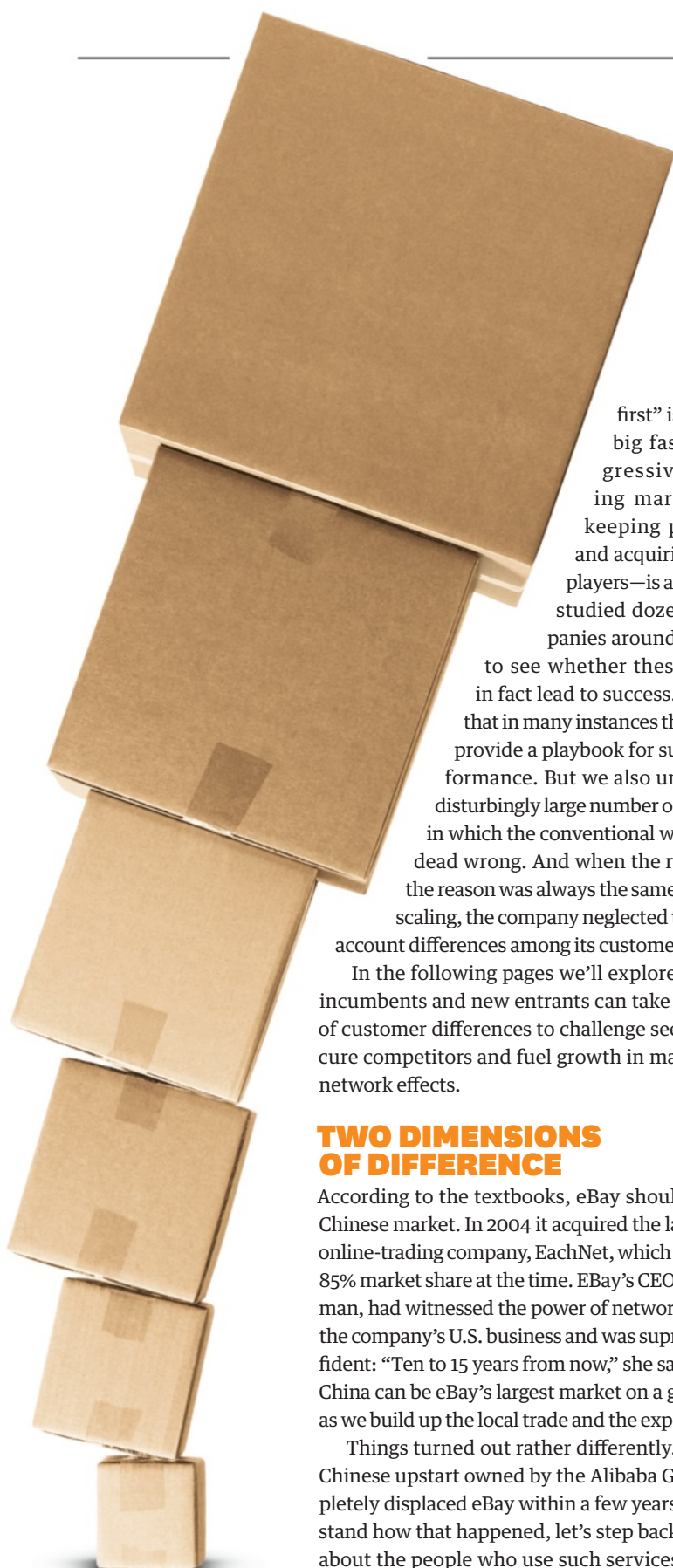


**Hanna Halaburda** is an economist at the Bank of Canada. **Felix Oberholzer-Gee** is the Andreas Andresen Professor of Business Administration at Harvard Business School.

Companies that get big fast are often left behind. Here's why.  
by **Hanna Halaburda**  
and **Felix Oberholzer-Gee**

**T**he value of many products and services rises or falls with the number of customers using them. The fewer fax machines in use, for instance, the less important it is to have one. In industries as varied as credit cards, fashion, and online games, these “network effects” influence consumer decisions and limit the number of companies able to compete.

Strategists have developed some well-known rules for navigating business environments with network effects. “Move



first” is one. “Get big fast”—by aggressively growing market share, keeping prices low, and acquiring smaller players—is another. We studied dozens of companies around the world to see whether these rules do in fact lead to success. We found that in many instances the rules did provide a playbook for superior performance. But we also uncovered a disturbingly large number of situations in which the conventional wisdom was dead wrong. And when the rules failed, the reason was always the same: In rapidly scaling, the company neglected to take into account differences among its customers.

In the following pages we’ll explore how both incumbents and new entrants can take advantage of customer differences to challenge seemingly secure competitors and fuel growth in markets with network effects.

## TWO DIMENSIONS OF DIFFERENCE

According to the textbooks, eBay should own the Chinese market. In 2004 it acquired the largest local online-trading company, EachNet, which enjoyed an 85% market share at the time. eBay’s CEO, Meg Whitman, had witnessed the power of network effects in the company’s U.S. business and was supremely confident: “Ten to 15 years from now,” she said, “I think China can be eBay’s largest market on a global basis as we build up the local trade and the export trade.”

Things turned out rather differently. Taobao, a Chinese upstart owned by the Alibaba Group, completely displaced eBay within a few years. To understand how that happened, let’s step back and think about the people who use such services and prod-

ucts. Our analysis reveals that customer groups can differ in two important ways:

**Mutual attraction.** Even in markets with network effects, not all customers benefit from the presence of every other customer. Consider two groups of Twitter users, one with an interest in politics and another that is passionate about entertainment. Twitter becomes more useful to the first group as more people share political news and information. Similarly, those interested in celebrities value Twitter more if a larger number of tweets cover entertainment. Some common ground may exist between the two groups—for example, news about the singer Lady Gaga’s political activism would be of interest to both. But generally the political types are strongly attracted to other political types, and the celebrity-obsessed prefer their own kind. The mutual attraction within the groups is very strong; between the two groups, it is far weaker.

When eBay first entered the Chinese market, e-commerce was in its infancy. At the time, technical equipment such as motherboards made up the bulk of online auction purchases, and EachNet, the company that eBay acquired, appealed mostly to technically sophisticated customers. Thanks to strong network effects, eBay’s platform became an increasingly attractive place to buy tech products.

Taobao’s Chinese executives recognized that the company couldn’t compete head-on with eBay in the existing market. So instead they focused on an emerging segment of online auction customers—people on the hunt for clothing and consumer products. Although eBay had a leading position in terms of overall market share, its share of the new segment—which would come to dominate e-commerce in China—was far less imposing. What’s more, eBay’s strong position with techies was no help at all in attracting fashion-focused customers, who were more interested in whether other fashionistas used the site.

Mistakenly assuming that the company had purchased its way to market leadership, eBay’s executives committed a series of strategic errors, ones they might have avoided if they had realized the threat Taobao actually presented. For example, eBay was slow to offer an integrated payment solution, and it insisted on charging customers significant transaction fees. Had its network advantage been real, the model would have made sense—the company with the strongest network effects can typically get away with higher charges (or lower quality). But eBay was not dominant in the emerging consumer mar-

## Idea in Brief

### THE PROBLEM

We all know that winning in markets with network effects is about moving first and getting big fast, right? Wrong. All too often, a strategy of rapid scaling can be dead wrong.

### WHY IT HAPPENS

Companies trip up when they try to attract large volumes of customers without understanding (1) the strength of *mutual attraction* among various customer groups and (2) the extent of *asymmetric attraction* among them.

### SOLUTIONS

New entrants should focus on customer groups not currently being served by incumbents, either by targeting customers they are uniquely positioned to serve or by appealing to the most attractive customers in a set.

Incumbents pursuing growth in adjacent markets or new geographies should consider the levels of mutual and asymmetric

attraction between new and existing customers. Offering complementary products and services that leverage the differences among customer groups also allows incumbents to expand their reach.

ket—the mutual attraction between fashionistas and techies was weak—and so its model didn't fly. In 2006 eBay shut down its business in China.

**Asymmetric attraction.** In any network, some customers are more equal than others. Shopping malls provide the classic example. Retailers benefit from the presence of anchor tenants, which are powerful magnets for consumers and help drive traffic in all stores. But anchor tenants benefit less, or not at all, from the presence of smaller stores with lesser brands. The attraction between anchor tenants and small stores runs mostly in one direction; it is asymmetric. Fashion offers another example. Many customers like to wear the kind of clothing that they see on stylish people, creating significant network effects. But celebrities have a disproportionate influence on the fashion decisions of regular customers.

In markets with asymmetric attraction, getting big fast is often a poor strategy. Smart firms instead restrict the size of their network to focus on select customer groups that promise to attract everyone else. Threadless, a Chicago-based clothing company that crowdsources its designs, initially restricted its membership to designers of the respected Dreamless community. From a traditional perspective, this move seems puzzling. Companies like Threadless compete on the quality and variety of products. The greater the number of designers, so the logic goes, the stronger the company's competitive position. But in the fashion market, asymmetric attraction is important: Limiting contributors to just a few respected designers made others hungry to join. Threadless did open up eventually—anyone can submit designs now—but only after the company had established its position as market leader.

Getting users to join a new online community is not easy. Such efforts very often fail, usually because the companies pay little attention to differences among their customers and variations in the strength

of mutual and asymmetric attraction among them. Friendster, an early Canadian-based precursor of Facebook, illustrates how a lack of selectivity can weaken a growing network. The company's service had huge appeal—so much so that Friendster did not have the server capacity (and financial means) to accommodate everyone interested in signing up.

Faced with this constraint, Friendster decided to admit new members on a first-come, first-served basis, adding large numbers of users in the United States and Asia. But because the mutual attraction between these groups was low, this strategy actually made Friendster's network effects weaker: Asian users did not care much about U.S. users, and vice versa. It would have been better to focus on one region, say customers in New England, and perhaps better still to focus on New England celebrities, in an attempt to exploit asymmetric attraction. The lesson is clear: Indiscriminate growth often undermines the very network effects you're trying to achieve. That's why developing a finer understanding of customer differences can lead to better strategic decisions, for both new entrants and incumbents.

## STRATEGIES FOR NEW ENTRANTS

Dethroning an incumbent is a famously hard challenge for any company, even if the new entrant offers a superior product or service. Exploiting the differences among the incumbent's customers can help upstarts gain an edge. Let's look first at a strategy for networks in which the mutual attraction of customers varies.

**Pick off the most interested.** For much of its history, the *New York Times* was a regional newspaper with a small readership outside its home area. This was no coincidence. The newspaper business exhibits strong network effects at the local level: More readers attract more advertisers, which attract

even more readers. Local interests tend to dominate, and as one or two papers achieve critical mass, they leave the others behind. As a result, most U.S. cities have only a few major papers.

When the *New York Times* expanded to serve readers nationally, it had to overcome local network effects. It did so by focusing in each new market on the small subset of readers whom it could serve exceptionally well: those with a strong interest in international news. These readers were only weakly attracted to locally focused readers and advertisers. As they switched to the *Times*, the local competition cut costs by reducing global coverage, prompting additional readers to follow suit. As its overall circulation grew, the paper became more attractive to national advertisers. In some cities, it split the market with the local competition. In others, it put the locals completely out of business.

**Create an exclusive experience.** eHarmony, an online dating company, used asymmetric attraction to its advantage. Despite Match.com's leading position in an industry where customers value more choice and tend to flock to the largest sites as a result, eHarmony managed to successfully enter the market by creating an exclusive service for people looking for long-term relationships. In essence, it exploited the fact that for a subset of Match.com's customer base, some members were of more value than others: Commitment seekers wanted to connect with other commitment seekers; the casual daters in the mix were a nuisance. Because eHarmony screened out the daters, it provided a superior experience for the "committed" types. It entered a smaller market than the one Match.com served but did so successfully, attracting 600,000 users in just five years.

## STRATEGIES FOR INCUMBENTS

At some point dominant players in mature network-based industries face diminishing returns as they attempt to acquire new customers. The results can be extreme: A 2013 working paper by the University of Pennsylvania's Michael Sinkinson, for example, estimated that the exclusive distribution contract for Apple's first iPhone was worth more than \$20 billion to AT&T. However, the extra customers were worth much less—only around \$3 billion—to Verizon, the wireless market leader that already enjoyed a huge network.



When opportunities in existing markets begin to dry up, sustainable growth generally comes from entering adjacent markets, expanding into new geographies, or adding complementary features. Factoring into your analysis the differences among your customer groups can help you make the right choices in each case.

**Adjacent markets.** These are closely related but not identical markets, and there are usually several to choose from. In most cases, to make the right choice you must assess the level of mutual attraction between your current customers and those in the adjacent market.

Consider the travel services business TripAdvisor. Thanks to strong network effects—the more customers who write reviews, the more valuable the site becomes—TripAdvisor has captured more than twice the market share of its next-best competitor in the “destinations and accommodations” category. From this position of strength, the company considered expanding into restaurants and flights.

TripAdvisor's principal attraction is the reviews that customers enjoy reading and writing. Such reviews are equally valuable to people choosing a restaurant; however, reviews of past flights on a given route for a given airline are poor predictors of the quality of future flights. Consequently, other people's experiences are largely irrelevant. Note that the customers in all three markets (hotels, restaurants, flights) are the same people. But what they value about the TripAdvisor experience in hotels carries over to restaurants—and not to flights. This meant that restaurants provided a far better opportunity for expansion.

**New geographies.** The mutual attraction between existing and new customers also matters when choosing new geographic markets. Consider Wikipedia. Founded in 2001, the encyclopedia now offers more than 4 million entries. There are strong network effects in this industry: the larger the number of entries, the greater the benefits of using Wikipedia.

When Wikipedia sought to expand its offering to foreign-language encyclopedias, it considered a range of markets. One option was to select a large market in which few people speak English and thus are unable to use the English-language version—Japan, for instance. The prob-

## WIKIPEDIA: THE ENGLISH ADVANTAGE

lem with that approach is that because only a small number of Japanese speak English and not many Americans speak Japanese, Wikipedia can't leverage the network effects of its English-language version. It would have no special competitive advantage in launching an online encyclopedia in that market.

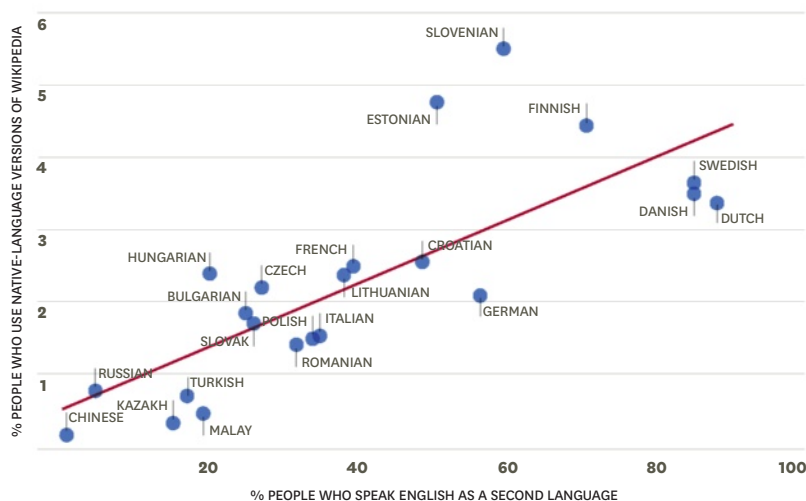
But not all geographic opportunities have customers with such low levels of mutual attraction. By targeting countries in which English was commonly spoken as a second language and recruiting bilingual authors, Wikipedia was able to exploit advantages from its existing network. Many early contributors to the English-language version were Dutch and German. Those authors were well positioned to help launch foreign-language editions in their home countries; they were already familiar with Wikipedia and its rules of authorship, and they enjoyed contributing to the crowdsourced effort. The bilingual readers benefited from the U.S. network effects directly, and the monolingual readers were served by the local language entries prepared by the bilingual authors. Wikipedia eventually expanded to 285 languages. (See the exhibit "Wikipedia: The English Advantage.")

**Complements.** As incumbents expand into adjacent markets and new geographies, levels of both mutual and asymmetric attraction increase, presenting opportunities for focused entrants. But here, the strategic priority lies not in exploiting differences but in finding ways to bridge them.

One of the best ways to do that is by offering a complement (a product or service that adds value to another product or service: for instance, a razor and razor blade). Consider Facebook. How did it manage to become a dominant global enterprise when its network effects, while enormously strong, were largely U.S.-based? Most Norwegians, for example, don't care that Facebook is the leading social network in the United States, because they do not have many American friends. So why did Facebook displace domestic competitors such as Blink and Playahead?

The answer was social games like Zynga's FarmVille. These games, which used Facebook as a platform, allowed users to interact with strangers in an engaging manner, bridging the differences between Norwegians and Americans. Moreover, when Zynga developed its next game, it was able to spread the fixed cost of game development over millions of users, increasing development budgets and (it hoped) the quality of the games. Gaming companies that served smaller markets found it difficult to compete.

The mutual attraction between existing and new customers matters when expanding into new markets. By targeting countries in which English was commonly spoken as a second language, Wikipedia was able to exploit advantages from its existing network, improving its success in entering those markets.



This is not just a social media story. Complements play an important role in many industries. Take retail banking. ATMs and branches are strategically important because they create network effects—but these effects are fairly local. A Bostonian appreciates her bank's having an ATM in Chapel Hill, but the benefit is limited because she is rarely in North Carolina. The missing piece is the complements: banking products and services that customers appreciate irrespective of their location. If a bank developed a reputation for superior financial advice, customers might want the institution's products and services whether or not it had ATMs in the area. For ATMs, customer preferences are heterogeneous; everybody wants them close to home, which favors local incumbents. In financial planning, however, there is far less heterogeneity, which creates an opening for new entrants.

**THE STRENGTH** of network effects can be as varied as the human beings who make up the network. A strategy that fails to take into account this variation—ignoring differences in mutual and asymmetric attraction among customers—is likely to fail. It is the rare and lucky firm that prospers simply by being first and getting big fast. In nearly any market with network effects, customers will find the presence of too many of the "wrong" sort of people a distinct turnoff. Welcome to the networked economy—perhaps not so different from the old economy after all. ♥

HBR Reprint R1404G

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# COACHING **THE** TOXIC LEADER



ILLUSTRATION: GUSTAVO BRIGANTE

**Four pathologies that can hobble an executive and bring misery to the workplace—and what to do about them.**

*by Manfred F.R. Kets de Vries*

Senior executives have the power to create an environment that allows people to grow and give their best—or a toxic workplace where everyone is unhappy. How executives end up using that power depends in part on their mental health. Sound, stable bosses generally build companies where the rules make sense to employees, freeing them to focus on performing their jobs well. But if the boss’s psychological makeup is warped, business plans, ideas, interactions, and even the systems and structure of the organization itself will reflect his or her pathologies.

As an executive coach, I’ve sometimes come across leaders with mental demons. I’ve put a number of these bosses on the couch, in an effort to understand and counsel them. In the following pages I’ll describe some of the more common pathologies I’ve encountered and explain how I’ve helped people deal with them.

Notably, these pathologies don’t include isolated instances of depression. Depression is part of the human condition; we all suffer from it. When it’s moderately present, it doesn’t require special coaching intervention. And when it’s acute and chronic, it tends to be part of the syndromes I’ll present here.

Not everyone falls neatly into one or another of the categories I describe; we’re often a bit of this and a bit of that. And most bosses are not mentally ill, but a surprising number of senior executives do have a personality disorder of some kind. Even with executives who are relatively healthy emotionally, you nearly always run across some of the characteristics described here, which need to be addressed in similar fashion (though not necessarily accompanied by medication and formal therapy).

While these disorders can be managed, some toxic leaders will prove impossible to change. (See the sidebar “The Incurable Executive.”) Change can often be an uphill battle, in no small part because many companies support (and are even breeding grounds for) dysfunctional behavior. Fortunately, most executives recognize when they have problems and have the strength of character to want to fix them, as the stories that follow will illustrate.



## THE NARCISSIST

The dysfunction most frequently found at senior levels is pathological narcissism. Narcissism is not something a person either has or hasn’t. We all possess narcissistic characteristics to a degree. In fact, we need a modicum of narcissism to function properly—it’s part of the immune system, if you will,

## Idea in Brief

### THE PROBLEM

Executives sometimes suffer from serious personality disorders, such as pathological narcissism, manic-depression, passive-aggressiveness, and emotional disconnection.

When these leaders reach positions of power, they create dysfunctional organizations in which everyone is miserable.

### THE REMEDIES

An executive coach can help people combat these syndromes, provided the coach recognizes their signs and understands how to address them. Each pathology requires a different approach. Narcissists have fragile self-esteem (despite their apparent confidence) and react poorly to confrontation. Coaches must build

them up carefully. In contrast, making manic-depressives face reality (in combination with therapy and medication) is key to getting them on track. The goal with passive-aggressives is teaching them to express anger in a healthy, direct manner. And exploring and describing emotional experiences helps the disconnected relate better to others.

### THE BOTTOM LINE

Though some people will prove impossible to change, these disorders can all be managed, and with the right interventions, executives with them can turn things around and become effective leaders.

defending us against the vicissitudes of life. It enables us to feel good about ourselves and to impose ourselves a little. But too much narcissism is dangerous. Driven by grandiose fantasies about themselves, pathological narcissists are selfish and inconsiderate, demand excessive attention, feel entitled, and pursue power and prestige at all costs.

### How to Recognize the Condition

A good way to spot a narcissist is to look at how his subordinates respond to him. Let me tell you about Simon. When I first met him, he was regarded as one of the most promising senior executives in his company, although a number of directors had doubts about whether he was the right person to succeed the CEO. Would Simon be able to take the company to its next level? Did he have enough maturity? Given their doubts, I was asked by Agnes, the VP of talent management, to become Simon's executive coach with the aim of preparing him for possible succession.

Questions about Simon had begun to arise, Agnes explained, after he made a series of rash decisions, which raised a red flag about whether he understood what the corporation's culture was all about. Meanwhile his lobbying efforts to be elected "businessman of the year" had inspired resentment in the company. If that weren't enough, he had relocated the regional head office to a new, more upmarket location. It may have been the right decision (given the cramped conditions of the old office), but it had turned out to be a lot more expensive than planned. Capping that (and here Agnes sounded exasperated), Simon was leasing a small corporate plane—his somewhat lame excuse being that it would save money, given the difficulties of connecting the head office to the other offices in the region.

Another criticism related to his deal making. Agnes told me that Simon had embarked on a dramatic

expansion plan and discussed possible acquisitions with investment bankers, despite cautioning from the people who worked for him.

More generally, people in the organization viewed Simon as a "user"—he never reciprocated. One person said that he felt like part of the furniture on Simon's stage to success. Agnes told me that when she met with some of Simon's subordinates over drinks, they went on and on about their dislike of what was happening at the office. Some of the better people had already joined the competition; some had transferred to different units. It made her (and others) wonder whether Simon really was the golden boy.

Like many narcissists, Simon was anything but a wallflower. He was tall, well dressed, and friendly, with a somewhat seductive manner. He seemed easy to talk to; he didn't hold back and opened up quickly about his relatively short tenure at the company—telling me he'd been "poached" from a competitor and adding that the press had made a fuss about how costly a hire he'd been. He told me that he'd really liked his previous job, but given how things stood, the top job would not have been open for some time. That was the main reason that he'd accepted his present position. When I asked about his future, Simon made it apparent that he believed he was a shoo-in as the CEO's replacement. He obviously didn't think much of the other candidates.

Most revealing was the extent to which Simon lived in a binary world where people were either "for" or "against" him. He made quite clear that anyone against him would be a target. He'd already removed some of the more independent thinkers on his team. Executives who hesitated to take his side were easily cast as villains.

### Coaching a Narcissist

Tempting though it may be to administer a loud wake-up call, the first rule when dealing with nar-



## The Incurable Executive

### How to Recognize the Condition

Let me share another experience I had, this one with a founder and CEO called Frank. People told me that dealing with Frank, a person for whom there seemed to be no emotional middle ground, often made them feel like firefighters; they were constantly running behind him putting out emotional blazes. But, despite his volatility, colleagues also noted how attractive and contagious Frank's energy and ebullience could be. What's more, he had a knack for drawing people to him—something that had contributed to the original success of the firm.

Yet Frank was now a major risk. The firm's situation was precarious: A big expansion attempt had failed, creating a serious liquidity problem, while a worrisome number of capable executives were leaving or looking for an exit. If Frank couldn't be reined in, the dissolution of the firm was a real possibility.

When I talked to Frank, it became clear that he had a bipolar disorder. Some years before (on the advice of his wife), he'd consulted a psychiatrist, who had prescribed him lithium. Frank acknowledged that it had helped him for a while but added that the experience had been mixed. Life with the drug was not as rich as life without it: It was more flat and less exciting and dampened his emotions. Whatever he did—looking at the garden, listening to the birds, talking with an associate, making a deal—was experienced much less deeply. He missed the “high highs,” and he decided to stop taking the medication.

Frank was also no stranger to substance abuse. He would turn to alcohol when he was feeling manic, because it seemed to prolong and intensify his euphoria. He also confessed that he had experimented with cocaine.

I learned that his marriage, at the age of 23, had helped balance his moods. Recently, however, his wife had embarked on a part-time career, which had changed the dynamic in their home, as they saw less and less of each other. Frank began to spend even more time at the office and on the road. He reluctantly confessed that he'd had a number of affairs. He wasn't sure whether his wife knew, but it was apparent that his behavior had affected their relationship. According to Frank, he and his wife had become like ships passing in the night. He admitted that he longed for their previous intimacy.

### Coaching a Manic-Depressive

Serious mood disorders like manic depression are usually treated with a combination of psychotherapy

and medication. The problem is, manic-depressives are rarely receptive to receiving treatment (and Frank was no exception). Their reality testing is impaired: Whether manic or depressed, they have poor insight into how they are perceived by and act toward others.

Getting them to admit that they have a problem is a main challenge. Here, the best approach is the opposite of what you would do with narcissists: Make manic-depressives confront the reality of their relationships with others and work with the people they affect to create a new structure in which they can operate safely. In this kind of situation a coach would do well to draw on the help of others (in Frank's case, his spouse and supporting executives).

**Partners and family.** I suggested to Frank that it would be useful to meet his spouse—an atypical

exercise. He seemed eager to oblige, but when the results came back, feedback from a number of important people with whom he interacted (in particular, his subordinates) was missing. I asked him to do something about this, naming the people he should include.

As expected, the second report came back with sharply negative comments: Arnold never acknowledged his mistakes and always shifted responsibility for them to others. He broke promises and did not respect confidentiality. I let him make his own interpretation of the feedback, asking him how he experienced the information: What surprised him? What was fair and what was unfair? I knew that with people like Arnold you have to avoid arguments and head-to-head confrontations.

Despite my reservations, Arnold managed to convince his bosses that he had made progress, and they sent him to Southeast Asia to spearhead the firm's expansion in that region. A year later I read in the financial press that the company had been involved in a major bribery scandal. Arnold had initiated a kickback operation in which he was one of the major beneficiaries.



She didn't seem to realize (in spite of having gone through a 360-degree feedback exercise) that others were perturbed by her behavior.

### Coaching a Passive-Aggressive

Passive-aggressives need to resolve their hostility toward authority figures. To help them do that, the coach has to encourage transference. By getting Mary to see me as an authority figure, I would attract her anger, which would allow me to work on helping her express it in a healthier, direct manner. This work involved:

**Consistent confrontation.** Every time that Mary was passive-aggressive with me I'd say something like: "Mary, it seems to me that you are angry at me. Is that what you are experiencing?" I would also point out the inconsistencies in her behavior. Of course, she would resort to denial or evasion—often citing forgetfulness as an excuse when she hadn't done what she was supposed to—but it became increasingly difficult for her to get away with it. I was always careful, however, to accept her defensive reactions for the time being. When dealing with people like Mary, you should never argue or correct denials; just quietly back away, leaving them to reflect on your comments. Passive-aggressives see arguments as an invitation to cast themselves as victims, making you the bad guy, and they are very experienced at it. By sharing my awareness of her covert anger, I gave Mary the message that her style was not the way to deal effectively with interpersonal relationships.

**Practicing better behavior.** Passive-aggressives have low self-esteem, and the coach has to help them build it up. This is best done by getting them to practice directness and asking them to explain how they would resolve or improve situations they find themselves in. In the beginning Mary would hem and haw, but over time I persuaded her to stick her neck out. I also assigned her specific tasks, putting them in writing. If she didn't deliver, I expressed my disappointment with her directly, factually, and unemotionally. I would say that I was confused by her behavior: Why did she keep doing what she was doing? Why not find a better way? If she wanted to continue our coaching sessions, such behavior needed to stop. At the same time, I devoted a considerable part of each session to acknowledging her strengths.

**Exploring the family.** Mary needed to recognize the causal relationship between her tendency to procrastinate and the resentment she felt toward

## What's the Difference Between Coaching and Therapy?

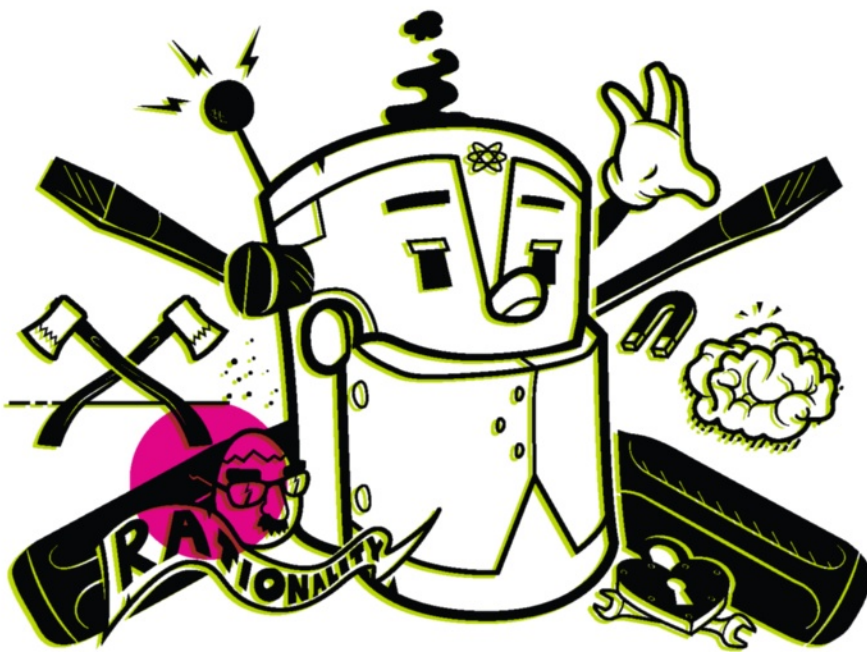
People often ask this question, and they get various answers. Some claim that the distinction lies in time orientation—that coaching focuses on the present and the future while therapy looks more at the past. Others draw a line between the conscious (coaching) and the unconscious (therapy). Still others see psychotherapy as a long-term treatment, and coaching as a short-term intervention.

These all seem rather artificial distinctions to me. It's fair, perhaps, to say that psychotherapists have more-intensive training in personality dynamics, while executive coaches focus more on the general work environment in which executives operate. But it's my conviction that therapists can benefit from knowing more about the organizational world, and coaches without training in psychology would do well to acquire its basics. In my own work, when appropriate, I often move from past to present and from conscious to unconscious material. Both as a therapist and as a coach, I've had some assignments that were short and highly focused and others that lasted for years.

the person making the request. Discussing her original family dynamics helped Mary understand why she was the person she was; it quickly came out that it had been very difficult for her to stand up to her authoritarian father. The analysis of her childhood

led to a general discussion of the way she dealt with authority figures—including me—and her frequent anger toward them, which she gradually came to acknowledge. Some of our discussions also centered on the way Mary dealt with her own family. We explored how her style affected her children—and what the consequences would be. After all, she wanted them to be happy, and the way she was treating them was no prescription for happiness.

Coaching passive-aggressives is exhausting. They're irritating because they subtly show that they feel a sense of accomplishment when they've managed to frustrate you. It took a lot not to let Mary get to me. But as time passed, she took the first baby steps of trying to interact with people in a different way. She would practice expressing her irritation more directly and then report her successes and failures back to me. And because she generally liked the results, she gained the assurance to continue down the right path. Eventually, I expressed confidence that she could go on without my help. Thereafter, I saw her a few times to check that she had not fallen into her old habits.



## THE EMOTIONALLY DISCONNECTED

The previous cases deal with executives who may be troublesome but can also be quite charismatic—

the kind of people who don't leave you emotionally untouched. But with the fourth type of pathology, a lack of feeling rather than an excess of it gives rise to difficulties.

The term psychiatrists use for these people is *alexithymia*, which comes from the Greek and means “no words for emotions.” Alexithymics are literal-minded, display little imagination, and typically are unable to describe or even recognize their feelings. This inability makes it difficult for them to interpret the many and often complex emotional signals they receive from others, which they perceive as dangerous, potentially uncontrollable forces.

That doesn't mean alexithymics cannot be successful, particularly within large, bureaucratic organizations where playing safe, making the right noises, predictability, and relative inconspicuousness are rewarded. But in other kinds of organizations, they provide entirely the wrong role models for others. Since alexithymics don't exude the dynamism, inspiration, or vision that a high-performing organization needs, it's hard for them to motivate others. Having poor communication skills and being hard to read, they don't get the best out of people. And because they have difficulty dealing with the unpredictable, they may get in the way of progress. Their emotional absence puts a negative stamp on an organization's culture, discouraging creativity and innovation.

### How to Recognize the Condition

One executive—let's call him Robert—came to me because he felt he was at a dead end in his firm. Until recently, he had been quite successful in his career, but after changing jobs he seemed to hit a wall. When I asked about his new job, he mentioned that he felt uncomfortable with its lack of structure. It wasn't clear to him what he was expected to do; there was a great fluidity in relationships and structures.

Robert had left a technical function in a government job to become the chief information officer of a private company, a position that required considerable interpersonal skills. Robert saw that he had difficulties integrating himself with the executive team. Not knowing what to do, he spoke with a colleague in HR, who suggested that he try to work on his emotional intelligence—the reason he came to me.

At our first meeting, I was struck by the mechanical manner in which Robert answered my open-ended questions—always completely matter-of-fact. From the way he talked about friends and family

members, I also inferred that he did not have any intimate relationships. When I asked how he saw his future, his imagined scenario was devoid of any emotional content. His fantasy life and emotional memory seemed impaired.

When I asked how he felt under stress, he mentioned stomach pains, muscle tension, and headaches, but was unable to articulate the corresponding feelings. That's typical of alexithymics: They feel physically unwell rather than recognize emotional reactions. It was clear that Robert didn't understand why his body acted the way it did.

Despite their physical complaints, you should resist any temptation to recommend medical interventions to alexithymics. (Physicians, take note.) In Robert's case, his doctor (obviously at her wit's end) had sought to refer him to a psychiatrist or a psychotherapist, but he had not chosen that option.

## Coaching the Emotionally Disconnected


Because alexithymics are not the most engaging clients, there's a risk that their coaches will get bored, which may undermine their effectiveness. And there is no direct medication for this disorder, although antidepressants can help people with it focus on feelings and interpret inner experiences. With Robert, my goal was to gradually get him to recognize and react appropriately to emotions. Our engagement had two phases:

**Fixing immediate problems.** What works best for me when dealing with people like Robert is first to explore and find solutions to their immediate interpersonal problems. To build a trusting relationship with Robert, therefore, I needed to help him become more effective in his day-to-day work environment, and in our initial sessions I focused on this. When I asked whether anything had recently happened at work that puzzled him, he mentioned the strange behavior of his new assistant, who had suddenly burst into tears in his office. When I pressed him on what he had felt when that happened, he said, "Not much." It only gave him a headache. When I asked what he'd done to stop his assistant from crying, he said, "Nothing." But he had asked her to return to her office. I asked whether it might have been more helpful to inquire what her problem was—and if there was anything he could do to help her. He responded that he hadn't thought about it, but if such a situation recurred, he would try to follow my advice.


**Describing the pain.** Once I'd built up Robert's confidence in the coaching process, I started getting him to describe more-difficult encounters at work, pushing him to say which part of the experiences had caused him pain. When distress had manifested itself physically, we developed a story about these symptoms—why they happened, what they represented, and how they fit within the chain of events described. After many sessions, Robert began to recognize the link between his symptoms and emotionally disturbing events in his life. As we progressed, he displayed an increasing depth of feeling, and it dawned on him that sharing it with others would be beneficial in his work. He became more playful and less mechanical.

Other approaches can also work with alexithymics. I've found that group and family therapy can help coachees learn to recognize, tolerate, and verbalize the emotional spectrum. It gives them a chance to practice reflective self-observation. Behavioral techniques such as biofeedback, relaxation training, autogenic training, guided imagery, and hypnosis may also help. These techniques may give people with the disorder a sense of control over stressful responses, increasing their awareness of the relationship between bodily sensations and the events around them.

Like the Tin Man, who discovered that he had a heart, alexithymic executives can learn to deal with emotions. When they do, the change in how they relate to others goes a long way toward inspiring the best from their people, raising morale, and making their organizations more exciting places to work.

**SIGMUND FREUD** once told the novelist Stefan Zweig that all his life he had been "struggling with the demon"—the demon of irrationality. Executives who fail to recognize their irrational side are like ships facing an iceberg, forgetting that the greatest danger lies below the surface. Effective executives know how to combine reflection with action by using self-insight as a restraining force when the sirens of power beckon them. It is here that the executive coach can help by pointing out the extent to which unconscious, seemingly irrational processes affect behavior. 

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 An executive coach, psychoanalyst/psychotherapist, and management scholar, **Manfred F.R. Kets de Vries** is the Distinguished Professor of Leadership Development and Organizational Change at Insead in France, Singapore, and Abu Dhabi. His most recent book is *The Hedgehog Effect: The Secrets of Building High Performance Teams* (John Wiley & Sons, 2011).



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# The Globe



## Europe's Solution Factories

Manufacturers in the developed world are discovering new ways to compete. *by Stephen E. Chick, Arnd Huchzermeier, and Serguei Netessine*

Until about a decade ago, the best way to make your manufacturing operations competitive was to apply the practices of lean management. But as those practices have become more universal, they are yielding less differentiation in cost and quality.

This presents an acute challenge for manufacturers in developed countries in Europe and North America. They cannot compete on price; plants in large emerging economies such as China, Mexico, and Brazil come to the table with significantly lower labor costs. And many of those low-cost factories have high quality standards, the ability to produce on a large scale, and manufacturing methods as advanced as those anywhere in the world.

Still, manufacturers in Europe have risen to the challenge, as we have observed since 1995 as judges for Europe's annual Industrial Excellence Award. Along with colleagues at several of Europe's top business schools, we have analyzed applications from organizations that deem themselves "excellent" in manufacturing, and every year we visit a handful of factories in each participating country—France, Germany, the Netherlands, Spain, and the United Kingdom—as well as sister plants in Eastern Europe. The Western European countries have some of the world's most stringent regulations regarding the use of labor, facilities, and equipment. Nonetheless, the factories that have won the award have all prospered in highly competitive industries.

## SCHMITZ CARGOBULL

The German truck body and trailer manufacturer has improved its operations by incorporating sophisticated information technology into its products.

<b>2000</b>	<b>2013</b>
<b>THE PRODUCTION PACE NECESSARY TO MEET CUSTOMER DEMAND DROPPED</b>	
<b>120</b> MINUTES	<b>12</b> MINUTES

<b>THE INTERNAL FAILURE RATE FELL</b>	
<b>35</b> PER SEMITRAILER	<b>3</b> PER SEMITRAILER

<b>ACCIDENTS DECLINED</b>	
<b>85</b>	<b>5</b>



What explains their success? The award winners, we have found, use one or more of four distinct strategies: They leverage data flows to integrate closely with their supply chain partners; they optimize customer value across the whole chain, not just their part of it; they cooperate with suppliers to rapidly improve their manufacturing processes; and they harness their technical capabilities to offer a high degree of product customization for their customers. In short, they work with partners to manufacture solutions for other partners.

### Data-Based Integration with Others in the Supply Chain

When all that links two companies in a value chain are product and financial flows, it is relatively easy to change a supplier: You can always look for a cheaper option, which will probably lead you to a low-cost country like China or Vietnam. But when two or more companies are linked by information flows, what was purely a transaction becomes a kind of co-creation fed by trust and loyalty. Like Japanese *keiretsu* systems, with their profound buyer-supplier links, information-based integration allows suppliers to become deeply ingrained in their customers' ecosystems. The difference is that with the latter type of integration, data linkages make it unnecessary to exchange employees or create mutual ownership, as is common in keiretsu networks.

From the customer perspective, creating a trusting partnership built on compre-

hensive information sharing is a tall order, especially with a new, unknown supplier in a low-cost country. Companies are apt to feel safer dealing with suppliers from developed countries, where high standards of quality prevail and intellectual property protection is strong. As a result, smart manufacturers in Europe look for opportunities to make information sharing part of the relationship.

Schmitz Cargobull, a German truck body and trailer manufacturer, is a case in point. The company's main customers are operators of truck or trailer fleets, mostly based in Europe. Like many of its competitors, Schmitz Cargobull derives a growing share of revenue from support services such as financing, full-service contracts for breakdowns and regular maintenance, and spare parts supply.

What sets the company apart is its use of telematics (the integrated application of telecommunications and data) to monitor the current state of any Schmitz Cargobull-produced trailer. Key information is continually available to the driver, the freight agent, and the customer: They can track, for example, when maintenance was done, how much weight has been loaded, what the cargo temperature is, and where the vehicle is on its route. As a result, Schmitz Cargobull customers can better manage their trailer use and minimize the risk of breakdowns.

In deploying these telematic tools in its products, Schmitz Cargobull is providing tangible benefits, not mere flash. The

company uses information technology only where it makes sense; on the production line, for instance, workers implement statistical quality controls manually rather than rely on an automated system, because the company has found that manual control improves engagement and job performance. The decision to introduce telematics derived from management's belief that the real-time sharing of data would bind the company more closely to its customers.

That strategy has helped make Schmitz Cargobull an industry leader. In 2013 the company accounted for 82% of the sales of semitrailer reefers (refrigerated trailers) in Germany, and its market share in Europe was approximately 50%. Its operational results are impressive as well: Takt time (the production pace necessary to meet customer demand) dropped from 120 minutes in 2000 to 12 minutes in 2013 (–90%), the internal failure rate fell from 35 per semitrailer in 2000 to 3 per semitrailer in 2013 (–92%), and accidents declined from 85 in 2000 to 5 in 2013 (–95%).

The water meter manufacturer Itron uses information flows in a similar way to make itself indispensable to its customers. At its research center in Mâcon, France, the company has developed intelligent water metering systems in which a wireless device allows for remote reading. And in collaboration with Cisco Systems, the networking equipment provider, Itron is working to develop “smart grid” solutions that provide data about municipal water systems.



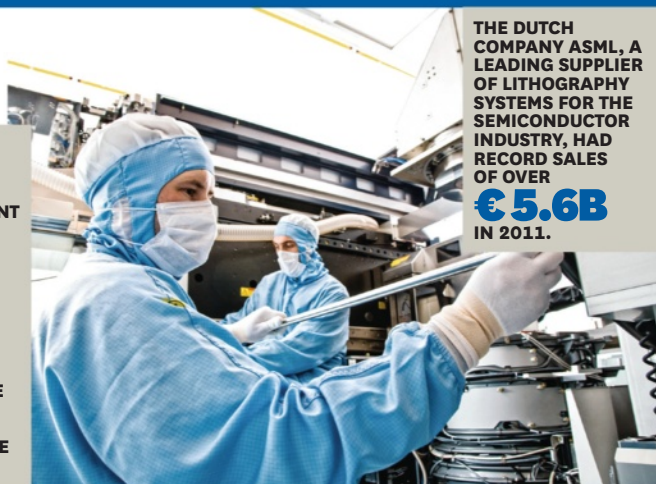
### TECHNIP

TECHNIP'S SUBSEA GROUP, WHICH PRODUCES INTELLIGENT GAS AND OIL PIPES IN LE TRAIT, FRANCE, SAW REVENUES RISE

**36%**  
FROM 2011  
TO 2012.

OPERATING MARGINS FOR THE GROUP WERE

**50%**  
HIGHER THAN FOR THE  
COMPANY OVERALL.



### ASML

THE DUTCH COMPANY ASML, A LEADING SUPPLIER OF LITHOGRAPHY SYSTEMS FOR THE SEMICONDUCTOR INDUSTRY, HAD RECORD SALES OF OVER

**€5.6B**  
IN 2011.

Using Itron's metering systems, municipalities can identify leakages and changes in water usage patterns so as to help plan maintenance and respond immediately to water waste and loss by consumers or in the water distribution network. The systems also support client service, billing, and water consumption analysis.

More than 30% of the drinking water produced worldwide never reaches the customer (because of leaks or other reasons) and thus never generates revenue. Even in a developed country such as France, "lost" water exceeds 20% of the supply. Efficient metering thus has great potential to reduce the need for expensive initiatives to expand water treatment. One project in Kalgoorlie, Australia, has reduced water loss by 10%, thanks to the kinds of products developed by Itron. In British Columbia, Canada, smart water metering is anticipated to save \$1.6 billion over 20 years. As a result of successes like these, Itron's production of communication modules for data transfer has increased by a factor of 15 since 2000, and production of its water meters has tripled.

### Value Creation Elsewhere in the Chain

A distant supplier is unlikely to have insight into the exact needs and expenses of buyers. It can perhaps improve the quality and reduce the cost of making the product, but in many situations the direct cost is only a fraction of what customers spend. Smart manufacturers understand that there are

other ways in which they can create value for customers; they do not have to base their value proposition only on the quality and price of products if they can help customers add worth elsewhere along the value chain.

The French manufacturer Markem-Imaje produces industrial printers for marking "best by" dates and other information on containers for beverages, food, pharmaceuticals, and other consumer products. Like its competitors, Markem-Imaje has introduced a number of ancillary services to add value to its products, and it has adapted its printing and marking technology to enter new markets, such as postal services and large-scale printing of billboards. The company has also recognized that environmental sustainability has become an important source of value for its customers. In partnership with a supplier, Armor's Thermal Transfer Industrial Expertise Centre, it has developed printers that apply a new solvent-free ink that delivers high print quality while causing minimal environmental damage—a combination European customers are willing to pay a premium for.

Similarly, Technip's Flexi France manufacturing plant has found innovative ways to add value for customers. The company produces subsea flexible pipes for the oil and gas industry. Flexi France's traditional services include installing, inspecting, maintaining, and repairing pipes in locations around the world, from the Arctic to the Arabian Gulf. The company now goes a step further. In a collaborative effort with

the oil field services giant Schlumberger, Technip has developed intelligent pipes that can monitor and regulate the temperature throughout an oil pipeline. Fluctuating temperatures pose a major problem; they cause changes in pipe diameter, which make the flow of oil more variable. This compromises drilling efficiency and is a significant source of costs for oil producers. Using intelligent pipes not only keeps temperatures steadier but also reduces the complexity of subsea drilling layouts and shortens pipe installation times. Technip has reaped clear rewards from implementing technological solutions such as this one: Subsea group operating margins were 50% higher than those for the company overall, while revenues for the group increased 36% from 2011 to 2012.

### A Cooperative Approach to Improving Manufacturing

When manufacturers change their product specifications, they may find that faraway, cost-driven parts suppliers are slow to respond. Smart European manufacturers, therefore, try to optimize production for maximum flexibility. In many cases this involves integrating tightly with their supplier or customer networks to rapidly adjust the manufacturing process so they can meet buyers' changing needs.

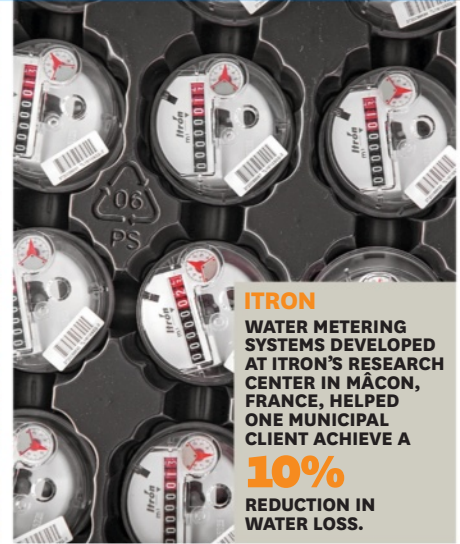
ASML, a Dutch company, provides leading-edge imaging solutions to enable manufacturing processes in the semiconductor industry. The firm operates in an extremely volatile sector: Over the past 30

## BMW

TO MEET CUSTOMERS' NEEDS, THE GERMAN CARMAKER'S PLANT IN LANDSHUT TRANSFORMED ITSELF IN

**2 years**

TO BE ABLE TO SUPPLY ENTIRE CHASSIS.



## ITRON

WATER METERING SYSTEMS DEVELOPED AT ITRON'S RESEARCH CENTER IN MÂCON, FRANCE, HELPED ONE MUNICIPAL CLIENT ACHIEVE A

**10%**

REDUCTION IN WATER LOSS.

years, annual growth in the semiconductor industry has oscillated between -40% and +140%. Nevertheless, in 2010 ASML booked record sales of €4.5 billion as the chip industry rebounded strongly after a period of underinvestment, thanks to growing demand for new electronic gadgets such as tablets and smartphones. In 2011, despite macroeconomic uncertainty, ASML posted record sales for the second year in a row—€5.65 billion—showing that the fundamentals of its business remained robust.

The key to this impressive performance is rapid innovation in response to customer needs. Semiconductor companies face constant pressure to create more advanced chips, in order to sustain the continued productivity gains that spur economic growth. As the chip-making technology becomes increasingly complex, ASML is refining its lithography equipment to help its customers manufacture smaller, more powerful chips at ever-faster speeds. Close cooperation with customers and first-tier suppliers during the product develop-

ment phase is a necessity; generally, any new system has more than 1,800 different components. Evolution of the manufacturing process requires large R&D expenses, and according to the 2010 EU Industrial R&D Investment Scoreboard, ASML spent nearly €78,000 per employee on this activity in 2009—more than most automotive or pharmaceutical companies anywhere in the world. To accelerate the development of next-generation lithography technologies, ASML and three of its large customers—Intel, TSMC, and Samsung—agreed in 2012 to launch the Customer Co-Investment Program. Under the program, the three customers are collectively contributing €1.38 billion over five years to ASML's research and development of next-generation lithography technologies.

A related strategy is used by BMW's exterior plastics department in Landshut, Germany, which transformed itself in two years from an in-house supplier of molded plastic parts to a supplier of entire chassis. Landshut's successful reinvention owes much to the fact that its purchasing func-

tion is colocated with the manufacturing unit. This allows the speedy disbursement of funds for conducting basic research, developing new production methods, piloting new manufacturing facilities, and disseminating process improvements.

Within BMW, the frequent exchange of ideas regarding technology leads to very quick innovation cycles, which motivates suppliers to provide exceptional levels of quality and on-time delivery. Among the innovations that have emerged are ultralightweight, high-tech plastic and carbon fiber body parts, which are now used in all of BMW's new i-series cars and increasingly in its traditional cars as well.

The exterior plastics department at Landshut further supports collaboration with suppliers by offering them a range of services (amounting to a significant revenue stream) that help them adapt to innovations. BMW has transferred a large team of developers from its main R&D site to Landshut to speed up innovation cycles even more and to decentralize the process. Because it can rely on the rapid evolution of its manufacturing process and the speedy dissemination of advances, BMW can set relatively low launch prices for its electric vehicles, even though production costs are relatively high.

### The Ability to Customize

A number of European manufacturers have succeeded by focusing on supplying

**Smart European manufacturers optimize production for maximum flexibility. They often integrate tightly with suppliers and customers in order to make rapid adjustments to the manufacturing process.**

small-run, customized products. This requires bringing a high level of knowledge and skill to product design. BuS Elektronik in Riesa in the former East Germany is a good example. Its business unit “industry” makes small and medium-sized electronics components and systems, specializing in custom-designed items produced in lot sizes very often smaller than 1,000 units—too small to warrant an Asian electronics firm’s entry into the market. Although BuS’s customers pay a premium for its products, the prices can be offset through reduced costs for transportation and other logistics.

Efficient communication during the development phase, along with the plant’s responsiveness and flexibility, adds considerable value to the BuS proposition. The company’s original-equipment-manufacturer customers give BuS a free hand in product design; they may present BuS with just a product idea or a performance specification. BuS engineers and designers—who were part of a cooperative for robotics until 1989—possess skills that traditional electronics suppliers lack. BuS leverages their capabilities to manage the complexities of customized manufacturing, where each new product involves assembling roughly 1,000 components. All products are designed to simplify the assembly process and reduce labor inputs. The design team is highly motivated to streamline, because members reap the efficiency benefits through a profit-sharing scheme.

With more than 200 customers and year-round demand, scheduling small batches and high-volume products on the same shop floor is a challenge. To hedge schedule risk, BuS quotes customers two weeks for order delivery, although production is often completed within one week. Moreover, it keeps up to 20% of its facilities idle, which builds in added flexibility.


The Daimler Group’s Smart plant in Hambach, France, provides another example of extreme customization. The factory complex produces the Smart car with

a collaborative network of seven suppliers (including Continental, Magna, Plastal, and ThyssenKrupp), who are paid only when a car comes off the factory floor. The high level of integration and colocation with these suppliers allows Smart to produce 10,000 cockpit variations. All these options are possible because the cockpit assembly line is interlinked with the Smart production line, allowing for just-in-sequence production, with trucks coming directly to the production line to deliver parts. The cockpit module is completely integrated into the car body, so only one automated station is needed for the final assembly.

**IN EACH OF THESE CASES**, and in numerous others we have seen in the Industrial Excellence Award competition, manufacturers moved away from an internal focus on improving traditional operations and

instead coordinated in a proactive and collaborative way with supply chain partners. As a result, they developed innovative solutions to give the end customer a better product or service bundle. Low-cost factories in emerging countries cannot easily copy this approach, because it requires sharing proprietary data, optimizing the total value-chain costs, rapidly adapting manufacturing capability through integration with suppliers, or being able to deliver highly customized products. Such strategies, therefore, are the future of European competitiveness in manufacturing. ♡

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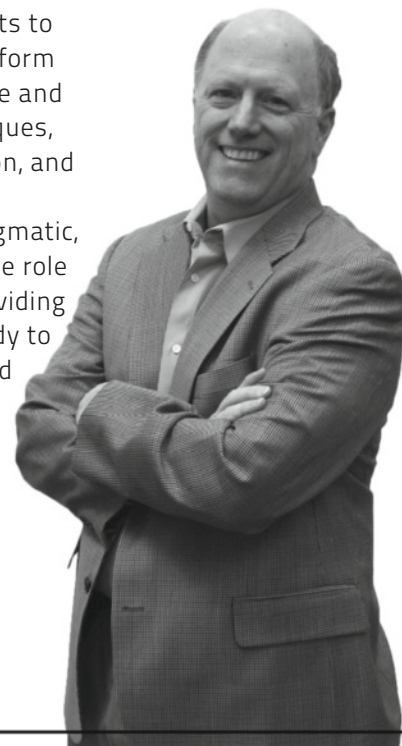
 **Stephen E. Chick** is the Novartis Chair of Healthcare Management at Insead. **Arnd Huchzermeier** is the chaired professor of production management at WHU–Otto Beisheim School of Management. **Serguei Netessine** is the Timken Chaired Professor of Global Technology and Innovation at Insead.

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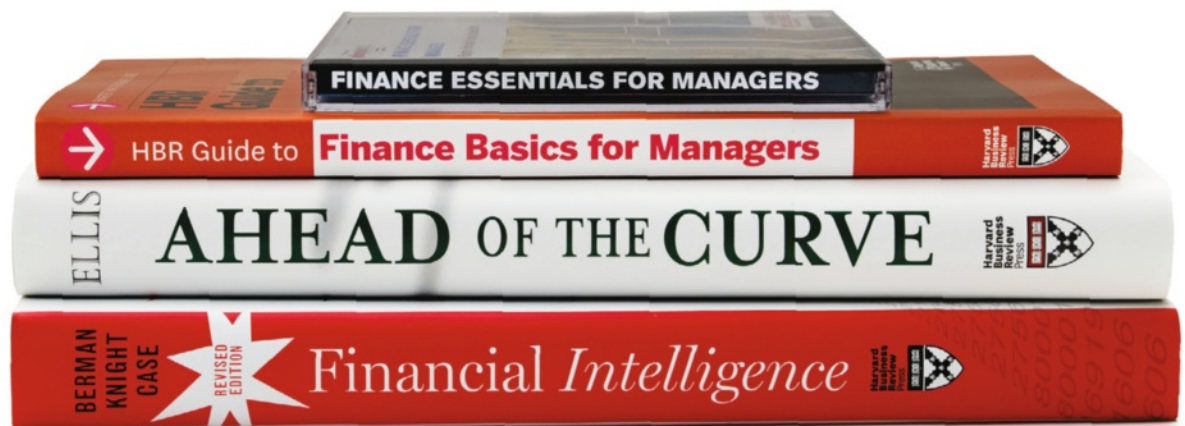
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# Experience

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ILLUSTRATION: OSCAR WILSON

**JOB-OFFER NEGOTIATIONS ARE** rarely easy. Consider three typical scenarios:

You're in a third-round interview for a job at a company you like, but a firm you admire even more just invited you in. Suddenly the first hiring manager cuts to the chase: "As you know, we're considering many candidates. We like you, and we hope the feeling is mutual. If we make you a competitive offer, will you accept it?"

You've received an offer for a job you'll enjoy, but the salary is lower than you think you deserve. You ask your potential boss whether she has any flexibility. "We typically don't hire people with your background, and we have a different culture here," she responds. "This job isn't just about the money. Are you saying you won't take it unless we increase the pay?"

You've been working happily at your company for three years, but a recruiter has been calling, insisting that you could earn much more elsewhere. You don't want to quit, but you expect to be compensated fairly, so you'd like to ask for a raise. Unfortunately, budgets

# THE RULES

are tight, and your boss doesn't react well when people try to leverage outside offers. What do you do?

Each of these situations is difficult in its own way—and emblematic of how complex job negotiations can be. At many companies, compensation increasingly comes in the form of stock, options, and bonuses linked to both personal and group performance. In MBA recruitment, more companies are using “exploding” offers or sliding-scale signing bonuses based on when a candidate accepts the job, complicating attempts to compare offers. With executive mobility on the rise, people vying for similar positions often have vastly different backgrounds, strengths, and salary histories, making it hard for employers to set benchmarks or create standard packages.

In some industries a weak labor market has also left candidates with fewer options and less leverage, and employers better positioned to dictate terms. Those who are unemployed, or whose current job seems shaky, have seen their bargaining power further reduced.

But job market complexity creates opportunities for people who can skillfully negotiate the terms and conditions of employment. After all, negotiation matters most when there is a broad range of possible outcomes.

As a professor who studies and teaches the subject, I frequently advise current and former students on navigating this terrain. For several years I have been offering a presentation on the topic to current students. (To see a video of this talk, go to [www.NegotiateYourOffer.com](http://www.NegotiateYourOffer.com).) Every situation is unique, but some strategies, tactics, and principles can help you address many of the issues people face in negotiating with employers. Here are 15 rules to guide you in these discussions.

## Don't underestimate the importance of likability.

This sounds basic, but it's crucial: People are going to fight for you only if they like you. Anything you do in a negotiation that makes you less likable reduces the chances that the other side will work to get you a better offer. This is about more than being polite; it's about managing some inevitable tensions in negotiation, such as asking for what you deserve without seeming greedy, pointing out deficiencies in the offer without seeming petty, and being persistent without being a nuisance. Negotiators can typically avoid these pitfalls by evaluating (for example, in practice interviews with friends) how others are likely to perceive their approach.

## Help them understand why you deserve what you're requesting.

It's not enough for them to like you. They also have to believe you're worth the offer you want. Never let your proposal speak for itself—always tell the story that goes with it. Don't just state your desire (a 15% higher salary, say, or permission to work from home one day a week); explain precisely why it's justified (the reasons you deserve more money than others they may have hired, or that your children come home from school early on Fridays). If you have no justification for a demand, it may be unwise to make it. Again, keep in mind the inherent tension between being likable and explaining why you deserve more: Suggesting that you're especially valuable can make you sound arrogant if you haven't thought through how best to communicate the message.

## Make it clear they can get you.

People won't want to expend political or social capital to get approval for a strong or improved offer if they suspect that at the end of the day, you're still going to say, “No, thanks.” Who wants to be the stalking horse for another company? If you intend to negotiate for a better package, make it clear that you're serious about working for this employer. Sometimes you get people to want you by explaining that *everybody* wants you. But the more strongly you play that hand, the more they may think that they're not going to get you anyway, so why bother jumping through hoops? If you're planning to mention all the options you have as leverage, you should balance that by saying why—or under what conditions—you would be happy to forgo those options and accept an offer.

## Understand the person across the table.

Companies don't negotiate; people do. And before you can influence the person sitting opposite you, you have to understand her. What are her interests and individual concerns? For example, negotiating with a prospective boss is very different from negotiating with an HR representative. You can perhaps afford to pepper the latter with questions regarding details of the offer, but you don't want to annoy someone who may become your manager with seemingly petty demands. On the flip side, HR may be responsible for hiring 10 people and therefore reluctant to break precedent, whereas the boss, who will benefit more directly from your joining the company, may go to bat for you with a special request.

## Understand their constraints.

They may like you. They may think you deserve everything you want. But they still may not give it to you. Why? Because they may have certain ironclad constraints, such as salary caps, that no amount of negotiation can loosen. Your job is to figure out where they're flexible and where they're not. If, for example, you're talking to a large company that's hiring 20 similar people at the same time, it probably can't give you a higher salary than everyone else. But it may be flexible on start dates, vacation time, and signing bonuses. On the other hand, if you're negotiating with a smaller company that has never hired someone in your role, there may be room to adjust the initial salary offer or job title but not other things. The better you understand the constraints, the more likely it is that you'll be able to propose options that solve both sides' problems.

## Be prepared for tough questions.

Many job candidates have been hit with difficult questions they were hoping not to face: Do you have any other offers? If we make you an offer tomorrow, will you say yes? Are we your top choice? If you're unprepared, you might say something inelegantly evasive or, worse, untrue. My advice is to never lie in a negotiation. It frequently comes back to harm you, but even if it doesn't, it's unethical. The other risk is that, faced with a tough question, you may try too hard to please and end up losing leverage. The point is this: You need to prepare for questions and issues that would put you on the defensive, make you feel uncomfortable, or expose your weaknesses. Your goal is

to answer honestly without looking like an unattractive candidate—and without giving up too much bargaining power. If you have thought in advance about how to answer difficult questions, you probably won't forfeit one of those objectives.

## Focus on the questioner's intent, not on the question.

If, despite your preparation, someone comes at you from an angle you didn't expect, remember this simple rule: It's not the question that matters but the questioner's intent. Often the question is challenging but the questioner's intent is benign. An employer who asks whether you would immediately accept an offer tomorrow may simply be interested in knowing if you are genuinely excited about the job, not trying to box you into a corner. A question about whether you have other offers may be designed not to expose your weak alternatives but simply to learn what type of job search you're conducting and whether this company has a chance of getting you. If you don't like the question, don't assume the worst. Rather, answer in a way that addresses what you think is the intent, or ask for a clarification of the problem the interviewer is trying to solve. If you engage in a genuine conversation about what he's after, and show a willingness to help him resolve whatever issue he has, both of you will be better off.

## Consider the whole deal.

Sadly, to many people, "negotiating a job offer" and "negotiating a salary" are synonymous. But much of your satisfaction from the job will come from other factors you can negotiate—perhaps even more

easily than salary. Don't get fixated on money. Focus on the value of the entire deal: responsibilities, location, travel, flexibility in work hours, opportunities for growth and promotion, perks, support for continued education, and so forth. Think not just about *how* you're willing to be rewarded but also *when*. You may decide to chart a course that pays less handsomely now but will put you in a stronger position later.

## Negotiate multiple issues simultaneously, not serially.

If someone makes you an offer and you're legitimately concerned about parts of it, you're usually better off proposing all your changes at once. Don't say, "The salary is a bit low. Could you do something about it?" and then, once she's worked on it, come back with "Thanks. Now here are two other things I'd like..." If you ask for only one thing initially, she may assume that getting it will make you ready to accept the offer (or at least to make a decision). If you keep saying "and one more thing..." she is unlikely to remain in a generous or understanding mood. Furthermore, if you have more than one request, don't simply mention all the things you want—A, B, C, and D; also signal the relative importance of each to you. Otherwise, she may pick the two things you value least, because they're pretty easy to give you, and feel she's met you halfway. Then you'll have an offer that's not much better and a negotiating partner who thinks her job is done.

## Don't negotiate just to negotiate.

Resist the temptation to prove that you are a great negotiator. MBA students who have just taken a class

on negotiation are plagued by this problem: They go bargaining berserk the first chance they get, which is with a prospective employer. My advice: If something is important to you, absolutely negotiate. But don't haggle over every little thing. Fighting to get just a bit more can rub people the wrong way—and can limit your ability to negotiate with the company later in your career, when it may matter more.

### Think through the timing of offers.

At the beginning of a job hunt, you often want to get at least one offer in order to feel secure. This is especially true for people finishing a degree program, when everyone is interviewing and some are celebrating early victories. Ironically, getting an early offer can be problematic: Once a company has made an offer, it will expect an answer reasonably soon. If you want to consider multiple jobs, it's useful to have all your offers arrive close together. So don't be afraid to slow down the process with one potential employer or to speed it up with another, in order to have all your options laid out at one time. This, too, is a balancing act: If you pull back too much—or push too hard—a company may lose interest and hire someone else. But there are subtle ways to solve such problems. For example, if you want to delay an offer, you might ask for a later second- or third-round interview.

### Avoid, ignore, or downplay ultimatums of any kind.

People don't like being told "Do this or else." So avoid giving ultimatums. Sometimes we do so inadvertently—we're just trying to show strength, or we're frustrated, and it comes

off the wrong way. Your counterpart may do the same. My personal approach when at the receiving end of an ultimatum is to simply ignore it, because at some point the person who gave it might realize that it could scuttle the deal and will want to take it back. He can do that much more easily without losing face if it's never been discussed. If someone tells you, "We'll never do this," don't dwell on it or make her repeat it. Instead you might say, "I can see how that might be difficult, given where we are today. Perhaps we can talk about X, Y, and Z." Pretend the ultimatum was never given and keep her from becoming wedded to it. If it's real, she'll make that clear over time.

### Remember, they're not out to get you.

Tough salary negotiations or long delays in the confirmation of a formal offer can make it seem that potential employers have it in for you. But if you're far enough along in the process, these people like you and want to continue liking you. Unwillingness to move on a particular issue may simply reflect constraints that you don't fully appreciate. A delay in getting an offer letter may just mean that you're not the only concern the hiring manager has in life. Stay in touch, but be patient. And if you can't be patient, don't call up in frustration or anger; better to start by asking for a clarification on timing and whether there's anything you can do to help move things along.

### Stay at the table.

Remember: What's not negotiable today may be negotiable tomorrow. Over time, interests and constraints change. When someone says no, what he's saying is "No—given how

I see the world today." A month later that same person may be able to do something he couldn't do before, whether it's extending an offer deadline or increasing your salary. Suppose a potential boss denies your request to work from home on Fridays. Maybe that's because he has no flexibility on the issue. But it's also possible that you haven't yet built up the trust required to make him feel comfortable with that arrangement. Six months in, you'll probably be in a better position to persuade him that you'll work conscientiously away from the office. Be willing to continue the conversation and to encourage others to revisit issues that were left unaddressed or unresolved.

### Maintain a sense of perspective.

This is the final and most important point. You can negotiate like a pro and still lose out if the negotiation you're in is the wrong one. Ultimately, your satisfaction hinges less on getting the *negotiation* right and more on getting the *job* right. Experience and research demonstrate that the industry and function in which you choose to work, your career trajectory, and the day-to-day influences on you (such as bosses and coworkers) can be vastly more important to satisfaction than the particulars of an offer. These guidelines should help you negotiate effectively and get the offer you deserve, but they should come into play only after a thoughtful, holistic job hunt designed to ensure that the path you're choosing will lead you where you want to go. ♡

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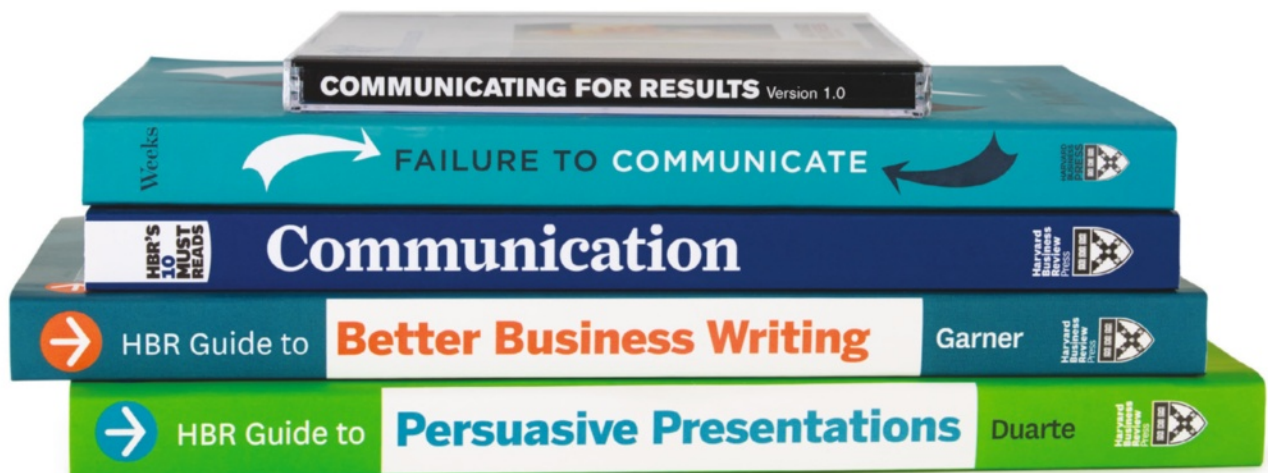
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## Case Study



**Christopher Marquis** is an associate professor at Harvard Business School. **Juan Almandoz** is an assistant professor at IESE Business School, in Barcelona.



## The Experts



**Ken LaRoe**, chairman and CEO, First Green Bank



**John Replegle**, president and CEO, Seventh Generation

# Can an “Ethical” Bank Support Guns and Fracking?

by Christopher Marquis and Juan Almandoz

As the founder and president of a new ethical bank focused on environmental sustainability, Jay McGuane realized that he and his board needed to set guidelines about which loans to approve and which to reject on “values” grounds—and fast. In his eagerness to get the business started, he’d put the issue off. But now the bank was facing two problematic requests: one from a company involved in fracking, the other from a gun maker.

Without clear ethics rules, Jay worried that his already divided directors would fall into bitter squabbling, leading to resignations, negative media attention, and a flight of investors.

Ethical banking had seemed so benign when Jay had decided to enter the industry. Now it seemed like a hornet’s nest.

## A Green Vision

Jay didn’t need this job. At age 50, he had years of entrepreneurship behind him. He

had founded a bank in Maryland, expanded it to six branches and \$400 million in assets, and sold it for a substantial profit. While looking for his next project, he happened to see the movie *An Inconvenient Truth* and decided, during the sleepless night afterward, to build something meaningful out of his concern for the environment, his love of his native Colorado, and his knowledge of banking. The result was Rocky Mountain Green Bank, a company with a mission to promote environmental stewardship.

He established himself in Colorado Springs and assembled a board of directors: Four successful entrepreneurs, a lawyer, an ex-mayor of the city, a former executive in the Maryland bank, a doctor who was a school friend and sometime hunting partner, and an evangelical (and ardently environmentalist) leader of a megachurch Jay attended occasionally.

To drive home its mission, the board hired a famous architect to make the

HBR’s fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study “First Green Bank: Bringing Bloom to Desert Landscapes” (case no. 9-413-073), by Christopher Marquis and Juan Almandoz. It is available at [HBR.org](http://HBR.org).

bank's headquarters an environmental showcase, with prototype solar-power windows, a set of wind turbines, and a butterfly roof that channeled rain and meltwater into underground cisterns.

Articles and TV segments about the building and about Jay, the returned native son and environmental crusader, helped attract local depositors and small borrowers, who'd grown disenchanted with the big national and global banks. Deposits grew at a healthy rate, but to succeed financially, the bank needed to make big loans to a few strong companies. So far, that hadn't happened.

Moreover, the values-based approach was proving harder to implement than Jay had anticipated. Rifts among the directors had started to appear. The first sign of conflict came up in a discussion of what Jay thought was a nonissue: a gym for employees.

"Oh, come on," Neitha Wellman said, shaking her head. "Are you going to have a personal trainer on-site, too?"

"Actually, yes," Jay said. "Two afternoons a week."

She rolled her eyes. "Since when does a gym or a personal trainer have anything to do with being green?"

An avid fly fisher and former bouldering champion, Neitha considered herself a pragmatic environmentalist, and she detested the idea of the "nanny state." She actively campaigned for Libertarian candidates—in fact, she had been at a rally at a mall when a shooter had gone after a Congressional candidate and the people waiting to shake his hand. A picture of her giving CPR to a wounded child, who later died, had been all over the internet, though she refused to discuss the incident.

Two other board members agreed with her about the gym, so Jay had scaled back those plans.

## Twin Debates

Neitha had been the one to solicit the first problematic loan application. She'd been talking to the head of a Colorado engineering company that developed pumping sys-

tems used in hydraulic fracturing—fracking—and wanted to expand into making the polymers, emulsions, and surfactants the industry relies on. These materials, the executive said, would be significantly less toxic than those currently in use. Though ambivalent about fracking in general, Neitha had recommended that the executive approach Rocky Mountain Green Bank.

But on hearing about the opportunity, Neitha's fellow directors were divided. One side touted the economic and employment

benefits of fracking, while the other insisted that the risks outweighed any good that could come from it. The 300-million-year-old sedimentary rock under the Denver Basin in eastern Colorado contained one of the country's largest gas deposits, and a number of local engineering firms were working on solutions for drilling, injecting, and waste disposal. It was a growth industry, but warnings from experts about the risks of groundwater contamination and seismic instability seemed to increase every day.

"Look, let's not get worked up about a loan application we haven't even received," Jay said, trying to lower the temperature in the room. "But when we are approached by a company like this one, we have to be ready. We need to be talking about how to make loans that reflect our mission."

Jay promised that he would research the guidelines other ethical companies used to make values-based decisions, solicit opinions from each director individually, and come back to the group with a proposal.

The next day, he visited the board member he knew best, Fred Keeler, a gastroenterologist. "I'm a believer in the precautionary principle," he told Jay. "It's the idea that in order to act, all you need is partial evidence—not proof." Bans on

smoking in public areas were a perfect example, he said: Many of them went into effect before the dangers of secondhand smoke had been proved.

So if it looks bad, it *is* bad, Jay thought ruefully. Hoping for a more nuanced perspective, Jay went next to the pastor, the Reverend Clyde Dahlberg, who, to Jay's surprise, advocated a completely evidence-based approach: "Make two columns, one for adverse environmental impacts, one for the positives," he said

## In some ways, it was just the type of loan the bank needed: Field Force was a solid performer, a growing source of local jobs, and a good corporate citizen.

matter-of-factly. "Figure out a way to quantify the effects, then do the math." Simple.

It was while wrapping up his meeting with Clyde that Jay received an e-mail from the bank's chief loan officer. "Wow—3 million dollars," he blurted out.

"What's this?" Clyde asked. Jay wished he hadn't said anything: The e-mail was about an official application from Field Force, a large, local firm that had been talking informally with Jay about a multi-million-dollar loan to expand its business. In some ways, it was just the type of loan the bank needed: Field Force was a solid performer, a growing source of local jobs, and a good corporate citizen.

"A gun manufacturer?" Clyde asked in horror.

"A military contractor," Jay said.

"A gun manufacturer," Clyde repeated. "In the state of Colorado? After Columbine and Aurora and Arapahoe High School? You'd better not do anything on that without a board decision. I'd put it on the agenda for next week's meeting if I were you."

## Changing the Subject

Jay didn't share the aversion that some of his directors felt toward guns, and it seemed to him that weapons had nothing



to do with environmentalism. But Clyde was right about the necessity of a board discussion, so he notified the directors about the Field Force application and planned his strategy for the meeting.

"As you all know," he said to the group a few days later, "I got into this business because I was excited by the environmental mission. And I think you all felt the same."

Heads nodded.

"But," he continued, "the regulators made it very clear that we were to be a profit-making bank first and a green bank second. To get our charter, we had to demonstrate that our mission wouldn't add significant costs or impose significant limits on our banking operations, that we wouldn't let the mission wag the dog. I remember telling them that even if we *wanted* to lend only to businesses aligned with our environmental mission, we couldn't—we'd go broke in a month.

"I'm not always happy with this situation," he added. "I didn't get into this just to run another bank, but I accept it as the price to play."

Mark Lerman, Jay's former employee from the Maryland bank, provided a few facts and figures to support Jay's point: "Green" loans—to green-certified builders and consultants, as well as landscapers, farms, nurseries, organic-food companies, and solar-energy firms—constituted only 7% of the bank's total; deposits from green businesses and from customers drawn by the bank's mission accounted for just 1.8%, the data showed.

"Probably our biggest impact on sustainability comes not through the loans we make," Jay said, "but through media coverage of our mission. By being a successful green bank—with an emphasis on 'successful'—we pave the way for more capital to flow to green causes.

"As I said last week, I think we need to create a decision-making framework so that we don't have to reinvent the wheel every time a loan application falls into what some of us might see as an ethically gray area. I've made a little progress on that front by talking to Fred and Clyde here—"

Clyde interrupted him. "With all due respect, Jay, we have one of those applications on the table. It's from Field Force."

Apparently, Clyde had recruited several other directors to his position, and together they had drafted a statement categorically rejecting business from gun makers.

Clyde began to read aloud: "Point number one: The economic considerations..." The statement compared gun makers with tobacco companies, arguing that their stocks would quickly lose value as the public became more concerned about violence. The statement cited Cerberus Capital Management's unsuccessful attempts to shed its investment in the company that made the weapon used in the 2012 Newtown elementary-school shooting. Under pressure from investors, Cerberus had finally allowed clients to sell their individual stakes.

Jay was irritated. "No one would ever advocate that our military do without weapons," he said. "And as long as there's demand from the Pentagon, Field Force's stock will be fine."

Clyde put down the statement and looked at Jay. "Rocky Mountain Green Bank is supposed to be founded on ethical principles," he said. "What is 'green' if not an ethical principle? That's why we're part of the Global Alliance for Banking on Values. Last time I looked, it wasn't the 'Global Alliance for Banking on *Selected* Values.' What would other alliance members think about our lending to a gun maker?"

"You say that our main impact is through media coverage," he continued. "What will the media say if we lend to Field Force? That certainly trumps our fancy LEED-certified office building. A loan to a gun manufacturer would announce to the world that we really have no principles and that the green thing is just a marketing gimmick. If that happens, I'll have to let this board."

Lukas Hoenig, a board member who was the founder of a chain of environmentally friendly dry-cleaning businesses, cut in. "Let's be real here," he said to Clyde. "We're a green bank, but when did

we become the bank for the entire liberal agenda? Selling weapons to our military is not only legal, it's laudable. And we need the business?"

"There's nothing unethical about making or selling arms that are purchased and used properly," Jay added. "I'm a gun owner myself, and so is Fred."

Looking for support, Jay turned to Neitha. She looked at him for moment and then said softly, "Jessica Belford was killed by a lightweight cartridge from an FF286."

It took Jay a few seconds to figure out what she was talking about: the girl on the ground at the mall, a weapon from Field Force.

"Sure, they sell to the military," Neitha said. "But you can buy the FF286 at gun shows. That's what makes it one of Field Force's most profitable products. Our bank's mission is sustainability. How can we have a sustainable society where military-grade guns are being used to kill children? How can we, in good conscience, do business with that company?"

"It's a no-brainer," Clyde said. "Jay was talking about establishing guidelines for decisions. I'm all in favor of weighing the pros and cons—let's do that when we discuss the shale gas loan. But when it comes to guns, there's only one guideline we should follow." He turned to Fred Keeler. "It's like the Hippocratic Oath, right? First, do no harm. Or how about this: Do no evil."

It was Fred who had advocated saying no to a loan if there was mere indication of harm, but now he looked conflicted. He loved his gun collection, from the flintlocks to the Uzis, as Jay well knew. Fred asked, of no one and everyone, "But what is 'harm'? What is 'evil'?"

## Should Rocky Mountain Green Bank deny a loan to a gun manufacturer?

See commentaries on the next page.

## The Experts Respond



**Ken LaRoe** is the chairman and CEO of First Green Bank.

**IT'S TRUE** that gun proliferation isn't an environmental issue. But having joined the Global Alliance for Banking on Values and staked its claim as an "ethical" bank, Rocky Mountain Green Bank has to do more than simply promote "green" causes. A loan to Field Force would suggest that the bank's position is indeed just a marketing gimmick. Instead of saying yes, the bank should affirm its commitment to a broader set of values.

That's what we've done at First Green Bank. While we emphasize environmental sustainability, our mission statement refers to "social responsibility"—a much broader concept. As a result, our loan decisions can be quite challenging.

When the issue of guns first came up, we wrestled with it. (This fictionalized case is loosely based on our experience.) Like Field Force, the manufacturer that wanted a loan from us was (and still is) a well-run company with great financial fundamentals. About half of our senior loan committee considered it a terrific prospect and believed we should approve the application. The other half—myself included—thought that the company's output of semiautomatics and ammunition for those types of firearms was ethically repugnant.

In the end, we were saved by circumstance: Another bank grabbed the business by offering the manufacturer a loan at a much lower rate.

**It's OK that some sectors are off the table for us, because that's what being an ethical bank is all about.**

When our bank was very small, ad hoc decision making was fine. But as we've grown, we've seen the value, as Jay McGuane does, of having a set of guidelines to which everyone can refer. We explicitly decided, for example, that we're not going to lend to companies in the extractive industries or to gun manufacturers.

In some cases, this doesn't have a big impact on our bottom line; in others, there are definite economic consequences. Florida, where we're based, has a good amount of mining, and a new pipeline for fracked gas is being considered. But it's OK that some sectors are off the table for us, because that's what being an ethical bank is all about. We make trade-offs on the

basis of our mission to do the right thing for the environment, our people, our community, and our shareholders.

We realize, too, that it's important to build flexibility into our guidelines. We might, for example, consider lending to a company that manufactures only high-end shotguns used exclusively for trapshooting.

Real estate is another sector that prompts serious debate. As the central Florida market heats up, we expect lots of requests for loans to support the kind of slash-and-burn development that hurts the state's delicate ecosystems and contributes to sprawl. If we flatly say no, we'll be rejecting a steady stream of revenue, and other banks will support the projects.

Our hope is instead to say yes to developers willing to make their projects more environmentally responsible. We'd like to help them find the right architects, teach them to use solar and other sustainable technologies and practices, and influence their thinking for the future.

Rocky Mountain Green Bank should consider saying yes to companies that are receptive to guidance and assistance on sustainability and other ethical issues. But if the loan requests come from corporations that are clearly set in their ways, then saying no is the only option.



### WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

**ROCKY MOUNTAIN** Green Bank should do whatever its shareholders want it to do. "Ethical" is in the eye of the beholder, so there is no objective standard to apply to the question of which potential customers are mission-appropriate. The challenge is to find out what shareholders want.

**Gary Phillips**, CEO, Republic Finance, LLC

**THE BANK** should be able to succeed by operating only in the industries it deems ethical. There are many segments this bank could lend to that would not disrupt the green vision. Choosing to focus on fewer industries will increase credit risk, but with proper management and oversight, the risk can be managed.

**Justin Evenden**, credit union director

**ROCKY MOUNTAIN** Green Bank should accept business from a firearms manufacturer. The real question for an "ethical" bank in Colorado is whether it should accept deposits from, and provide services to, a marijuana retailer.

**Kenneth Mitchell**, software engineer



**John Replegle** is the president and CEO of Seventh Generation.

**THE RESPONSE** to Field Force's loan request should be obvious. Jay McGuane founded Rocky Mountain Green Bank on ethical principles and enrolled it in the Global Alliance for Banking on Values. His intention to create a bank that's a positive, progressive force in society is crystal clear. Given all that, he has no business even wondering whether to lend to a maker of semiautomatic weapons that find their way to the street. Yet he's stuck. Why the disconnect?

Two reasons. The first is that he has shortcomings as a leader. In his hurry to get the bank up and running, he missed a crucial step: He didn't clearly define the company's purpose. He didn't articulate his vision and principles. Every company needs to know its reason for being in business, and his doesn't.

This leadership gap is evident in Jay's interactions with the directors. He bounces questions off them, trying to weave a path between opposing sides. That's not what a leader does. And he allows himself to be dominated by the regulators' requirements. The legal stipulation that Rocky Mountain Green Bank be a profit-making organization first and a green bank second doesn't mean that Jay always needs to choose profits over people. Once he starts doing that, he'll find that he can rationalize any decision. He'll destroy what was supposed to have been the core purpose of the organization. He would have been better off establishing his bank as a "B corporation": an entity that focuses on social and environmental performance, accountability, and transparency as well as profit. Several states, including Colorado, have passed legislation allowing companies to choose that designation.

The second reason for the disconnect is that Jay built the wrong board. His directors are divided over ethical issues. That's a huge handicap for a values-based organization. The board is supposed to be the company's North Star, looking beyond short-term needs and providing unified guidance on strategic issues.

So his next moves should be first to clearly define his company's purpose and principles and then to reboot the board. In my view, the more explicit the purpose and principles, the better. Companies with clear guiding principles tend to stay out of trouble. Look at the value of Johnson & Johnson's credo during the Tylenol-poisoning crisis in 1982. The company had explicitly determined that it would prioritize the needs and well-being of the people it serves, so it decided to do a recall, despite the cost. The decision protected the company's reputation, brand, and business.

**Over time, the bank's vagueness about where it stands on ethical issues will erode its relationship with customers.**

Jay can then use the purpose and principles to recraft the board. Half of the directors need to go. In his search for replacements, he should establish selection criteria and seek the help of a corporate recruiter who truly understands his goals. Jay shouldn't rely on friends and acquaintances this time around—that's not the way to build a professional board.

In the long run, the lack of clear principles is going to hurt Rocky Mountain Green Bank. We live in a transparent world. Consumers are looking at companies' principles and values and voting on them with their wallets. Over time, the bank's vagueness about where it stands on ethical issues will erode its relationship with customers. Jay's idealism will be for nothing, and his bank will become a story of good intentions gone bad. ❧

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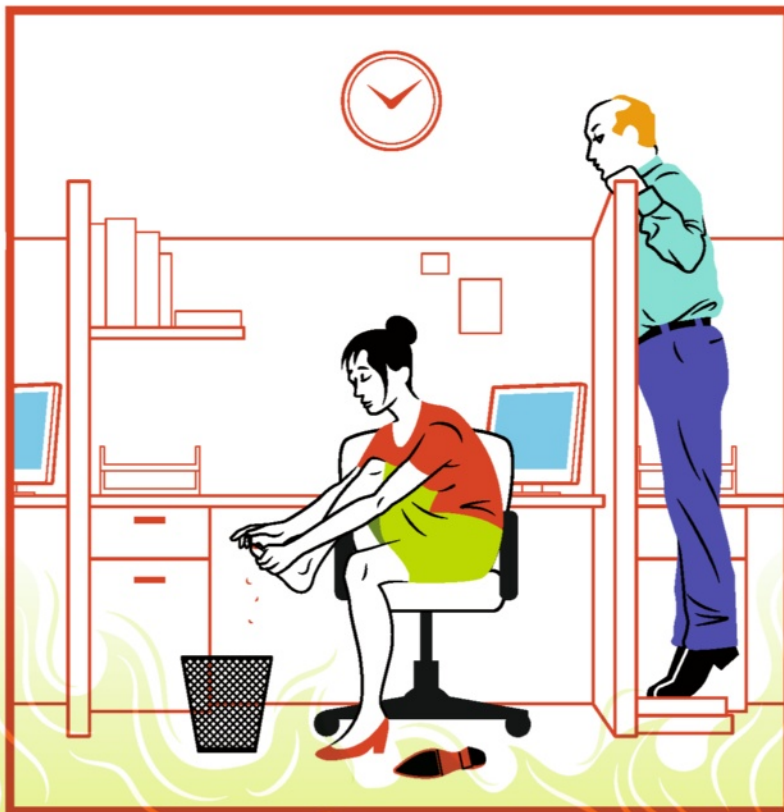
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# Synthesis

A review of emerging ideas in the media



## Behave Yourself!

Good manners can protect you from the petty annoyances of the modern workplace.

by Amy Bernstein

Let's admit it. We all slip up occasionally. Maybe we don't respond promptly to every e-mail message, or we swear under our breath from time to time. But we're doing OK, right? Do we really need to worry about the finer points of correct behavior?

Let me answer that question with a polite "Yes."

In an age when offices have given way to cubicles, when electronic devices keep us in constant communication, and when the boundaries between our professional and personal lives are dissolving, we need the rules of etiquette more than ever. Etiquette, after all, is just a code of conduct that allows us to live and work together with relative ease, fosters good relationships, and reduces the social frictions that impede our happiness and even our professional success. As Peggy Post and Peter Post argue in their update to *Emily Post's The Etiquette Advantage in Business*, "Knowing how to behave in a wide variety of professional settings not only makes you a more pleasant, confident, and enjoyable person to work with; it also provides you with all-important tools...that will help propel you and your company toward your mutual goals." Or, as Judith Martin puts it tartly in her recent *Miss Manners Minds Your Business* (coauthored with her son, Nicholas Ivor Martin), we're all fumbling with a "wider cultural confusion that has left the workplace riddled with etiquette land mines. Whether you blame resistance to relaxing the old rigidity of behavior or ignorance of traditional businesslike behavior, everybody... seems to be getting on everybody else's nerves."





Indeed, social mores are changing so quickly and home and office becoming so intertwined that even the most mannerly are probably confused. Thus the staying power of the etiquette advice genre (Erasmus put out a book on good manners for boys in 1530—no fidgeting, no scratching), the ongoing popularity of trusted authorities such as Miss Manners and Emily Post (via her great-grandson and his wife), and the rise of such relative newcomers as *Slate's* Dear Prudence, the *Financial Times's* Dear Lucy, and the *New York Times's* “Social Q’s” column.

Consider: Should a female manager stand to shake hands with a younger male associate? Miss Manners instructs us to factor in age, rank, and venue. The core rules still apply generally: Women don't rise for men, older people don't rise for younger ones, and higher-ranking people don't rise for those of lower rank. But if you're an older, higher-ranking woman, and you're meeting in your office, then you should stand to shake hands—as a sort of “hostess.” However, Miss Manners nods to evolving notions of gender roles, allowing that someone's sex is the least important factor in an office setting.

Got it. But how do you deal with the petty annoyances of the modern workplace? What do you do when the colleague in the neighboring cubicle breaks out a smelly lunch? When people bellow into their cell phones? When your boss fails to respond to your e-mail? When a prospective employer doesn't acknowledge receiv-

ing your résumé? The rules of work are changing. Does that mean that the basics of good manners are changing, too?

Emphatically not. The Posts put it simply: Good business etiquette “is not a set of ironclad ‘rules.’ In fact, most of what people call business etiquette is really little more than common sense driven by being considerate, respectful, and honest with others in your business life.” The

“When attempting to enter the business world, you need to learn to be someone else. It is called having a professional identity.”

Judith Martin and Nicholas Ivor Martin,  
*Miss Manners Minds Your Business*

Martins draw a helpful distinction: Manners are “the principles of courteous behavior” and etiquette “the rules that apply to a particular situation.” So manners don't change, but etiquette evolves. Once you understand that, you can pretty much figure out the rest.

If you read these two books, you'll learn that it's not smart to criticize the boss's attire, that you shouldn't use speakerphone unless you're behind closed doors, and that there are inoffensive ways to let your cubicle mate know he talks too loudly on the phone or that her fish dish is “distracting.” You'll find the answer to the question “to prairie-dog or not to prairie-dog?": The cultural norms in your office determine whether it's OK to pop up to look over your cubicle wall into your neighbor's space.

I was surprised by a couple of points. According to Miss Manners, “Unsavory as conducting business by phone from the bathroom may be, it doesn't violate etiquette.” Noted. And the next time you're stuck in the Escherian nightmare of an automated phone tree, you can break free by dropping a loud F-bomb, as one “gentle reader” did, whereupon he was finally delivered to a live customer service


representative. Miss Manners didn't approve—but great tip!

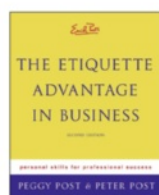
The Posts' encyclopedic guide is the more practical of the two books, addressing the résumé question, for example, while Miss Manners glosses over it. And the Posts are particularly good at walking through the protocols of job hunting and answering such touchy questions as what to say when a colleague is seriously ill, miscarries, or divorces.

If you, like me, read etiquette advice as sociology, however, you'll prefer Miss Manners's witty, though sometimes random, guide. Here's one gem: “My new boyfriend was recently released from our company,” writes a hapless correspondent. “My company picnic is coming up and I would like to ask him to go....I am afraid this would be awkward. Any advice?” Miss Manners's response: “Spare him.”

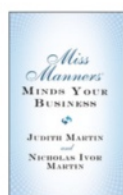
Both the Martins and the Posts are careful not to overreach. For example, Miss Manners defends those infuriating phone trees in response to a reader's complaints. They can be annoying; they can also be helpful. But in and of themselves, she writes, they are not rude.

To be sure, there are many “etiquette experts” out there, with sometimes questionable authority. I'm still puzzling over a recent *Forbes* column decreeing that one shouldn't check e-mail while riding in an elevator. Why not? As Miss Manners would remind us, business etiquette exists “to maintain personal dignity and to show respect for others...; to maintain a pleasant demeanor without invading others' privacy; to balance competitiveness with cooperation; to take responsibility but remain flexible; to be both attentive and discreet; and to combine honesty and tact.” Etiquette lays out the rules of sensible living. It helps us be less annoying and, to be venal about it, get what we want. It can save us from the quotidian nuisances of office life. Most important, it allows us to redraw the boundaries that define civility and ensure our own sanity. ♡

 **Amy Bernstein** is the editor of *Harvard Business Review*.



**Emily Post's  
The Etiquette  
Advantage in  
Business (second  
edition)**  
Peggy Post and  
Peter Post  
William Morrow, 2005



**Miss Manners  
Minds Your  
Business**  
Judith Martin  
and Nicholas  
Ivor Martin  
W.W. Norton and  
Company, 2013



The Supreme Committee for Delivery & Legacy (SC) ensures that all preparations for the 2022 FIFA World Cup™ align with Qatar's development imperatives, as described in the Qatar National Vision 2030 and the National Development Strategy 2011-2016. Along with its stakeholders, the SC is tasked with delivering stadia and other infrastructure that will leave a lasting legacy for Qatar, the region and the world.

The SC is currently recruiting top-caliber professionals for the following positions in its Strategic Development & Assurance Department:

## Strategic Operations Director

### Summary of Position

- Lead and drive the Strategic Operations Division, comprising of key strategic themes such as Stakeholder Collaboration, Quality & Excellence, Sustainability and Innovation, reporting to the Executive Director of the Strategic Development & Assurance Department.
- Develop strategies and implementation plans for the key strategic themes, and ensure their execution.
- Develop policies, guidelines, standards and reporting frameworks for the key strategic themes.
- Monitor performance, quality and risk for the key strategic themes across the Strategic Programme.

### Experience & Skills

- Minimum 13 years of relevant experience, with at least 7 years in a management position.
- Experience working in a multi-stakeholder environment.
- Experience in managing a multi-faceted strategic division.
- Broad strategic management experience, with a management consulting background.
- A good manager and leader who is capable of building excellent relationships at all levels.

### Qualifications

- Advanced degree (MBA, MA/MS in Business or Economics) from an accredited top-tier institution.
- Certification in Project Management (PMP) is desirable.

## Head of Corporate Planning

### Summary of Position

- Support the Strategy & Planning Senior Manager in managing the strategic, operational and departmental planning processes.
- Support the corporate planning process through development and approval of the 3-year corporate plan & annual operational plans.
- Collaborate with departments to integrate corporate plans into operations and execution.
- Ensure corporate plans are clearly communicated, understood and adopted within the organization.
- Manage the quarterly organizational planning review through close collaboration with all departments, including Finance & Procurement and Human Resources.

### Experience & Skills

- Minimum 8 years of relevant experience in corporate planning and strategic development.
- Advanced MS Excel and MS PowerPoint skills are a must.
- Excellent analytical, negotiation and personnel management skills.
- Strong initiative and ability to manage multiple projects/priorities simultaneously on challenging deadlines.

### Qualifications

- Bachelor's degree in Business Administration, Management, Economics, Finance or relevant discipline.
- Advanced degree (MBA, MA/MS in Business) from an accredited top-tier institution is preferred.



## Senior Economic Development Candidate

### Summary of Position

- Lead and drive economic initiatives, working under the Executive Director of the Strategic Development & Assurance Department.
- Conduct economic impact studies to assess the macro and microeconomic benefits of a large-scale event.
- Assess the intangible benefits of hosting a major event, including legacy benefits, reputational enhancement, wider cultural impacts, indirect and multiplier impacts.
- Conduct sectoral impact analyses, including environmental, social and health.
- Develop and coordinate the implementation of sector-specific strategic economic plans for creation of new industries; business development; addressing barriers to economic growth and job creation; and increasing local and international economic opportunities.
- Evaluate past and present economic issues and trends, and make recommendations on how a large-scale event can play a role in catalyzing economic diversification and job creation.
- Identify and report market needs and new opportunities to senior management.
- Collaborate with key internal and external stakeholders to identify opportunities for mutual collaboration and benefit, and tackle current challenges hindering the growth of the private sector.
- Support the development of business clusters, from concept stage to implementation.

### Experience & Skills

- Minimum 12 years of relevant experience working on large-scale programmes.
- Experience working on economic impact analyses for infrastructure mega-projects.
- Experience in private sector/economic development, cluster development and stakeholder management.
- A substantial history of successfully delivering large and diverse private sector and small and medium enterprise (SME) projects.
- Experience working on previous large-scale events is a plus.

### Qualifications

- MA/MS in Economics, Econometrics or relevant discipline from an accredited top-tier institution is preferred. PhD in a related field is preferred.

## Assurance & Integration Senior Manager

### Summary of Position

- Lead and drive the Assurance & Integration Division, working under the Executive Director of the Strategic Development & Assurance Department.
- Manage and coordinate overall delivery, integration and assurance across the Strategic Programme.
- Manage the integration of the Strategic Programme, in alignment with the strategic goals and objectives.
- Provide strategic advisory support in all areas related to the Strategic Programme.
- Drive organizational change, planning & implementation across the organization.
- Provide strategic assurance of programme content and deliverables.
- Support the development of business plans and business cases, as required.

### Experience & Skills

- Minimum 12 years of relevant experience in large-scale programme management or similar work environment.
- Experience in project management and organizational change management.
- A management consulting background is desirable.
- A good manager and leader who is capable of building excellent relationships at all levels.

### Qualifications

- Advanced degree (MBA, MA/MS in Business, Economics) from an accredited top-tier institution.
- Certification in Project Management (PMP) is preferred.

SPOTLIGHT ON PRACTICAL SUSTAINABILITY



Few now doubt the impact that climate change will have on business—but many companies haven't considered it from a strategic rather than an operational perspective. This package includes guidance on doing so and tools for implementation.

## SUSTAINABILITY

### Resilience in a Hotter World

Andrew Winston | page 56

As the planet warms, storms and floods are becoming wilder—killing thousands, disrupting supply chains and power grids, and causing billions of dollars in damage. Meanwhile, supplies of all kinds of resources are dwindling, and demand is rising. These two megachallenges—extreme weather and resource scarcity—could have an unprecedented impact on corporate profits and global prosperity, warns Winston. To manage these threats, companies must do what he calls “the big pivot.”

The big pivot represents a radical change in strategy, operations, and mind-set. Instead of focusing first on short-term earnings and treating environmental challenges as niche issues, firms must prioritize tackling the world's big problems and use the tools of capitalism to do so profitably. That means taking new approaches to vision, valuation, and collaboration: Companies must set long-term goals based on science and pursue innovations that seem heretical (dyes that don't need water, say, or services that replace products). They'll need new ROI tools that factor in unpriced costs and benefits. And they'll have to work with other organizations, including competitors, to reduce resource dependency (for instance, sharing methods for reducing energy use).

By making these moves, firms will increase their resilience to volatile resource prices, electrical outages, and shifts in customer needs. They will improve business performance while advancing the common good.

HBR Reprint R1404C

## LEADERSHIP

### Sustainability a CFO Can Love

Kurt Kuehn with Lynnette McIntire  
page 66

As the CFO of UPS—and a founding member of its sustainability steering committee—Kuehn wrestled with the question of where and how to most effectively direct the company's resources. The approach he developed is rooted in two beliefs: Companies have a responsibility to contribute to society and the environment, and every investment a company makes should return value to the business. These beliefs don't have to be at odds, he writes, although they often mean that sustainability programs must be subjected to alternative financial evaluation models. In fact, the programs with the most impact not only align with companies' strategies but move in tandem with their activities.

UPS's breakthrough came when it recognized that efficiency would be greatest in any initiative where momentum existed and where the company was positioned to make a pivotal or tipping-point difference. To guide its sustainability choices and investments, UPS has implemented a clear process of (1) assessing its strengths; (2) choosing its spots; (3) finding momentum; (4) building productive partnerships; and (5) convening other sources of strength. This approach avoids missteps such as executive pet projects and directing the volunteerism of employees to tasks at which they are not actually good. Kuehn draws lessons from UPS's own experience and from that of others, including Campbell Soup, Pfizer, and Marks & Spencer.

HBR Reprint R1404D

## COLLABORATION

### The Collaboration Imperative

Ram Nidumolu, Jib Ellison, John Whalen, and Erin Billman | page 76

Addressing global sustainability challenges—including climate change, resource depletion, and ecosystem loss—is beyond the individual capabilities of even the largest companies. To tackle these threats, and unleash new value, companies and other stakeholders must collaborate in new ways that treat fragile and complex ecosystems as a whole.

In this article, the authors draw on cases including the Latin American Water Funds Partnership, the Sustainable Apparel Coalition (led by Nike, Patagonia, and Walmart), and Action to Accelerate Recycling (a partnership between Alcoa, consumer packaged goods companies, and local governments, among others) to describe four new collaboration models that create shared value and address environmental protection across the value stream.

Optimal collaborations focus on improving either business processes or outcomes. They start with a small group of key organizations, bring in project management expertise, link self-interest to shared interest, encourage productive competition, create quick wins, and, above all, build and maintain trust.

HBR Reprint R1404E

## TOOL KIT

### How to Survive Climate Change and Still Run a Thriving Business

Eric Lowitt | page 86

Climate change presents clear and pressing threats to business—materials and product shortages, price volatility, legal bans or consumer backlash, and damaged transportation infrastructure, to name just a few. But there are opportunities as well. Lowitt, a consultant in the sustainability field, has developed a series of detailed checklists that will help smart managers reduce operational, regulatory, and reputational risk while finding new ways to cut costs, improve performance, enhance customer relationships, and otherwise increase competitiveness.

The checklist recommendations, tested and refined through Lowitt's research into and work with firms including Coca-Cola, GE, and Owens Corning, cover four broad areas in the product life cycle: sourcing, manufacturing, distribution, and consumption. Actions range from educating and incentivizing employees to use climate change-conscious behavior to measuring and reporting key metrics to determining when alternative materials, methods, sites, or contract partners may be called for.

Like any such tool, the checklists don't provide a one-size-fits-all plan. Rather, they equip executives to customize their strategies according to factors such as their goods and services, risk tolerance, customer needs, and reliance on third parties throughout the value chain.

HBR Reprint R1404F

## The Big Idea



### ORGANIZATION & CULTURE

#### Making Business Personal

Robert Kegan, Lisa Lahey, Andy Fleming, and Matthew Miller | page 44

Most people expend a lot of energy at work attempting to hide their inadequacies from colleagues. The authors believe that this is the single biggest cause of wasted resources in nearly every company today. When they went in search of firms where people see their mistakes not as vulnerabilities but as prime opportunities for growth, they found only a handful. Two stood out: Bridgewater Associates, an East Coast investment firm, and the Decurion Corporation, a West Coast real estate manager, cinema operator, and senior living center owner. Both are committed to developing every one of their people by weaving personal growth into daily work—and both are highly successful businesses.

The authors spent hundreds of hours observing their practices and interviewing employees at all levels. What they saw was people working together, in meetings, in one-on-one sessions, and in the course of their everyday work, to get at the root causes of problems and devise more-productive ways of doing things. Many companies conduct root cause analysis but stop short of crossing into an employee's interior world, where so many problems begin—in, for example, a tendency to avoid confrontation, to act before thinking things through, to be overly aggressive if one's ideas are criticized, and other counterproductive thinking and behavior. At Decurion and Bridgewater, everyone from the CEOs on down to the teenage ushers works on identifying and overcoming these patterns as part of doing the job well.

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As always, the Red Rover game took hours to play.

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## EXECUTIVE SUMMARIES

# Features

### STRATEGY & COMPETITION

#### The Limits of Scale

Hanna Halaburda and Felix Oberholzer-Gee | page 94



The value of many products and services rises or falls with the number of customers using them; the fewer fax machines in use, the less important it is to have one. These network effects influence consumer decisions and affect companies' ability to compete.

Strategists have developed some well-known rules for navigating business environments with network effects. "Move first" is one, and "get big fast" is another. In a study of dozens of companies, however, the authors found that quite often the conventional wisdom was dead wrong. And when the rules failed, the reason was always the same: Companies trip up when they try to attract large volumes of customers without understanding (1) the strength of *mutual attraction* among various customer groups and (2) the extent of *asymmetric attraction* among them.

Looking at examples such as TripAdvisor, Wikipedia, and the *New York Times*, the authors offer strategies for competing in markets with network effects. New entrants should focus on customer groups that they are uniquely positioned to serve or appeal to the most attractive customers in a market. Incumbents pursuing growth strategies in adjacent markets or new geographies should consider how similar the needs of new customers are to those of existing customers. Offering complements also allows incumbents to reach additional customer groups.

HBR Reprint R1404G

### LEADERSHIP

#### Coaching the Toxic Leader

Manfred F.R. Kets de Vries  
page 100



A surprising number of senior executives have a personality disorder of some kind.

In his work as an executive coach, psychotherapist Kets de Vries sometimes comes across bosses with mental demons. The four kinds he encounters most frequently are *pathological narcissists*, who are selfish and entitled, have grandiose fantasies, and pursue power at all costs; *manic-depressives*, who can leave a trail of emotional blazes behind them; *passive-aggressives*, who shy away from confrontation but are obstructive and underhanded; and *the emotionally disconnected*—literal-minded people who cannot describe or even recognize their feelings.

Left unchecked, these personalities can warp the interactions, plans, and systems of entire organizations. But with appropriate coaching, toxic bosses can learn to manage their conditions and become effective mentors and leaders. This article describes how to recognize each pathology and, step by step, guide people who suffer from it toward healthier and more-productive interactions.

HBR Reprint R1404H

### THE GLOBE

### OPERATIONS

#### Europe's Solution Factories

Stephen E. Chick, Arnd Huchzermeier, and Serguei Netessine | page 111



Manufacturers in developed countries can no longer rely on lean management practices to stay profitable. They face increasing competition from plants in large emerging economies that are able to produce on a large scale at a lower cost, while still providing high quality. The way forward, the authors suggest, can be glimpsed from analyzing past winners of Europe's annual Industrial Excellence Award. Those companies have succeeded by using one or more of these strategies:

**Leveraging data flows to integrate closely with supply chain partners.** Germany's Schmitz Cargobull, for example, has become a leading trailer manufacturer by using sophisticated information technology to help customers monitor their vehicles.

**Creating value downstream in other parts of the supply chain.** One example is Markem-Imaje, a maker of industrial printers for coding products; the company adds value for customers by offering a variety of ancillary services.

**Collaboratively designing manufacturing processes that can rapidly evolve to meet customers' needs.** A prime example is ASML, which works closely with customers and suppliers to make innovations in production technology for the semiconductor industry.

**Specializing in customized products.** Focusing on small runs of custom-designed products has been an effective strategy for companies like BUS Elektronik and the Daimler Group's Smart car division.

HBR Reprint R1404J

## How I Did It

## LEADERSHIP

## The CEO of Automattic on Holding “Auditions” to Build a Strong Team

Matt Mullenweg | page 39



Mullenweg founded Automattic, the company behind WordPress, in 2005, and began hiring in the traditional way: using résumé screening, reference checks, and interviews. He focused on the experience candidates

had and paid special attention to what other start-ups they'd worked for. He and his colleagues invested a lot of energy in the process and believed that they were being as rigorous as they could. But when some hires didn't work out, they began to examine their approach in light of Automattic's unconventional philosophy: Work where you want and when you want; you'll be measured by outputs, not by time spent at a desk in an office. They realized that being well-spoken or charming in an interview often had little bearing on how a candidate would perform the job in question. So they introduced tryouts. After an initial screening, promising candidates are required to work with the company for three to eight weeks (with pay), performing real tasks that are closely related to the jobs they're applying for, and working alongside the people who will be their colleagues if they're hired. They can size up the company as it evaluates and provides feedback to them, benefiting all concerned.

**HBR Reprint R1404A**

## Managing Yourself

## 15 Rules for Negotiating a Job Offer

Deepak Malhotra | page 117



The author, a professor of negotiation at Harvard Business School, offers specific pieces of advice for job candidates:

- Don't underestimate the importance of likability.
  - Help prospective employers understand why you deserve what you're requesting.
  - Make it clear that they can get you.
  - Understand the person across the table from you.
  - Understand his or her constraints.
  - Be prepared for tough questions.
  - Focus on the questioner's intent, not on the question.
  - Consider the whole deal.
  - Negotiate multiple issues simultaneously, not serially.
  - Don't negotiate just for the sake of negotiating (a pitfall for recent MBA graduates).
- Think through the timing of offers.
  - Avoid, ignore, or downplay ultimatums.
  - Remember that your interviewer isn't out to get you.
  - Stay at the table.
  - Maintain a sense of perspective.

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Printed in the U.S.A. *Harvard Business Review* (ISSN 0017-8012; USPS 0236-520), published monthly with combined issues in January–February and July–August for professional managers, is an education program of Harvard Business School, Harvard University; Nitin Nohria, dean.

Published by Harvard Business School Publishing Corporation, 60 Harvard Way, Boston, MA 02163.

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Volume 92, Number 4

# Life's Work

**HBR.ORG** To read the extended interview, go to [hbr.org/rhodes](http://hbr.org/rhodes).



**Zandra Rhodes** may be 73, but she still wears platform heels and hot-pink hair. The British designer gained fame for her edgy, eponymous fashion line in the 1970s, only to close up shop in the 1990s. But she's now in the midst of a renaissance, which those involved in a MassArt retrospective of her work have credited to her "originality, authenticity, and tenacity." *Interviewed by Alison Beard*

**HBR:** You're known for challenging the status quo. How do you keep generating fresh ideas?

**Rhodes:** As you get older, you're worried you don't. You hope the system hasn't beaten you down and that you do keep coming up with radical ideas. The trouble is that the more well-known you are, the more difficult it is to hide away and actually work. When no one's interested in you and inviting you to things, it's easier.

**Was it a conscious decision to always embody your brand?**

It's just who I am. When I was younger, I did green hair, then blue with curls drawn on my face. Someone said, "If you look like that, your textiles must be marvelous."

**When do you do your best work?**

When I'm two weeks traveling somewhere—India, Egypt, Kenya, Japan. You get up, have breakfast, walk around, and draw something—at least one drawing or watercolor a day, maybe two or three. When you're done, maybe you go to a museum, or if you're really tired, you go shopping. My prints nearly always come from a trip—when I'm lucky enough to get away.

**When the big fashion companies rejected your designs early on, you started your own business. What advice do you have for young entrepreneurs?**

Keep going by whatever means you can. Don't let people crush you. Have an inner belief in yourself. In the end, what you do will come through. We suffer today from people wanting fame rather than earning fame through their work. Your work is what you're there for, and you should do it regardless. If it brings you something else, that's a plus. You can be ambitious, but you have to be content with the fact that it might not make you a millionaire.

**Did you ever feel pressure to be more commercial?**

When I tried, it never worked. It's always the original thought that sells better.

**How do you handle big setbacks—having to close your shop and factory, for example?**

You just have to face them. If you know you haven't cheated anyone, and you're working to the best of your ability, you just climb the hurdle. I'd saved all the originals of my clothes, and friends suggested I start a museum. So I bought a warehouse and, on the advice of my partner, built apartments on top and presold them to cover my costs. Just as that was coming together, I got asked to do the costumes for *The Magic Flute* at the San Diego Opera, and John Galliano brought out a collection of chiffons, and everyone said, "That's Zandra Rhodes's influence." And suddenly the world comes back to me, and I have too much to do. When I'm dead and pushing up the daisies, they might see me as a second Chanel or something. But you never know what's going to happen. You just continue on.

**What's good and bad about the fashion industry today?**

I think it's a more difficult, cutthroat world. The champagne and handbags and perfume keep the companies going. They're not supported by the clothes. Magazines are more interested in who's been wearing it than the content of the design. And then people do work that is only adequate. I can't think of anything good to say. But I try to keep my head screwed on and hope that success will come. ♡





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